ASIAN DEVELOPMENT BANK
Operations Evaluation Department

PROJECT PERFORMANCE EVALUATION REPORT

IN

INDONESIA

In this electronic file, the report is followed by Management’s response.
Performance Evaluation Report

Project Number: PPE: INO 29592
Loan Number: 1501-INO
May 2007

Indonesia: Regional Development Account Project

Operations Evaluation Department

Asian Development Bank
CURRENCY EQUIVALENTS
Currency Unit – rupiah (Rp)

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ABBREVIATIONS

ADB – Asian Development Bank
AFMA – Agency for Financial and Monetary Analysis
BAKD – Badan Analisis Keuangan Daerah (Agency for Regional Financial Analysis)
BAPPENAS – Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
BME – benefit monitoring and evaluation
BPD – Bank Pembangunan Daerah (Regional Development Bank)
DGFI – Directorate General of Financial Institutions
DPPP – Direktorat Pengelolaan Penerusan Pinjaman (Directorate for Subsidiary Loan Management)
EIRR – economic internal rate of return
FIRR – financial internal rate of return
ICB – international competitive bidding
IDC – interest during construction
IUIDP – Integrated Urban Infrastructure Development Program
KMK – Keputusan Menteri Keuangan (Minister of Finance decree)
LCB – local competitive bidding
MOF – Ministry of Finance
O&M – operation and maintenance
OED – Operations Evaluation Department
OEM – Operations Evaluation Mission
PCR – project completion report
PDAM – Perusahaan Daerah Air Minum (Local Government Water Supply Enterprise)
PPER – project performance evaluation report
RDA – Regional Development Account
RDAP – Regional Development Account Project
RRP – report and recommendation of the President
SLA – subsidiary loan agreement
TA – technical assistance
TCR – technical assistance completion report
NOTE

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

Key Words
ADB, Asian Development Bank, bus terminal, evaluation, failure, fiscal decentralization, Indonesia, intergovernmental onlending, local market, urban infrastructure

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Operations Evaluation Department, PE-699
The guidelines formally adopted by the Operations Evaluation Department on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. The fieldwork was undertaken by Abdul Malik (decentralization expert/international consultant); Iwan Widodo (urban development expert/domestic consultant); and Dwianto Rasisto (research assistant) under the guidance of the mission leader. To the knowledge of the management of the Operations Evaluation Department, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.
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Attachment: Management Response
## BASIC DATA

### Project Preparation/Institution Building

<table>
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<tr>
<th>TA No.</th>
<th>TA Project Name</th>
<th>Type</th>
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### Key Project Data ($ million)

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### Key Dates

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<td>60</td>
</tr>
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### Borrower

| Republic of Indonesia |

### Executing Agency

| Directorate General of Financial Institutions |

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<sup>a</sup> Represents approved amount of technical assistance.
EXECUTIVE SUMMARY

On 5 December 1996, the Asian Development Bank (ADB) approved a loan for $50 million from its ordinary capital resources to the Republic of Indonesia for the Regional Development Account Project (RDAP). The Directorate of Subsidiary Loan Management (DPPP), under the Directorate General of Financial Institutions within the Ministry of Finance (MOF), was the Executing Agency for the loan. The purposes of RDAP were to (i) improve the availability of long-term credit to local governments and enterprises to allow them to finance locally initiated urban investments, (ii) support the Regional Development Account (RDA) as a revolving municipal facility and to advance its institutional development, and (iii) promote the financial and institutional autonomy of local governments. The RDAP has two parts: (i) the urban infrastructure subprojects (Part A); and (ii) implementation of the physical investments, and the capacity building of RDA and local governments (Part B). Part A was to finance 25–30 pending investment applications that RDA received from secondary cities and small towns. Subprojects eligible for financing under the RDAP included water supply, bus terminals, local markets, wastewater disposal, and solid waste disposal.

In conjunction with the RDAP, ADB approved an advisory technical assistance (TA) grant for $600,000 for the institutional strengthening of the RDA. The Bureau for Regional Finance Analysis, under the Agency for Financial and Monetary Analysis of MOF, was the Executing Agency for the TA. The loan included capacity building for the immediate improvement of the RDA, while the TA was to explore the long-term development of RDA.

ADB disbursed only $7.74 million (or 15%) of the approved $50 million under the RDAP by the loan closing date of 29 November 2002, with the remaining balance progressively canceled. Underutilization of the loan reflects three factors: (i) inadequate capacity and staffing of DPPP during loan appraisal and administration; (ii) the financial crisis of 1997–1998; and (iii) MOF’s RDA decree issued in 2000 that tightened the RDA eligibility criteria without producing any fundamental change in RDA management, as envisaged at RDAP appraisal.

Of the RDAP disbursement of $7.74 million, $6.85 million was allocated to Part A and the remaining portion to Part B. Under Part A, $4.48 million (equivalent to Rp41.2 billion) was allocated for civil works and $2.37 million for interest during construction. Of the nine civil works subloans disbursed under the RDAP (to eight subborrowers, including six district governments, one city government, and one metropolitan-owned company), eight for $4.21 million supported renovation of markets. The other subloan for $0.27 million was for building a new bus terminal. In addition to Rp41.2 billion from the RDAP, MOF disbursed Rp87.8 billion—more than double the ADB financing—in matching funds from its own resources. Thus, the RDA disbursed Rp129 billion for these nine subloans. At the time of the Operations Evaluation Mission (OEM), these nine subloans had Rp47.4 billion outstanding, with the arrears totaling Rp11.3 billion. The three district governments recorded the arrears.

The targeted results of the RDAP were consistent with the Government’s development priority and ADB’s country strategy at the time of loan approval. However, the RDAP is rated partly relevant due to (i) weak appraisal, which did not address adequately the institutional issues in the RDA that the project preparatory TA consultant had highlighted; (ii) questionable timing of approval; (iii) inadequate analysis of risks associated with a potential delay in the issuance of an envisaged new RDA decree, and lack of a risk-mitigation measures; and (iv) ADB’s inappropriate response to external factors, i.e., the financial crisis of 1997–1998, resulting in changes in country’s needs and the risk profile of the RDAP.
The RDAP is rated ineffective based on the (i) significant underutilization of the loan and the underperformance of the nine subprojects, (ii) less-than-satisfactory RDA disbursement and underperformance of the funded projects, and (iii) RDAP’s and RDA’s minimal contribution to the promotion of financial and institutional autonomy of local governments. Most of the RDAP targets identified in the project framework were not achieved.

The RDAP is rated inefficient due to the negligible contributions of the (i) three subprojects (visited by the OEM) to the improvement of allocative efficiency of the economy, and (ii) RDA to the improvement of allocative and process efficiency in urban infrastructure investments.

The RDAP is rated unlikely sustainable because (i) DPPP classifies three of the nine subloans under the RDAP as bad or questionable, and arrears of these three RDA subloans (including the RDAP portion) amount to Rp11.3 billion (or 24% of the total outstanding from the nine RDA subloans); (ii) demand for the three subprojects visited by the OEM is not evident; (iii) budget allocations for operations and maintenance of these three subprojects have been inadequate; (iv) the RDA has made few approvals in recent years, and the restructuring of nonperforming RDA loans has been slow; and (v) political support for the RDA has been weakened.

TA 2699-INO is rated as partly relevant, despite its evident complementarity to the RDAP, because the Government’s commitment to RDA reform faded during TA implementation. The TA contributed to some policy changes in RDA management through near-term recommendations. However, the TA is rated less effective as it did not lead to fundamental changes in RDA management and establishment of a robust intergovernmental onlending mechanism. It is rated inefficient in view of the significant underutilization of consultant outputs. Since the future operations of the RDA are uncertain, the TA is rated less likely sustainable.

Based on this evaluation, RDAP and the TA are rated unsuccessful overall.

The report identified the following key lessons:

(i) ADB should consider project preparatory TA findings sufficiently in determining the project design and timing of approval. For the RDAP, the project preparatory TA highlighted the lack of an enforcement mechanism for RDA loan recovery, inadequate staffing for RDA operations, and operational inefficiency. Nevertheless, ADB processed the loan with the hope that the envisaged new RDA decree would address these fundamental issues. A better strategy would have been to wait for the RDA decree to be issued, and for tangible actions to be taken to address the weaknesses identified in the project preparatory TA, before loan processing. The evidence suggested that ADB did not consider seriously the project preparatory TA outputs, and was more focused on project approval than achieving development results.

