

ASIAN DEVELOPMENT BANK

TAR: INO 35147

TECHNICAL ASSISTANCE
(Financed by the Government of the United Kingdom)

TO THE

REPUBLIC OF INDONESIA

FOR

**MANAGING REGIONAL DISPARITY IN ECONOMIC AND POVERTY
REDUCTION
PROGRAMS UNDER DECENTRALIZATION (PHASE 1)**

December 2002

CURRENCY EQUIVALENTS

(as of 6 December 2002)

Currency Unit	–	rupiah (Rp)
Rp1.00	=	\$.000111
\$1.00	=	Rp8,998

ABBREVIATIONS

ADB	–	Asian Development Bank
ADTA		advisory technical assistance
BAPPENAS	–	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
<i>DAU</i>	–	Dana Alokasi Umum (General Allocation Fund)
	–	Dana Alokasi Khusus (Special Allocation Fund)
	–	Department for International Development of the Government of the United Kingdom
DFID		
Kepmen	–	Keputusan menteri (ministerial decree)
Keppres	–	keputusan presiden (presidential decree)
PMO	–	Project Management Office
PROPENAS	–	Program Pembangunan Nasional (National Development Program)
PROPEDA	–	Program Pembangunan Daerah (Regional Development Program)
RAKORBANG	–	Rapat Koordinasi Pembangunan (Development Coordination Forum)
RENSTRADA	–	Rencana Strategis Daerah (Regional Strategic Plan)
REPETADA	–	Rencana Pembangunan Tahunan Daerah (Regional Annual Development Plan)
TA	–	technical assistance

NOTES

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. On 1 January 2001, Indonesia embarked on a major decentralization exercise. Key functions and institutions of the Government have to be altered to respond to the immense changes taking place. As decentralization should lead to balanced development, managing regional disparities in economic and poverty reduction programs is a major central government responsibility. The Government requested Asian Development Bank (ADB) assistance during the 2001 Country Programming Mission to support an advisory technical assistance (ATA) project to address this issue. An ATA project—Managing Regional Disparity in Economic and Poverty Reduction Programs under Decentralization—was programmed for 2002. ADB staff undertook fact finding in June–November 2002, and reached a broad understanding with the Government on the project’s design and scope.¹

II. ISSUES

2. The decentralization program has devolved vast responsibilities on regional governments. Under Laws 22 and 25 of 1999, which underpin decentralization, other than foreign policy, defense, security, judiciary, monetary and fiscal matters, and religious affairs, almost all other matters are being devolved to regional² governments in 31 provinces and about 360 districts and cities. The primary responsibility to provide basic services as well as the national³ effort to reduce poverty will now mainly be their responsibility. However, the fiscal capacities of regional governments vary considerably, hindering the national effort to reduce poverty. Many governments in regions with large numbers of poor have inadequate resources to accelerate overall development, particularly in rural areas, and to reduce poverty and continue the previous central government-assisted efforts begun before decentralization.

3. Wide disparity exists among regional governments in poverty reduction, human development, and access to development resources. Although Indonesia made rapid progress in poverty reduction before the Asian economic crisis, incidence of poverty sharply increased during the crisis. The 1999 National Socio-Economic Survey (SUSENAS) revealed that 23.5% of the population was poor (current estimates are 17%). Recent data indicate that, nationally, real wages are at about 20% below the precrisis levels, suggesting persistent poverty. As part of its geographical focus strategy for Indonesia, ADB found considerable disparity in poverty incidence, human development, and access to financial resources among regions. Before decentralization, the central government directly addressed this issue, particularly poverty reduction, through a nationally driven effort that focused on rapid and sustained growth of agriculture, high growth in nonagricultural sectors, high investments in human development, and targeted poverty programs.⁴ Under decentralization, the coordinated national effort might weaken, and institutional arrangements, particularly, might not be adequate to reduce economic and social disparities across regions.