(ii) The project experience underscores the need for proper risk analysis and risk-mitigating measures in project design. The success of RDAP was contingent on the envisaged RDA decree. However, the report and recommendation of the President did not analyze the risk associated with a potential delay in the issuance of this decree. Thus, no risk-mitigating measures were put in place, leaving the RDAP extremely vulnerable.

(iii) The experience with the RDAP underscores the need for better handling of an underperforming project within ADB.
(iv) Project-related tasks should be integrated effectively into an executing agency’s core operations. While the eligibility criteria of RDAP subprojects largely followed those in place for the RDA, the RDAP appraisal requirements were more onerous. This was the main reason that typically multitasked DPPP staff became more and more dependent on ADB consultants in handling the RDAP. As a result, the envisaged technical transfer did not materialize.

(v) As empirical studies across countries show, and as the RDAP demonstrated, establishing a functional intergovernmental onlending mechanism is challenging. Taking this into account, ADB should pay extra attention to the economic justifications and financial viability of subprojects, as well as the capacity of the central and local governments concerned, if it becomes involved in such an onlending mechanism in the future.

Since the Government no longer prioritizes this operation, no specific follow-up actions were identified for the Borrower and for ADB.

Bruce Murray
Director General
Operations Evaluation Department
I. INTRODUCTION

A. Evaluation Purpose and Process

1. On 5 December 1996, the Asian Development Bank (ADB) approved a loan for $50 million from its ordinary capital resources to the Republic of Indonesia for the Regional Development Account Project (RDAP). The Directorate of Subsidiary Loan Management (DPPP), under the Directorate General of Financial Institutions (DGFI) within the Ministry of Finance (MOF), was the Executing Agency for the loan. In conjunction with RDAP, ADB approved an advisory technical assistance (TA) grant for $600,000 for the institutional strengthening of the Regional Development Account (RDA). The Bureau for Regional Finance Analysis (BAKD), under the Agency for Financial and Monetary Analysis (AFMA) of MOF, was the Executing Agency for the TA.

2. ADB's Operations Evaluation Department (OED) selected RDAP as part of the annual sample of completed projects for performance evaluation. The Operations Evaluation Mission (OEM) that visited Indonesia 1–18 October 2006 prepared this project performance evaluation report (PPER). The evaluation draws upon a review of RDAP documents and other relevant studies, as well as discussions between OEM members and representatives of DPPP, the National Development Planning Agency (Badan Perencanaan Pembangunan Nasional or BAPPENAS), selected subborrowers (two local governments and one metropolitan-owned enterprise), relevant development partners, and other stakeholders. It also incorporates the results of the OEM's field inspections of selected subprojects. The draft PPER was shared with the Executing Agency and the concerned ADB departments and offices, and their views have been incorporated as appropriate.

3. In April 2005, the project completion report (PCR) rated the RDAP as unsuccessful. It was judged to be less relevant, less efficacious, and partly efficient, with unlikely sustainability. The OEM found that the PCR assessment was objective with sufficient information on the outcomes of the three selected subprojects. However, the PCR did not provide enough information on the overall performance of the RDA and the progress in decentralization of public services and finance, which were integral parts of the project goals. The OEM aimed to fill this gap.

4. In June 1999, the TA completion report (TCR) rated TA 2699-INO as generally successful, while noting that “it is premature to evaluate the long-term success of the TA as the action plan will be implemented over a 3–5 year period.” The OEM aimed to reevaluate this TA especially in view of the implementation status of the TA recommendations to date.

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1 ADB. 1996. Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance to the Republic of Indonesia for the Regional Development Account Project. Manila.
2 DPPP subsequently was transferred under the Directorate General of Treasury with the MOF.
4 In conjunction with the 1999 decentralization legislation, the AFMA was divided into two, and the BAKD was placed under Directorate General for Fiscal Balance in 2001. In 2004, the Agency for Research on Economic, Financial and International Cooperation (Bapekki) was created, and most of the former BAKD functions were transferred to this agency.
B. Expected Results of the Project

5. The goals of the RDAP were to (i) improve access to basic urban infrastructure and services, and (ii) help the Government achieve its urban sector policy and development priorities. The purposes of the RDAP were to (i) improve the availability of long-term credit to local governments and enterprises to allow them to finance locally initiated urban investments, (ii) support the RDA as a revolving municipal facility and to advance its institutional development, and (iii) promote the financial and institutional autonomy of local governments (Appendix 1).

6. The RDAP had two parts: (i) the urban infrastructure subprojects (Part A); and (ii) implementation of the physical investments, and the capacity building of RDA and local governments (Part B). Part A was to finance 25–30 pending investment applications that the RDA received from secondary cities and small towns. Subprojects eligible for financing under the RDAP included (i) water supply, (ii) bus terminals, (iii) local markets, (iv) wastewater disposal, and (v) solid waste disposal. This component was expected to benefit about 500,000 users of water supplies and other basic urban facilities, as well as about 2 million users of bus terminals and local markets. Part B was to finance consulting services to help (i) DPPP strengthen its subproject appraisal capacity, and (ii) local governments and local enterprises strengthen subproject proposals.

7. Urban development projects formulated by local governments and local government enterprises were eligible for subloans under the RAPD. Subprojects were required to comply with the national design criteria and standards, including all relevant environmental standards and regulations. Eligible subprojects also needed to meet the following criteria: (i) the investments are well focused, need- and demand-responsive, and affordable; (ii) the subborrowers are willing to contribute 25% of the subproject cost and borrow the balance; (iii) the local government/enterprise can prepare, implement, and manage the subproject; (iv) the local government or local government enterprise has the financial capacity to meet the ensuring debt service obligations; and (v) the subproject is financially sustainable. The subproject loans would range between the equivalent of $240,000 (about Rp560 million) and the equivalent of $6.5 million (about Rp15 billion).

8. The purposes of TA 2699-INO were to (i) review the Governments’ policies and the RDA’s role in financing urban investments and supporting regional development; (ii) analyze the options for transforming the RDA into an autonomous financial intermediary fund for local governments and their enterprises, and outline an action plan; (iii) review and assess financial intermediaries, including regional development banks (Bank Pembangunan Daerah [BPD]), as conduits of local governments; and (iv) consider the Government’s plan to move RDA’s interest rate closer to the market rate and assess the implications, if any, on the affordability of the RDA’s lending to potential borrowers. The loan included capacity building for the immediate improvement of the RDA, while the TA was to explore the long-term development of RDA.

C. Evaluation Methodology and Limitation

9. The OEM assessed the RDAP based on (i) DPPP’s feedback to the questionnaire that was sent prior to the OEM; (ii) interviews with representatives of DPPP, BAPPENAS, and the

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6 The Loan Agreement stipulated that subprojects eligible for financing should meet the following criteria: (i) well focused, need- and demand-responsive, and affordable investments; (ii) preparation, implementation, and management of the subproject by the Level II government or concerned local government enterprise; (iii) financial capacity of the local government or local government enterprise to meet ensuing debt service obligations; and (iv) financial sustainability of the subproject.
selected subborrowers (two local governments and the metropolitan-owned enterprise); (iii) site visits of three selected subprojects (in Jakarta, Surakarta, and Ponorogo); (iv) interviews with the relevant aid agencies’ staff and researchers; and (v) relevant consultant reports, and the recent study on an intergovernmental onlending mechanism in Indonesia.\(^7\)

10. Following the *Guidelines for Preparation of PPERs of Public Sector Operations*,\(^8\) the OEM aimed to evaluate the RDAP based on the following criteria and subcriteria:

(i) **Relevance:**
(a) Adequacy of the assessment of problems, opportunities, and lessons at the time of project approval
(b) Consistency of the targeted impact, outcome, and outputs of the RDAP with the Government’s development strategy, ADB’s strategy and program for the country, and ADB’s strategic objectives, at appraisal and at evaluation
(c) Appropriateness of modality of ADB’s assistance, project design and scope, and implementation arrangement.
(d) Timeliness of ADB’s response to external factors that might have affected project implementation

(ii) **Effectiveness:**
(a) The RDA’s and RDAP’s contributions to improving the availability of long-term credit to local governments for urban infrastructure projects and their outcomes
(b) The RDAP’s contributions to the institutional development of the RDA, and institutional and financial autonomy of local governments

(iii) **Efficiency:**
(a) Subproject contributions to the improvement in allocative efficiency of the economy
(b) The RDA’s and RDAP’s contribution to the improvement of process efficiency in urban infrastructure investments

(iv) **Sustainability:**
(a) Adequacy in demand for subprojects’ outputs, and their cost recovery\(^9\)
(b) Financial capability and repayment performance of the relevant local governments\(^10\)
(c) Availability of continued funding to maintain proper operations and maintenance of subprojects
(d) Environmental, socioeconomic, and technological risks of subprojects
(e) Policy and institutional environment to maintain the RDA

11. The RDAP’s project framework identified the seven project targets (corresponding to the project purpose): (i) participation of about 25–30 local governments/enterprises; (ii) $68 million available for credit finance; (iii) strengthened appraisal procedures; (iv) repayment rate over 85%; (v) improved monitoring of loans portfolio; (vi) local governments identify, prepare, implement, and operate urban infrastructure and services; and (vii) local governments contribute

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\(^9\) This assessment will refer to the risks and assumptions identified in the project framework, such as local governments’ capacity to identify viable projects and apply for RDA funding, as well as increase tariffs and user fees to recover the investment costs.

\(^10\) This assessment will refer to the risks and assumptions identified in the project framework, such as local governments’ capacity to commit counterpart funding, and repay the loan on a timely basis.
at least 25% of the subproject costs, and borrow the balance. The OEM referred to the achievement of these targets in assessing the effectiveness of the RDAP.

12. A benefit monitoring and evaluation (BME) system of the RDAP was to be created under the institutional development component of TA 2699-INO. However, this component subsequently was canceled, and the BME system was not created. This prevented the OEM from obtaining information on outcomes, sustainability, and development impacts, especially of the six subprojects that the OEM did not visit. As a result, the OEM’s ability to undertake the evaluation was constrained.

13. The OEM could not obtain the updated data on the number of approvals of RDA loans, their outstanding loans, and arrears. This also hampered the evaluation of the RDAP. DPPP explained that the data exclusively on RDA loans was not readily available as it managed RDA with subsidiary loan agreement (SLA) loans (footnote 11). Public disclosure of the RDA transactions should have been part of the RDAP loan covenants, and the project framework should have identified the relevant RDA indicators as performance targets of the Project.

II. DESIGN AND IMPLEMENTATION

A. Formulation

14. In 1985, the Government adopted the Integrated Urban Infrastructure Development Program (UIDJP) to decentralize the urban development functions to provincial and local governments. In line with the UIDJP, the Government set up the RDA in 1988 to improve local governments’ access to long-term credit for municipal investment.11 The RDA began operations in 1991 at the issuance of a formal ministerial decree stipulating the RDA policy and procedures. Detailed administrative processing instructions on RDA were issued in 1992 in the form of ministerial implementation guidelines. The United Nations Development Programme (UNDP) assisted with the preparation of the decree and guidelines. The main objectives of the RDA were to strengthen local governments’ financial autonomy, and promote the decentralization; and to achieve the regional urban development targets. By the end of January 1996, the RDA had approved 306 loans totaling $373 million (Rp865 billion), of which about 70% had been disbursed. Most of the loans were for water supply projects of local government companies

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11 Before the establishment of the RDA, the Government had onlending mechanisms, such as the Investment Fund Account (Rekening Dana Investasi or RDI) and the INPRES Pasar. RDI loans were used to finance subnational government infrastructure projects; INPRES Pasar loans were exclusively for market construction. Moreover, the SLA has been the central Government’s mechanism for onlending foreign funds, mainly from the World Bank and ADB, to subnational governments and their enterprises (Lewis, Blane D. 2006. Onlending in Indonesia: Past Performance and Future Prospects. Jakarta). The consultant report of TA 2500-INO clarified the relations among RDA, SLA, and RDI as follows: “The (Government of Indonesia) intends for RDA lending to fully supplant SLA type lending as quickly as local governments are fully able to prepare projects for long-term debt financing.” Further, the report stated: “RDI is the account in the MOF into which repayments from state enterprises, SLAs to regional governments, and various other (Government of Indonesia) loans to public and private sector entities flow. It is used primarily now to make domestically-sourced loans to state-owned enterprises and other national government entities. It also serves as a reserve account for repayment of (Government of Indonesia) foreign-sourced loans. Occasionally, RDI funds have been transferred to RDA to fund loans to local governments and enterprises. RDA loan repayments do not, however, go into RDI, but back to the RDA itself. RDI is considered off-budget.” The RDI and INPRES Pasar since have been rolled into RDA operations. (Lewis [2006]).
(Perusahaan Daerah Air Minum or PDAM), followed by bus terminals, solid waste management, and market improvements.¹²

15. The demand for the RDA increased significantly in the mid-1990s, with 77 pipeline projects amounting to the equivalent of $161 million (Rp375 billion) at the end 1996. While the national budget allocation of $32 million (Rp74 billion) to the RDA was likely to be maintained during 1997–1999, the funding requirements of approved projects would utilize most of the budget funds. To meet the demand, the Government requested ADB in 1995 to finance part of the backlog of loan applications for the RDA, with the balance to be funded by loan repayments and other sources.¹³ In response, ADB approved a small-scale project preparatory TA¹⁴ grant to facilitate preparation of a project to support the RDA. Based on the TA output submitted in April 1996, ADB fielded a Reconnaissance Mission (upgraded later to a Fact-Finding Mission) in May 1996 and the Appraisal Mission in July–August 1996, and completed the loan negotiation in October 1996.

16. The consultant report of the project preparatory TA estimated the collection ratio of RDA loans at around 80% as of early 1996. The report noted that “RDA’s collection rate is affected by absence of enforcement mechanisms as well as provisions with teeth for dealing with borrowers in arrears or in default. Local government loans are unsecured, and a borrower in arrears or default is not even officially ineligible for additional RDA loans. Provisions to correct these enforcement weaknesses are being considered in the new RDA Decree.” The consultant report also noted that the inadequate staffing in the relevant DPPP section (Public Works and Communications Investment in the Subdirectorate of Investment) and multiple tasks assigned to the staff concerned might constrain the development of the RDA.¹⁵ The Report and Recommendation of the President (RRP)¹⁶ did not elaborate on these issues, while planning to allocate more than $3 million of the loan fund for project implementation support and institutional development. Moreover, the RRP did not analyze the risk associated with a delay in issuance of the envisaged new RDA decree.

¹² The RDA financed up to 75% of the project cost, with the balance financed by local governments and local enterprises. Loan terms varied by type of project, with the maximum term of 20 years and a maximum grace period from principal repayment of 5 years. To qualify for funding, a project had to finance infrastructure or services that had social importance, and had to be financially sustainable by raising revenues from the borrower directly through user charges or indirectly through increase in general revenue. The Government provided most of the capital for RDA operations, mainly through the national budget. Meanwhile, the United States Agency for International Development (USAID), through its Housing Guarantee Loan program, provided $43.5 million in capital to the RDA; and ADB provided $5 million as part of the Eastern Island Urban Development (Sector) Project.

¹³ USAID was processing assistance to capitalize the RDA under the Housing Guarantee Loan. The Government also requested the World Bank and Japan to consider funding the RDA.


¹⁵ The section concerned comprised 15 staff, of which eight attended the training course that was specially designed to support the operations of the RDA. However, the project preparatory TA report pointed out that “staff involved in RDA loan evaluation have many other non-RDA duties so that it is difficult for them to perform all the duties required for effective loan appraisal and administration. This will be addressed by the new decree by shifting detailed loan appraisal to the regional development banks, although RDA staff will have an overall quality control and monitoring role vis-à-vis the BPDs [Regional Development Banks].”