4. The fiscal instruments available after decentralization to achieve equity in providing basic services and reducing economic disparities are ineffective and insufficient. The decentralization laws provide for revenue sharing under the General Allocation Fund (*DAU*), grant transfers under the Special Allocation Fund (*DAK*), and market borrowing by regional governments. However, due to the absence of proper guidelines and execution, these

¹ The TA was first listed in *ADB Business Opportunities in April 2002*.

² The term “region” refers to province, district and city

³ Throughout this paper, “national” refers to the country as a whole, embracing center and regions.

⁴ The most prominent among the latter was the grant-based 20,000-village INPRES Desa Tertinggal program launched in 1993.

instruments are ineffective. Although the allocation formula for *DAU*, for instance, has strong features to support equity (such as weight on population and level of income), stipulations of Parliament that allocations received should not fall below the previous year's allocation have severely limited *DAU*'s effectiveness. *DAK* guidelines are yet to be finalized, although allocations for 2003 have been made in some sectors. The regional borrowing instrument is not in operation as the central government has, in the interest of fiscal prudence, placed a temporary moratorium on the instrument's use. The central government has not yet developed a framework for intergovernmental fiscal relations or a detailed policy of fiscal support to weaker regional governments for development and poverty reduction.

5. Law 22 of 1999 provides that national planning and national development should be central government responsibilities. The supporting regulations are being finalized by National Development Planning Agency (BAPPENAS). Current thinking focuses mainly on coordination of national development goals and priorities with local ones, to be reflected ultimately in the main planning documents at the central and regional levels (National Development Program [PROPENAS], Regional Development Program [PROPEDA], Regional Strategic Plan [RENSTRADA], Regional Annual Development Plan [REPETADA], etc.). Formal coordination meetings between agencies responsible for the various levels of planning have been prescribed at the district/city, provincial, and national levels through the Development Coordination Forums (RAKORBANG). The Government has so far held three large national RAKORBANG workshops since decentralization.⁵ Discussion has also begun on monitoring and evaluation of planning outcomes although nothing concrete has emerged.

6. The centralized planning system has to give way to one responsive to the challenges of decentralization. However, the discourse on developing a new system of central-regional development relationships could clearly benefit from insights into the following three main areas.

7. First, the planning and budgeting process at the regional level is not sufficiently geared to reduce poverty, and the consultative validation with the central government of strategic priorities—particularly those that should be transformed into programs for implementation—is weak. To begin with, these plans should be poverty oriented and realistic. Financing of the plans is not emphasized and the central government's role in supporting regions' pro-poor planning is not adequately defined. Although RAKORBANG provides for consultation, the process has not been sufficiently structured to yield meaningful results. This is partly because the end results of the consultations—the annual plans—are not sufficiently grounded on resource considerations and are, therefore, often unrealistic, making them inadequate tools for development and poverty reduction. The process also appears to need a higher degree of systematic technical evaluation of regional development plans and adequate representation of stakeholders such as civil society and the private sector.

8. Second, resource planning remains weak. The regional development strategies and annual plans are limited by lack of resources. The central government plays virtually no role in making resources available for priorities agreed upon at the regional level. Discussions on the architecture for intergovernmental fiscal relations are taking place independently of the planning process. So far, most discussions have centered around revenue sharing, and discussions beyond that on funding development (such as *DAK*) are at a preliminary stage (para. 4.)

⁵ A workshop of the Development Coordination Forum for central government agencies (RAKORBANGPUS) was also conducted in September 2002, emphasizing poverty reduction, employment generation, development of lagging regions, and human resource development. The workshop also emphasized sharing information on central government budgetary allocations with regions.