¹⁶ ADB. 1996. Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to Indonesia for the Regional Development Account Project. Manila.
B. Rationale

17. The RDAP built on ADB’s extensive assistance to the urban infrastructure sector in Indonesia from 1972 to 1995. Based on this experience and the policy dialogue, ADB identified, in its country operational strategy, the three key policy thrusts in the sector: (i) reinforcing decentralization, (ii) strengthening local resource mobilization, and (iii) supporting an institutional framework for municipal borrowing. The RDAP addressed these thrusts in line with the Government’s Sixth Five-Year Development Plan (REPELITA VI [1994/95-1998/99]), which also prioritized strengthening the RDA.

18. The RRP stated the rational of the RDAP as follows: “Rapid urbanization coupled with strong economic growth has greatly increased the demand for urban infrastructure and services. The Project is essential in helping the Government to realize its regional development targets, in line with its urban sector policy and development priorities. In particular, the Project will provide long-term credit to finance small-scale locally initiated urban sector investments through RDA. It will also enable RDA to process a large number of pending loan applications for urban infrastructure projects (footnote 16).”

19. At appraisal of the RDAP, the Government considered a two-step approach in institutional development of the RDA. In the first stage, by 1998, the MOF planned to issue a new RDA decree to (i) delink the Government’s budget allocation process from RDA subproject approvals, which would significantly increase RDA autonomy; (ii) set in motion the transformation of the RDA into a wholesale financing facility by shifting direct responsibility for loan approval, monitoring, and collections to select BPDs and/or other financial institutions; (iii) increase the interest rate toward market rates; and (iv) provide liens on property tax revenues of local governments in case of default on RDA loans, which would improve the long-term financial viability of regional lending. The second stage would involve the establishment of the RDA as an autonomous financial intermediary independent of MOF, which would require a presidential decree and substantial institutional strengthening. A long-term strategic plan for the RDA being developed under TA2699-INO was to be impetus, especially for the institutional development of the second stage.

C. Cost, Financing, and Executing Arrangement

20. The RDAP was estimated to cost the equivalent of $90 million ($68 million for Part A; $4.6 million for Part B; and $17.4 million for taxes, duties, and interest during construction [IDC] and other charges). Of $90 million, $30 million was to be the foreign exchange cost ($19.7 million for Part A, $2.6 million for Part B, and $7.7 million for IDC), and the remaining $60 million was to be the local currency cost ($48.3 for Part A, $2 million for Part B, and $9.7 for IDC). The ADB loan for $50 million was to finance the entire foreign exchange cost of $30 million and the equivalent of $20 million of the local currency costs relating to civil works, equipment and materials, and consulting services, excluding land, taxes, and duties. The central Government, participating local governments, and their enterprises were to cover all other costs. The actual project costs and the disbursements under the RDAP are in para. 28.

21. The ADB loan had repayment period of 25 years, including a grace period of 5 years, and an interest rate denominated in accordance with ADB’s pool-based variable lending rate

17 This included 23 loans (amounting to $1.5 billion) and 30 TAs ($15.6 million). Under the ADB-supported Eastern Islands Urban Development Project, for $85 million, approved in 1993, $5 million was to be channeled through the RDA on a pilot basis.

system for dollar loans. The Government was to bear the foreign exchange risk. Subborrowers were to contribute at least 25% of the subproject costs, with the balance financed by subloans. Of the ADB loan, the equivalent of $39 million was to finance infrastructure development, while the equivalent of $11 million was to be used to finance consulting services and IDC. The relending terms to local governments and their enterprises would be those prevailing for urban sector projects under RDA, which included an annual interest rate of 11.5%, amortization of up to 20 years, a grace period of up to 5 years, and commitment charge of 0.75% at loan approval. The Government agreed to align the relending interest rates under the RDA to the Bank Indonesia certificate’s rate by the end 2000. However, the Government has not complied with this agreement.

22. Line agencies of local governments and local government enterprises would be responsible for the identification, preparation, and day-to-day implementation of subprojects. DPPP was responsible for appraisal of subloan applications, as well as coordinating, supervising, and monitoring RDAP implementation. The appraisal was to include (i) social analysis, (ii) technical analysis, (iii) environmental analysis, (iv) financial analysis, and (v) economic analysis. A project director was supported by a working team from DPPP, BAPPENAS, and the Directorate General of Budget, as originally planned. DPPP was to submit to ADB a summary of appraised subprojects for use of the RDAP. The first three subprojects and any subprojects exceeding the equivalent of $5 million required ADB approval prior to the approval by MOF. However, MOF approved the second subloan before submitting the application to ADB. Detailed information on RDAP implementation is in paras. 28–32.

23. The RDAP special account was established in accordance with ADB’s Guidelines on Imprest Fund and Statement of Expenditure Procedures. As per the guidelines, initially $5 million was deposited in the account. However, considering the slow progress in project implementation and interest payment obligations for the amount credited to the special account, the Government requested the conversion of the disbursement procedure from the special account to reimbursement in March 2000.

D. Procurement and Scheduling

24. Goods and services to be financed from the proceeds of the loan were to be procured in accordance with ADB’s Procurement Guidelines (April 2006, as amended from time to time). Civil works contracts with a value of $3 million or more would be awarded through international competitive bidding (ICB). Civil works contracts with a value of less than the equivalent of $3 million may be awarded through local competitive bidding (LCB) procedures acceptable to ADB. However, LCB contracts valued at the equivalent of $2 million or more would require ADB approval prior to award. In accordance with ADB procedures, foreign contractors would be allowed to participate in LCB packages. Equipment and materials estimated to cost the equivalent of $500,000 or more would be procured through ICB. International shopping procedures may be followed for supply contracts with a value of less than the equivalent of $500,000. Certain items that would not be suitable for international shopping may be procured through LCB, subject to a maximum contract amount not exceeding the equivalent of $500,000. Supply contracts costing less than the equivalent of $50,000 may be procured by direct


20 Disbursements for one subproject under Part A and some portion of the consulting services conducted under Part B were made from the special account before its closure. The reimbursement procedures were followed for the subsequent disbursements.
purchase. The OEM did not discern any major deviations from ADB’s guidelines in the RDAP procurement procedures.

25. For Part B of the RDAP, 485 person-months of consulting services, comprising inputs from 110 person-months of international consultants and 375 person-months of national consultants, were to be required. Consultants were to be selected in accordance with ADB’s Guidelines on the Use of Consultants (April 2006, as amended from time to time) and other arrangements acceptable to ADB. The OEM did not discern any major deviations from the guidelines in the RDAP recruitment procedures.

26. The RDAP was to be implemented over 5 years, with completion scheduled for 31 March 2002, and the expected closing date for withdrawals from the loan account on 30 September 2002. The RDAP became effective on 8 April 1997 and closed on 29 November 2002, 2 months after the original closing date. TA 2699-INO closed on 31 January 1999, 6 months later than initially planned.

E. Design Changes

27. The design of Part A of RDAP was not changed during implementation, while the institutional strengthening element of Part B was canceled in January 2001 at the request of the Government. Although the OEM could not verify fully the reason for this cancellation, the review of project files suggested that the uncertainty involved in future RDA operations was the main reason for this request.

F. Outputs

1. Use of the Loan

28. ADB disbursed only $7.74 million (or 15%) of the approved $50 million under the RDAP by the loan closing date of 29 November 2002, with the remaining balance progressively canceled. Project costs are estimated at $18.9 million, compared with $90 million projected at appraisal. Of the $18.9 million, $5.2 million was financed by the central Government, $6 million by local governments and a metropolitan government enterprise, and the remainder by ADB (Appendix 2).

29. The cancellations, in part, reflected proactive measures by ADB and the Government to manage the portfolio and improve its performance in the aftermath of the Asian financial crisis. The first reduction occurred during the 1998 comprehensive portfolio review when $7.8 million, representing savings from currency devaluation, was canceled. The second reduction of $20.0 million came after the midterm review of February 1999, mainly due to weak demand. The third adjustment of $5.2 million in July 2000 was made after a sector portfolio review. The unused loan balance of $9.3 million was canceled at the closure of the loan account on 29 November 2002.