9. Finally, the process pays no attention to a major central government responsibility: fostering regional balance and facilitating reduction of regional disparities by focusing on the needs of weaker regions. Regional governments with insufficient revenues from revenue sharing and own revenue mobilization efforts will require assistance to generate development funds for high-priority programs. The Committee on Poverty Reduction established under Presidential Decree (Kepres) 124 of 2001 mandates BAPPENAS to develop basic policy on macro planning involving regional governments and other stakeholders. An area-based poverty profile has to be developed and all sources of funding—public, private, and from the financial sector—tapped. The committee will rely on the Ministry of Home Affairs to coordinate development programs at the regional level. This work may need to be coordinated with the ongoing development of the architecture for decentralized planning.

10. Although BAPPENAS is strongly committed to bring about improvements along the above lines, given the scale of work required, the central and regional governments should be prepared to address the problems mentioned. Central draft regulations for regional planning and budgeting are under development and must be supported. First, however, the ideas to be incorporated into these regulations need to be pilot-tested. Five poor regional governments will be selected under this TA for this purpose.

11. Although Japan International Cooperation Agency (JICA) and United States Agency for International Development (USAID) provided some bilateral support for some aspects of regional planning, they do not address the issue of achieving equity in the distribution of fiscal resources for fighting poverty. The ADTA's support will fit in well with ADB's overall activities in support of decentralization, and the coordinated funding agencies' efforts in this area.⁶ Apart from an institutional structure for decentralized planning, regional governments need considerable capacity building. A capacity-building project for regional governments, including in planning and development,⁷ is programmed for 2002 and can utilize the TA outputs. During TA implementation, learning from all relevant funding agency-assisted activities,⁸ past and ongoing, will be incorporated.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

12. With decentralization, poor regional governments have little capability to promote development and fight poverty. The TA's goal is to support processes and/or procedures to improve pro-poor planning and develop recommendations for a national program of action to reduce regional disparities and poverty. The TA will identify pragmatic approaches to ensure that poor regions have adequate resources and support to deliver basic services and to pursue development programs, particularly in reducing poverty, to catch up with the better-off regions of the country. The TA will help the Government pilot-test policies and systems in one province, one city, and three districts (Appendix 1).

⁶ The Consultative Group for Indonesia (CGI) Working Group on Poverty Reduction has also sought support in this area.

⁷ Sustainable Capacity Building for Decentralization Project, programmed for 2002.

⁸ Such as World Bank's Kecamatan Development Project.

B. Key Activities and Methodology

13. Central and regional government readiness to make planning and budgeting practices pro-poor is uncertain. A key outcome of this TA is an assessment of such readiness. The following activities are involved:

- (i) Select five of the poorest regional governments which show readiness to undertake sound pro-poor planning and budgeting practices, and help them build capacity in these areas utilizing national and international best practices.
- (ii) In these selected regional governments, pilot-test consultative processes between regional and central governments and hold consultations with stakeholders such as civil society and the private sector. Develop best processes to ensure that local conditions are adequately reflected in the plans. Study the RAKORBANG process to improve its effectiveness so that it leads to a concrete validated development strategy, agreed between the central and selected regional governments, including agreements on minimum quality of services provided through detailed annual inventory of projects and schemes based on technical analyses and clear annual budgeting of resources for development. Help the central government develop processes to validate these plans.
- (iii) Based on needs of the five regions and their validated pro-poor plans, provide advice on financial support mechanisms from the regions' own and outside sources to support the plans. Explore coordinating arrangements and the role of the central government in enabling regions to utilize the whole range of fiscal and other instruments to provide needed development resources, including grants through *DAK*, block loans from the center to the regions, external assistance, national schemes supported by cost-sharing between the center and the regions, national resource mobilization through market borrowings by regions facilitated by the center, improved provision of resources from the financial system for poverty reduction programs (such as microcredit), private sector participation, and participation by civil society.

14. Based on these regions' experience, the TA will propose to the central government alternative development-cum-financing arrangements to support sustainable development and focus on reducing regional disparities and poverty, and enable the central government to finalize its draft regulations on regional planning under preparation. A follow-on ADTA (phase 2) will be prepared to utilize the experience gathered from this TA to make national-level recommendations, particularly with respect to methods to determine if regional plans are pro-poor, and to advise on mechanisms to identify and broker alternative funds for poor regions left with gaps in their resources to support pro-poor initiatives. Phase-II will also cover the issue of mechanisms to monitor expenditures to ensure that they achieve pro-poor outcomes.

C. Cost and Financing Plan

15. The total TA cost is estimated at \$605,000 equivalent, of which \$270,000 is the foreign exchange cost and \$335,000 equivalent is the local currency cost. The Government has requested ADB to finance \$484,000 equivalent, covering the entire foreign exchange cost, and \$214,000 equivalent of the local currency cost. The TA will be financed as a grant from the Government of the United Kingdom. The Government of Indonesia will bear the balance of \$121,000 equivalent of the local currency cost by providing office facilities, administrative

support, and remuneration and per diem of counterpart staff and their local transport (Appendix 2).

D. Implementation Arrangements

16. The Executing Agency will be BAPPENAS (under the deputy minister for local autonomy and regional development). A steering committee will be established, comprising representatives from the Offices of the Coordinating Ministers for the Economy and for Peoples' Welfare, Ministry of Finance, Ministry of Home Affairs, Committee on Poverty Reduction, the Chamber of Commerce and Industry (KADIN), civil society, and the five concerned regional governments. The steering committee members are expected to provide coordination and detailed advice to the consultants during the tripartite meetings based on the reports (para. 18) submitted to them before meetings. BAPPENAS, the EA, will establish a project management office (PMO), at least 1 month before the TA starts and keep it fully functional during TA implementation. One staff member at the appropriate level will be designated full-time to head the PMO and will be responsible for coordination, facilitation, and supervision of the consultants' work. The EA will provide adequate administrative support for the consultants.

17. ADB will select and engage, using the simplified technical proposal, a firm or consortium of international and domestic consultants in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants. A total of 12 person-months of international and 24 person-months of domestic experts (in decentralized planning and public finance, poverty reduction and decentralization law) is anticipated to be required to implement the TA. The work of the consultants is expected to commence in March 2003 and continue for 8 months, the expected TA duration. The outline terms of reference of the consultants are in Appendix 3.

18. Wide stakeholder consultations (including with those engaged in external funding agency supported activities) through workshops will be essential. The consultants will prepare a brief inception report after the first fortnight, an interim report after the end of 4 months, a draft final report in the middle of the eighth month of the TA, and a final report at the end of the eighth month. These reports will be circulated in advance (at least 5 days before meetings) to steering committee members and discussed at tripartite meetings consisting of the Government (steering committee members), consultants, and ADB.