30. Subloans (Part A). Of the total disbursement of $7.7 million, $6.85 million was allocated to finance nine subprojects, including $4.5 million (equivalent to Rp41.2 billion) for civil works and $2.4 million for IDC. For the civil works of the nine subprojects, ADB initially approved the equivalent of Rp48.8 billion. However, Rp7.6 billion was not disbursed because (i) one subloan

\[21\] The OEM could not verify independently the actual project costs. Thus, it tentatively used the data submitted by DPPP at project completion.
was terminated before project completion (para. 40), and (ii) three subprojects approved by DPPP during July 2001–June 2002 were not completed before the closing of the RDAP in November 2002. The total cost of the nine subprojects funded under the RDAP was estimated at $13.8 million, including $12 million for civil works.

31. Three key factors can explain the underutilization of the loan: (i) inadequate capacity and staffing of DPPP in loan appraisal and administration; (ii) the Asian financial crisis of 1997–1998; and (iii) MOF’s RDA decree issued in 2000, which tightened the RDA eligibility criteria without producing the fundamental change in RDA management envisaged at RDAP appraisal. First, the eligibility criteria of RDAP subprojects largely followed those in place for the RDA. However, the RDAP requirements during appraisal were more onerous for DPPP, particularly regarding economic analysis and social assessment, and translation of subproject documents into English. For this reason, ADB did not approve any subloans before the inception of the consulting work under Part B in June 1999 and after the completion of the consulting work in September 2001. Second, as a consequence of the Asian financial crisis of 1997–1998, the Government’s priorities changed. It reassessed its borrowing position, aiming to reduce future liabilities and reallocate loan proceeds to mitigate the impact of the crisis on the poor. The financial crisis also disrupted some PDAM projects that relied on imported material for construction, and caused the deterioration of their financial positions. Third, the RDA decree of 2000 made all borrowers with arrears and with debt service coverage ratios of less than 2.5 ineligible for any additional RDA loans, making most PDAMs ineligible to participate in the RDAP.

32. Consulting Work (Part B). ADB disbursed $0.89 million for consulting services to implement Part B of the RDAP. Part B was implemented in two phases. In the first phase, international and national consulting firms were engaged as individual consultants and fielded from June 1999 to March 2002. In the second phase, other international and national consulting firms were engaged and fielded from January 2000 to August 2001. DPPP’s lack of experience in handling ADB projects delayed the selection of consultants at the initial stage of RDAP implementation, which delayed Part A implementation. In response, while considering the broad scope of the terms of reference of Part B, this two-phase approach was adopted instead of engaging one consulting team throughout.

2. Performance of Subloans (Part A)

33. Of the nine subloans disbursed under the RDAP (to eight subborrowers) for $4.48 million (equivalent to Rp41.2 billion), eight subloans for $4.21 million supported the renovation of markets. The other subloan for $0.27 million was for building a new bus terminal. Of the eight market renovation subloans, two (for $2.4 million) were extended to PD Pasar Jaya, the market management company owned by metropolitan Jakarta; one (for $0.75 million) was to the city (kota) government of Surakarta (in Central Java); and the remaining five (for $1.06 million) were to kabupaten (district) governments of AcehTenggara (in Sumatra), Barito Kuala (in Kalimantan), Mandailing Natal (in North Sumatra), Polewali Mamasa (in South Sulawesi), and Kediri (in East Java). The borrower of the bus terminal subproject was the district government of Ponorogo (in East Java). The locations of the subprojects are shown on the map on page vii.

22 During the financial crisis, BAPPENAS proposed the cancellation of the RDAP to use the loan fund for other urgent matters. The OEM could not verify the MOF’s response to this proposal. Evidently, this proposal was not approved.

23 PD Pasar Jaya received two subloans under the RDAP.
34. The Project was designed to catalyze the mobilization of additional Government financing. In addition to the ADB loans totaling Rp41.2 billion, MOF disbursed Rp87.8 billion in matching funds from its own resources. Thus, Rp129 billion was disbursed from the RDA for these nine subprojects.\(^{24}\) The interest rate for the nine subloans was 11.5% in accordance with the RDA rule, with maturities ranging from 6.5 years to 20 years, including a grace period ranging from 1 year to 5 years.

35. At the time of OEM, the nine subloans had Rp47.4 billion outstanding, with the arrears totaling Rp11.3 billion or 23.8%. The district governments recorded the arrears: (i) Aceh Tenggara for Rp3.6 billion (amortization of Rp1.5 billion, interest payments of Rp1.5 billion, and penalty and other charges of Rp0.6 billion); (ii) Barito Kuala for Rp5.3 billion (amortization of Rp2.6 billion, interest payments of Rp1.9 billion, and penalty and other charges of Rp0.8 billion); and (iii) Mandailing Natal for Rp2.4 billion (amortization of Rp1.5 billion, interest payments of Rp0.6 billion, and penalty and other charges of Rp0.3 billion).

36. Appendix 3 illustrates the profiles of three subprojects (of PD Pasar Jaya, and the Surakarta and Ponorogo governments) visited by the OEM. Paras. 37–42 summarize the OEM findings on these three subprojects, and the information provided by DPPP on other subprojects.

37. **PD Pasar Jaya (Phase I).** This subproject aimed to renovate three markets (Minggu, Cipete, Palmerah) managed by PD Pasar Jaya that were burned down during civil unrest in May 1998. Newly constructed Minggu Market is a compound of two four-story buildings with a total of 132 shops. Cipete Market is a compound of three two-story buildings and one three-story building with a total of 428 shops. Palmerah Market is a four-story building with 890 shops. PD Pasar Jaya is owned by DKI Jakarta, which manages 151 markets. Since PD Pasar Jaya is not allowed to use these markets as collateral for bank borrowing, it is operating under financial constraints. PD Pasar Jaya considered privatization as an option, but DKI Jakarta rejected this approach. After reducing its workforce by 700 in 2003, the company employed 2,241 persons at the end 2004. However, the management believes 500 staff would be enough to manage the 151 markets, suggesting that the company retains some operational inefficiency.

38. **Surakarta.** This subproject aimed to rehabilitate a market that was burned down during civil unrest in May 1998. The newly constructed four-story market is 4,800 square meters (m\(^2\)) with traditional shops for perishable goods, small booths for cellular phones and garments, nationwide department store chain, cinema, playground, and parking. Although the market was rehabilitated in response to strong demand from the vendors that occupied the old market, the traditional shops for perishable goods and small booths selling cellular phones and garments are limited to the ground floor. A nationwide department store chain occupies the remaining building area. The management noted that the rent of the space is below the market price. This implies that the local government is subsidizing those privileged tenants that have the opportunity to operate within this market.

39. **Ponorogo.** This subproject aimed to construct a new bus terminal on the outskirts of the city to replace the old terminal that was creating traffic congestion and pollution. The bus terminal has an area of 54,000 m\(^2\), housing the (i) main facilities (vehicle tracks and maneuver area for public transportation, management office building, passenger lobby and vehicle shelters, control tower); (ii) supporting facilities (parking space for passenger/operator vehicles, toilet, \\

\(^{24}\) At subloan approval, the costs of these nine subprojects totaled an estimated Rp210.2 billion, of which Rp144.4 was to be funded through the RDA and the remaining Rp65.8 to be contributed by the subborrowers. The OEM could not obtain the actual total costs and subborrowers’ contributions for the nine subprojects.
clinic, restaurant/canteen, post and telephone corner, mosque, kiosk arcade, workshop and car wash, building connection roofs, and checkpoint post); (iii) additional facilities (announcement boards, direction guides, garden, pond, water tower, fence); and (iv) utilities (power/energy, water system, communication system, fire hydrant). The OEM noted that the lower-than-expected revenue generated was due to the national decrease in the number of passengers using public transportation, as well as the overestimation of the number of passengers at appraisal.

40. Aceh Tenggara. During project implementation, after the disbursement of Rp3.5 billion, the Aceh government declined to submit the required fiduciary documents. Thus, MOF suspended loan disbursements. The OEM could not find any correspondence from DPPP regarding this matter in the project file. The Aceh government completed the project using its own resources. The funded market is operational with the capacity to accommodate 620 traders, 250 kiosks, and four larger-scale shops.

41. Barito Kuala. The construction of a market was completed as planned. However, its occupancy ratio remains far lower than expected since the construction of the planned access road and bridge was not completed. The OEM could not get further information on this subproject from DPPP.