IV. THE PRESIDENT'S DECISION

19. The President, acting under the authority delegated by the Board, has approved ADB administering technical assistance not exceeding the equivalent of \$484,000 to the Government of Indonesia to be financed on a grant basis by the Government of the United Kingdom for Managing Regional Disparity in Economic and Poverty Reduction Programs Under Decentralization (Phase 1), and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal Support processes and/or procedures to improve pro-poor planning and develop recommendations for a national program of action to reduce regional disparities and poverty</p>	<ul style="list-style-type: none"> • Pro-poor planning and budgeting in target regions • Sufficient response to suggest feasibility of replication on national scale 	<ul style="list-style-type: none"> • Regional government plans and budgets • ADB review missions 	<ul style="list-style-type: none"> • (A) The central and national governments are fully committed to reduce poverty.
<p>Purpose Develop, through pilot testing in five poor regions pro-poor planning practices involving central government and stakeholders, pro-poor regional plans that are realistic and fully funded to achieve pro-poor outcomes</p>	<ul style="list-style-type: none"> • Enhanced capacity in five pilot regional governments to undertake pro-poor planning 	<ul style="list-style-type: none"> • ADB reviews of capacity in regional governments 	<ul style="list-style-type: none"> • (R) The Government, while interested in issuing guidelines for pro-poor regional planning, may not adequately appreciate the need for pro-poor planning • (R) The political environment and relationship with regions may not be conducive to carrying out the TA.
<p>Outputs</p> <ul style="list-style-type: none"> • Five regions helped with training to improve capacities to prepare pro-poor regional plans • Improved RAKORBANG process involving technical evaluation of regional plans and participatory processes to ensure that local conditions are adequately reflected in the plans • Identified funding sources for regional plans pilot-tested in five regions • BAPPENAS helped to finalize the policy and regulatory framework and operational guidelines on planning and budgeting for regional planning 	<ul style="list-style-type: none"> • Five such pro-poor plans developed, leading to improved allocations and well-designed projects and schemes for poverty reduction • Improved RAKORBANG process used to prepare five regional plans • Policy and regulatory framework and operational guidelines finalized by BAPPENAS based on consultancy inputs 	<ul style="list-style-type: none"> • Workshops to review outputs and develop recommendations for adoption of phase 2 of the TA 	<ul style="list-style-type: none"> • (A) The regions are fully committed to undertake pro-poor planning. • (R) The regions may resist being subjected to central validation processes. • (R) The regions may not accept central guidelines.

Activities <ul style="list-style-type: none"> • Inception workshop • Regional training workshops • Interim workshop • Draft final report workshop • Final workshop 		<ul style="list-style-type: none"> • ADB review missions 	<p>(A) The concerned parties participate properly and provide inputs on time. Central and regional governments and stakeholders provide adequate support to the activities.</p>
Inputs <ul style="list-style-type: none"> • ADB TA grant of \$484,000 • Consultancy and other TA support • Government counterpart support of \$121,000 • Stakeholder inputs 	<ul style="list-style-type: none"> • ADB and government contribution to TA resources (Appendix 2) 		<ul style="list-style-type: none"> • (A) Consultants provide inputs according to TA Terms of Reference • (A) Central and regional governments provide full counterpart support. • (A) All stakeholders fully support the project and provide necessary inputs

ADB=Asian Development Bank, BAPPENAS= Badan Perencanaan Pembangunan Nasional (National Development Planning Agency) RAKORBANG= Rapat Koordinasi Pembangunan (Development Coordination Forum), TA=Technical Assistance

COST ESTIMATES AND FINANCING PLAN
(\$)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	240,000	0	240,000
ii. Domestic Consultants	0	144,000	144,000
b. International and Local Travel	10,000	10,000	20,000
c. Reports and Communication	0	10,000	10,000
2. Equipment	0	10,000	10,000
3. Workshops	0	20,000	20,000
4. Contingencies	20,000	20,000	40,000
Subtotal (A)	270,000	214,000	484,000
B. Government Financing^b			
1. Office Accommodation and Administrative Support	0	70,000	70,000
2. Remuneration and Per Diem of Counterpart Staff and their Transport	0	40,000	40,000
3. Contingencies	0	11,000	11,000
Subtotal (B)	0	121,000	121,000
Total	270,000	335,000	605,000

^a Financed by the Government of the United Kingdom

^b Financed by the Government of Indonesia

Source: Asian Development Bank Estimates

OUTLINE TERMS OF REFERENCE OF CONSULTANTS

A. International Consultants (12 person-months)

1. Expert on Development Strategy and Institutions for Decentralized Developing Economies/Team Leader (8 person-months)

1. The expert will have substantial expertise in public development planning, including at the regional level in developing countries, and have the following responsibilities:

- (i) Coordinate all tasks of the team and be responsible for timely preparation and completion of all outputs. Coordinate with other external funding agencies and the Government.
- (ii) Along with other team members, assess central and regional government readiness to make planning and budgeting practices pro-poor. Help five regional governments develop capacity for pro-poor planning and budgeting. Organize training for staff involved in regional planning and budgeting. Help the five regions prepare plans that have fully funded programs for regional development and poverty reduction.
- (iii) Study the RAKORBANG process to improve its effectiveness so that it leads to a concrete agreed-on and validated development strategy, based on agreements with the central government and other stakeholders on minimum quality of services provided through detailed annual inventory of projects and schemes based on technical analyses and clear annual budgeting of resources for development. Pilot-test the consultative process between regional and central governments, and consultations with stakeholders such as civil society and the private sector. Help the central government develop processes to validate these plans.
- (iv) Based on needs of the five regions and the validated pro-poor plans developed by them, and in consultation with the international specialist in public development financing, provide advice on financial support mechanisms from the regions' own resources and from the central government to back the plans.
- (v) Along with the other team members, utilize the experience of the five regions to advise National Development Planning Agency (BAPPENAS) on the policy and regulatory framework and operational guidelines on planning and budgeting for regional planning.

2. Specialist on Public Development Financing in a Decentralized Context (4 person-months)

2. The specialist will have experience in public finance, with focus on development financing in a decentralized context, and be responsible for the following:

- (i) Develop the financial support mechanisms to back the strategy and institutional arrangement being developed by the team leader and make it feasible.
- (ii) Explore the whole range of fiscal instruments to provide needed development resources, including grants through the Special Allocation Fund (*DAK*), block loans from the center to the regions; external assistance, national schemes

supported by cost-sharing between the center and the regions, national resource raising through market borrowings by the regions supported by central facilitation, improved provision of resources from the financial system for poverty reduction programs (such as microcredit); coordination of private sector participation; and coordination of participation by civil society. Examine possibilities of financial cooperation between regions, including mechanisms that allow flow of surplus funds from better-endowed regions to those that have a financial deficit.

- (iii) Using the cases of the five regional governments, examine how to finance in a sustainable fashion the development of poor regions and, particularly, their efforts to reduce poverty. The expert will recommend ways to optimize interaction among regional governments, central government, private sector, and other stakeholders to bring this about.

B. Domestic Consultants (24 person-months)

1. Specialist on Indonesian Local/Regional Development (8 person-months)

3. The specialist will have extensive background in local/regional development planning, with substantial experience in working with regional governments in Indonesia. The specialist will support the team leader's activities—(i) to (v)—to assess the readiness of regional and central governments and help develop the five regional governments' capacity to prepare realistic, fully funded plans under the improved pro-poor processes.

2. Specialist on Poverty Reduction and Participatory Processes (8 person-months)

4. The specialist will help the international consultants develop capacity in regions and processes for pro-poor planning, and in processes that assist in participatory planning, to ensure responsiveness to local needs.

3. Specialist in Indonesian Decentralization Law and Policy (8 person-months)

5. The main task of the specialist, who will be familiar with drafting regulations, will be to examine the legal and policy aspects of decentralization laws and recommend implementing regulations based on the Technical Assistance (TA) team's recommendations on regional planning, and on the TA findings.

C. Workshops

6. To gain acceptance for the recommendations, several workshops are necessary. The number, types, and schedules of such workshops will be decided at the inception meeting. They will disseminate work in progress and recommendations as well as include learning from other relevant TAs, including Interim Poverty Reduction Strategy Paper (IPRSP) TAs.

D. Reporting Requirements

7. The consultants will prepare a brief inception report 2 weeks after commencement, an interim report at the end of the fourth month, and a draft final report at the middle of the eighth month of the TA to be discussed at the final tripartite meeting. The final report will be presented

at the end of the eighth month after reflecting all comments at the final tripartite meeting. Reports will be circulated at least 5 days before meetings to members of the steering committee and discussed at tripartite meetings consisting of the Government (members of the steering committee), consultants, and the Asian Development Bank (ADB). Reporting formats will need prior ADB clearance.