42. Natal Mandailing. The construction of a market was completed as planned. The OEM could not obtain details on this market, except that it can accommodate 750 kiosks and 300 traders. DPPP could not say why the Natal Mandailing government did not repay the loan.

3. Performance of Consulting Work (Part B)

43. Phase I. The consultants, composed of a senior management advisor, a municipal development specialist, and a junior financial analyst, were hired as individual consultants. The team was assigned to support DPPP in implementing the RDAP and particularly strengthening subproject appraisal capacity. During the 8 months of the consultants’ services, the senior management advisor drafted some guidelines to support the RDA management. However, DPPP did not seem to adopt formally any of these products. A member of the DPPP staff indicated to the OEM that the products did not even receive feedback from DPPP. The municipal development specialist supported the DPPP in appraising several subproject applications, including those of PD Pasar Jaya, and Surakarta City and Ponorogo District governments. The limited relevant documents available in the project files suggest that the municipal development specialist did not conduct (or assist DPPP in conducting) the economic analysis of these subprojects. These subprojects were not assessed adequately during appraisal. An OEM interviewee stated that the municipal development specialist was not technically fully qualified as he specialized in water supply. Perhaps for this reason, he failed to identify the unrealistic assumptions on the demand for services and the overly optimistic revenue projection included in the feasibility study for the Ponorogo Bus Terminal.

44. Phase II. The consulting team consisted of a senior management advisor acting as a team leader, a municipal engineer, two financial/economic advisors, and a financial/database management advisor. The team leader was changed soon after the commencement of the consulting work, and the municipal development specialist under phase I was recruited again as the municipal engineer to provide an effective link between the two phases. The consulting team

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25 The PCR noted that this subproject was suspended "due to persistent civil unrest." DPPP failed to confirm the accuracy of this information to the OEM.
was to (i) assist DPPP with the loan portfolio review of borrowers, especially nonperforming loans, including an evaluation of rescheduling options and/or revision of terms and conditions of the loan; (ii) strengthen overall RDA management, emphasizing the strengthening of appraisal procedures; (iii) assist DPPP in conducting a review and evaluation of new subprojects, as well as assist the local government and local government-owned enterprises in improving the selection and implementation of subprojects; and (iv) assist DPPP with overall project management and coordination.

45. The consulting team conducted a comprehensive loan portfolio review and an assessment of loan rescheduling feasibility. However, the resulting recommendations were not implemented. In the final report, the consulting team indicated that no dialogue had taken place with DPPP management regarding the rescheduling proposal taken up during the 4 May 2000 meeting. The consulting team acknowledged the difficulty in transferring knowledge, despite having a good relationship with DPPP at the working level, mainly because budgetary restrictions prevented the staff from accompanying the consultant to on-site discussions with nonperforming borrowers.

46. To support overall loan management, the consulting team developed some guidelines. The approach taken was not obviously consistent with the ones developed by the consultant engaged in the first phase. The guidelines covered four aspects of loan management, including guidelines for loan application, loan appraisal, loan monitoring, and conduct of a demand survey. The four clusters of guidelines seemed to have covered all aspects of loan management in a systematic and less complicated way. However, the extent to which the guidelines have been used in the day-to-day practice of current loan management is unclear. Currently, no significant activities to prepare new loans are underway. Also, intensive loan monitoring activities do not seem to be taking place using the guidelines developed by the consulting team.26 Discussions with DPPP did not reveal any evidence of sustainable compliance with the guidelines, indicating the lack of internalization and sustainability.

47. In conjunction with RDAP implementation support, the consulting team initially believed that the institutional strengthening was a higher priority than direct support of the administrative actions necessary for gaining approval of projects. The consulting team considered that the experience of the “support” action would provide the background understanding to support implementation of guidelines to be prepared. “However, the ADB drew attention to the need to give direct support a high priority. Indeed, during the October 2000 mission the ADB Project Officer stressed that the support function should receive a very high priority in order to maximize the use of the available funding from Loan 1501-INO.”27 Following this instruction, the consulting team reviewed 59 subloan applications, including seven for PDAM projects, 40 for market building (including the phase II of PD Pasar Jaya, Aceh Tenggara, Barito Kuala, Mandailing Natal, and Polewali), and 14 for transport terminals. The OEM could not verify if the weak repayment performance of the Aceh Tenggara, Barito Kuala, and Mandailing Natal reflected the deficiency of the implementation support offered by the consultant.

48. The consulting team contract expired in August 2001. However, the ADB Project Review Mission fielded 7–10 August 2001 expressed concern that “without continuing implementation support, processing of pipeline subprojects would cease. During the Mission, DGFI agreed to a

26 Discussions with subborrowers during the field visit revealed that neither MOF officials nor ADB staff had ever visited, monitored, and evaluated on site most of the subprojects.
three month extension of the consulting services for implementation support under Package A, which can be financed out of contingency of the consultants’ contract.” In conjunction with the formal approval of this extension of the consulting services in September 2001, ADB set conditions for further extension, including (i) efforts to comply with the financial loan covenant to realign RDA lending rates to market levels and to Bank Indonesia rate; (ii) data confirming improved RDA loan performance, following subloan rescheduling and efforts with local governments and PDAMs; and (iii) an adequate business and resources mobilization action plan to continue subproject processing without loan consultants. At the expiry of the extended consulting contract on 30 November 2001, DPPP requested another extension, possibly until loan closure. However, ADB did not approve this request as none of the conditions set in September 2001 had been complied with.

G. Loan Covenants

49. The OEM asked DPPP to verify and update the compliance status of loan covenants with reference to the PCR findings. However, DPPP did not respond to this request. OEM interviews and a review of project files suggested that the status of most of the covenants that had been judged in the PCR as “not complied with” or “partly complied with” remained the same. Appendix 4 indicates the key unfulfilled covenants. These covenants concern (i) inadequate economic analysis and risk analysis at subproject appraisal, (ii) subproject BME, (iii) policy dialogue on reform of the RDA legal framework, and (iv) RDA lending rate.

III. PERFORMANCE ASSESSMENT

A. Overall Assessment

50. Overall, the RDAP is rated as “unsuccessful” (Table 1). This overall rating reflects weighted averages of the individual ratings for four criteria: relevance (20%), effectiveness (30%), efficiency (30%), and sustainability (20%). Individual criterion ratings are in whole numbers from 0 to 3, in increasing order of project performance. As discussed in Sections B–E (paras. 51–66), the RDAP is assessed as partly relevant, ineffective, and inefficient, with unlikely sustainability. Most of the project targets identified in the project framework were not achieved.

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<th>Criteria</th>
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<td>1. Relevance</td>
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<td>2. Effectiveness</td>
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<td>3. Efficiency</td>
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<td>4. Sustainability</td>
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<td><strong>Total Rating</strong></td>
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RDAP = Regional Development Account Project.

*Highly successful > 2.7; 2.7 ≥ successful ≥ 1.6; 1.6 > partly successful ≥ 0.8; unsuccessful < 0.8.


28 ADB. *Back to Office Report of Loan Review Mission, 7-10 August. 2001*

29 For example, irrelevant = 0, less relevant = 1, relevant = 2, and highly relevant = 3.
B. Relevance

51. The targeted results of the RDAP were consistent with the Government’s development priorities and ADB’s country strategy at loan approval. However, the OEM rates the RDAP as partly relevant due to (i) weak appraisal, which did not address adequately the institutional issues in the RDA that the project preparatory TA consultant had highlighted; (ii) questionable approval timing; (iii) inadequate analysis of the risks associated with the potential delay in issuing an envisaged new RDA decree, and the lack of a risk-mitigation measures; and (iv) ADB’s inappropriate response to external factors, i.e., the financial crisis of 1997–1998, resulting in changes in the country’s needs and the risk profile of the RDAP.

52. The project preparatory TA consultant highlighted as critical issues of the RDA the lack of an enforcement mechanism for loan recovery and inadequate staffing in DPPP. However, the RRP did not elaborate adequately on these issues, and expected the envisaged new RDA decree would address them. The institutional strengthening component of the RDAP (Part B) also was premised on the new RDA decree. Hence, a delay in issuing this decree should have been considered a significant risk factor for the RDAP. However, since the RRP did not analyze adequately this risk, no risk-mitigation measures were put in place. Questions remain as to why ADB did not wait until the issuance of such a critical act, or assist the Government in expediting the legislation process, before approving the RDAP. The reasons why ADB processed the loan without addressing the serious weaknesses addressed in the project preparatory TA are also unclear. These factors suggest that ADB was more focused on loan approval than on achieving development results.

53. The project preparatory TA indicated that MOF had approved 346 RDA loans and disbursed Rp725 billion by the end of February 1996. Of the disbursed amount, the TA found that the total amount due was only Rp108 billion, of which Rp88 billion had been repaid and the remaining was recorded as arrears. Considering the maximum grace period of 5 years and the progressive increase of RDA loan disbursements since 1991, the amount due should have increased progressively during 1996–1998. Another question arises as to why ADB Management did not wait until the repayment performance of the existing RDA portfolio became clearer before submitting the RDAP to the Board of Directors for approval.

54. During implementation, ADB should have had at least three opportunities to cancel or suspend the RDAP. The first opportunity was when BAPPENA proposed the cancellation of the Project to MOF during the financial crisis. The second was when the long-awaited issuance of the RDA decree in August 2000 did not result in any fundamental change in management of RDA. The third was when ADB accepted cancellation of the institutional strengthening component of Part B in January 2001 as requested by DPPP. The review of project files does not suggest that ADB seriously considered loan cancellation or restructuring on each occasion. The OEM does not believe an effective system was in place within ADB to take responsive actions to restructure or cancel the underperforming loan.

C. Effectiveness

55. The OEM rates the RDAP as ineffective considering the (i) significant underutilization of the loan and underperformance of the nine subprojects, (ii) less-than-satisfactory RDA disbursement and underperformance of funded projects, and (iii) RDAP’s and RDA’s minimal contribution to the promotion of the financial and institutional autonomy of local governments.
56. Most of the project targets indicated in the RDAP’s framework were not met: (i) only eight of the envisaged 25–30 local governments/enterprises participated to the RDAP, (ii) only 15% of the approved $50 million was disbursed under the RDAP, (iii) the RDAP’s contribution to improving the RDA’s appraisal procedures was marginal, (iv) repayment performance was far less than targeted (para. 60), (v) project contributions to improving the RDA’s loan portfolio monitoring was marginal, (vi) project contributions to building the capacity of local governments and the enterprises to handle urban infrastructure projects was marginal, and (vii) the OEM could not verify fully subborrowers’ financial contributions to some of the subprojects.

57. According to Lewis (2006), the aggregate intergovernmental lending through SLA and RDA mechanisms reached a peak in the mid-1990s, and declined precipitously along with the financial crisis. That report states that “lending under the central government’s decentralization program, which began operations in 2001, has been near zero.” This suggests the marginal RDA loan portfolio growth, as well as contributions to the promotion of local government autonomy. Appendix 6 illustrates the progress in decentralizing public administration and finance in Indonesia over the years.

58. The OEM interviews with the representatives of Surakarta City and Ponorogo District governments suggested that the RDAP’s and RDA’s contributions to their efforts in capacity building and strengthening financial autonomy were insignificant.

D. Efficiency

59. The OEM rates the RDAP as inefficient due to the negligible contributions of the (i) RDA to the improvement of allocative and process efficiency in urban infrastructure investments, and (ii) three subprojects (that the OEM visited) to the improvement of allocative efficiency of the economy.

60. Appendix 5 illustrates the evolution of the RDA based on the limited, fractional data available to the OEM. The key findings on the RDA portfolio performance (as of the end of March 2006) can be summarized as follows: (i) DPPP categorized more than 70% of RDA loans to the regional governments, and more than 85% of RDA loans to the PDAMs, as nonperforming, and (ii) nearly half of the PDAMs repaid less than 5% of the cumulative amount due.

61. The excessive number of employees in PD Pasar Jaya suggests its operational inefficiency in market management. The below-market rent charged to tenants in Singosaren Market might undermine the allocative inefficiency of the district economy. The excessive investment for the oversized Ponorogo Bus Terminal, based on the unrealistic demand assessment, was evidently cost-ineffective with the recalculated financial internal rate of return (FIRR) of close to zero.

62. During subproject appraisal, DPPP calculated the FIRR but not the economic internal rate of return (EIRR). This indicated that less emphasis was placed on economic efficiency of subprojects. Although none of the nine subloans have been fully repaid, DPPP does not monitor effectively the subborrowers’ operational performance. The OEM could not detect any evidence of RDA’s or RDAP’s contribution to the improvement in process efficiency in urban infrastructure investments.

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30 DPPP considers RDA loans with arrears of more than 6 months as nonperforming.
E. **Sustainability**

63. The OEM rated the RDAP as unlikely sustainable.

64. DPPP classifies three of the nine subloans under the RDAP as bad or questionable. Arrears of the corresponding three RDA loans (including the RDAP portion) amount to Rp11.3 billion. This represents about 24% of the outstanding amount of the nine RDA loans. The OEM did not obtain the relevant fiscal data for three subborrowers i.e., Aceh Tenggara, Barito Kuala, and Mandailing Nata governments.

65. The demand for the Ponorogo Bus Terminal is not adequate relative to its investment, and cost recovery remains a question. The four markets that the OEM visited appear to generate profits, and the subborrowers (PD Pasar Jaya and Surakarta City) have regularly repaid the RDA loans. Nonetheless, most of OEM interviewees working in these markets feel that customers have shifted gradually to emerging large-scale supermarkets and shopping centers run by the private sector. The economic justification of public ownership in market activities is weak, especially considering the potential crowding out of private sector investments. Neither PD Pasar Jaya nor Surakarta City has built new markets over the years, and their activities are limited to renovation and management of existing markets. PD Pasar Jaya has been exploring private sector partners, especially when renovating old markets. Surakarta City also considers private sector partnerships a possible option. Access to a concessional loan facility offered only to public sector operators, such as RDA, distorts market competition and does not support public-private partnerships.

66. The OEM interviewees working at Ponorogo Bus Terminal and Singosaren Market felt that budget allocations for operations and maintenance were inadequate. The OEM supported their views based on on-site inspection of these facilities. The OEM could not obtain the relevant information to assess the sustainability of the five subprojects that were not visited.

67. Despite the long history and many inputs that have gone into the institutional strengthening, the performance of the RDA system has not been impressive. Although the variety and dimension of problems facing its implementation have changed over time, the fundamental issues facing the RDA remains the same. These include the inadequate capacity of DPPP and local governments in project appraisal and monitoring, and the poor repayment performance. Progress in restructuring of nonperforming RDA loans has been slow. Under the circumstances, voices in the House of Representatives apparently are growing increasingly stronger in favor of closing the account.

IV. **OTHER ASSESSMENT**

A. **Impact**

68. The project goals of the RDAP were to (i) improve access to basic urban infrastructure and services, and (ii) help the Government achieve its urban sector policy and development priorities by supporting decentralization and the use of loan financing. The RDAP helped improve access of only eight urban centers, compared with 25–30 targeted in the project framework.
17

69. Fiscal capacity generally has improved in Indonesia following decentralization that began in 1999. A 2002 study by ADB\textsuperscript{31} suggested that the aggregate data, as well as the data on the studied province and local government, show an increase in revenues at all levels of government. The general purpose grants are more than twice the size of previous government transfers to provincial governments, and more than four times the size to the local governments. OEM observations in Ponorogo and Surakarta were consistent on this—overall fiscal capacity increased by more than three times in Surakarta and by almost four times in Ponorogo between 1999 and 2004. During the same period, transfers from the central Government increased about threefold in both districts. The RDA failed to complement the progress in fiscal decentralization. Appendix 7 illustrates the progress of fiscal decentralization.

1. Impact on Institutions

70. The consultants recruited under Part B of the RDAP developed some guidelines to support RDA loan appraisal and management. However, most of these guidelines have not been used effectively. Aiming to expedite loan disbursement, ADB guided the consultants to prioritize support for RDAP implementation. While the eligibility criteria of RDAP subprojects largely followed those in place for RDA, the RDAP appraisal requirements and approval procedures were more onerous. This was the main reason that typically multitasked DPPP staff became dependent on the ADB consultants in handling the RDAP. As a result, the technical transfer envisaged through RDAP implementation support did not materialize. The institutional strengthening element of Part B was canceled in January 2001 at the request of MOF. Thus, institutional impacts of the Project and TA are insignificant.

2. Socioeconomic Impact

71. DPPP did not monitor systematically the socioeconomic impacts of the subprojects. The socioeconomic impacts of the three subprojects that the OEM visited can be summarized as follows: (i) three markets of PD Pasar Jaya (Phase I) contributed to the creation of 4,407 jobs;\textsuperscript{32} (ii) Singosaren Market contributed to the creation of about 1,500 jobs, of 30\% are filled by male and 70\% are filled by female employees;\textsuperscript{33} and (iii) Ponorogo Bus Terminal contributed to the creation of about 960 jobs, of which 100 were terminal employees, 360 were vendors for shops/restaurants, and 500 were bus drivers/assistants. The OEM did not discern any adverse socioeconomic impact of the subprojects from information provided by DPPP and the three subborrowers that were visited.

3. Environmental Impact

72. The OEM did not discern any adverse environmental impact of the subprojects from information provided by DPPP and the three subborrowers that were visited. The three subborrowers confirmed that they complied with statutory environmental requirements.

B. Asian Development Bank Performance

73. ADB’s performance is rated as less than satisfactory based on its (i) weak appraisal, which did not address adequately the institutional issues in the RDA that the project preparatory TA consultant had highlighted; (ii) inappropriate timing of loan approval; (iii) inadequate analysis


\textsuperscript{32} About 90\% of market managers and security personnel are male; 80\% of department store employees are female.

\textsuperscript{33} Of the 1,500 employees, Matahari employees account for approximately 1,000, of which 80\% are female.
of risks associated with a potential delay in issuance of an envisaged new RDA decree, and the lack of risk-mitigation measures; and (iv) inappropriate response to external factors, i.e., the financial crisis of 1997–1998, resulting in changes in the country’s needs and risk profile of the RDAP. ADB should have addressed more effectively the noncompliance of several loan covenants (para. 49) as critical issues during project implementation. The OEM considered ADB’s decision in November 2001 to decline DPPP’s request for another extension of consulting work under the RDAP (Part B) as appropriate.

C. Borrower Performance

74. DPPP’s performance is rated as unsatisfactory based on its (i) inadequate staffing and capacity, and excessive reliance on consultants for RDAP implementation; (ii) weak commitment to complying with several loan covenants, including BME requirements; (iii) inadequate monitoring of subprojects; (iv) lack of transparency and accountability in RDA transactions; and (v) inadequate participation in the performance evaluation process of the RDAP.

D. Technical Assistance

75. The core activities of TA 2699-INO were completed in January 1999, 11 months later than planned due to the Asian financial crisis and the resulting delay in fielding the consultants. By the account closing date of 30 September 2002, $585,643 of the approved amount of $600,000 had been spent. Despite its evident complementarity to the RDAP, the TA is rated as partly relevant, because the Government’s commitment to RDA reform faded during implementation. The TA contributed to some policy changes in RDA management through near-term recommendations. However, it did not lead to fundamental changes in RDA management or the establishment of a robust intergovernmental onlending mechanism. Therefore, it is rated as less effective. The TA is rated as less likely sustainable. Overall, this TA is rated as unsuccessful (Appendix 8).

V. ISSUES AND LESSONS

A. Issues

1. Intergovernmental Onlending Mechanisms

76. The performance of lending to the regional governments and their enterprises has raised serious concerns, reaching the point of undermining the credibility of the program. The mounting arrears on RDA and SLA lending, and the absence of policy instruments to address the issue, have led to a loss of political support. An increasing number of voices in the House of Representatives have expressed concerns about the scheme, with some demanding the closure of the RDA facility. For quite sometime, a vacuum has existed in the regulatory framework to solve the problem. Regulatory instruments that were intended to screen out potential problems related to local government borrowing were short of measures to deal with the problem, particularly nonperformance, when it occurred. These instruments included Regulation (PP) 23/2003 on Deficit Control, Keputusan Menteri Keuangan (Minister of Finance decree) (KMK) 35/2003 on Procedures for Subsidiary Loan Processing, PP 54/2005 on Regional Government Borrowing, and KMK 53/2006 (which replaces and supersedes KMK...
Fundamental reform of the RDA was envisaged in the mid-1990s, which was to set the stage for ADB assistance, including an advisory TA (TA 2699-INO) associated with a project loan (1501-INO). An MOF decree was to be enacted to facilitate development of a lending scheme for the local governments involving regional development banks as intermediaries. The planned decree was canceled, in part because the national banking system, including the BPDs, deteriorated due to the Asian financial crisis. Hence, the recommended options for institutional building under TA 2699-INO were narrowed down to two. The first option was to develop a mechanism to lend money “wholesale” to other financial institutions, such as BPDs and state-owned and private commercial banks. This, in turn, would channel the funds as loans to local governments and their enterprises. The second option was to develop a municipal financial intermediary to mobilize funds from the capital markets/other sources and lend money directly to local governments and their enterprises.

In late 2000, the ADB staff consultant conducted an in-depth analysis of the issues and future directions of the RDA. The consultant concluded that the RDA concept was not capable of fulfilling its initial objectives. The consultant recommended the development of a separate and new institution to assume the functions that the RDA system was intended to serve, as well as more capacity building investment focused on this new institution. A transition mechanism toward this new institutional setup would involve selected commercial and regional development banks assuming responsibility for providing retail lending to the local governments and enterprises. In this way, the detailed loan appraisal was expected to be conducted more efficiently by dedicated staff.

Despite the consultant’s recommendations, the reform of the RDA has shown little progress. Given RDA management’s track record particularly its capacity building since inception, substantial improvement in the current format appears unlikely. The skill composition of the staff, the mix of technical and financial skills, and the available incentive system does fit the task of developing and sustaining an intergovernmental lending mechanism. The OEM believes that an effective intergovernmental lending mechanism potentially could complement fiscal decentralization. The fundamental reform of the RDA would have significant implications for realizing such potential.

2. Fiscal Decentralization, and Urban Infrastructure and Services

Among the key remaining issues relating to fiscal decentralization are (i) the tension between political/regional autonomy on the one hand and fiscal autonomy on the other; and (ii) the pervasive regional disparities, particularly with regard to service delivery outcomes, in the

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34 The essence of these regulations are ex ante control mechanisms to safeguard local government borrowing, and to ensure that loans are made only to initiatives that reflect well the objective demand, are feasible financially and/or economically, and show readiness for implementation.

35 The Local Government Finance and Government Reform Sector Program (approved in November 2005) and the Development Policy Support Program (December 2005) supported the regulatory measures mentioned in para. 76. Moreover, among the TAs supporting fiscal decentralization, the outputs of TA 3935-INO to support the regional government borrowing system submitted in May 2005 formed the basis of the relevant program measures.

health and education sectors. These issues also lead to the following question: Should Indonesia adopt a different special window to channel assistance, or should it strengthen the fiscal transfer mechanism and design an incentive structure appropriate to the region?

81. Fiscal decentralization leaves most infrastructure investment decisions to the regional governments. The rapidly growing urban population increases demand for infrastructure services. Regional governments face two broad challenges to maximizing the utilization of their fiscal capacity: (i) allocating fiscal resources efficiently, and (ii) technically implementing infrastructure investment efficiently. In view of the agenda to promote cost recovery in the provision of urban services, efficient allocation of limited public resources necessarily would mean that the regional governments need to ensure that their involvement and investment will not crowd out private investment in the provision of urban infrastructure services. From this perspective, economic justification of regional governments’ investments in markets (such as Singosaren Market) and their enterprises specializing in market activities (such as PD Pasar Jaya) needs to be reassessed.

82. The challenge in achieving technical efficiency is planning and designing investments that are economically feasible, and that would prove sustainable in view of the facilities’ operation and maintenance in the longer run. A regional government needs to assess the need carefully, and then design the facilities based on realistic future demands within the horizon of economic time line. In some cases, perhaps including Ponorogo Bus Terminal, the design was conducted based on overly optimistic assumptions about the demand for the services. As a result, the facility was larger than needed.

83. Overly designed facilities would create a long-term financial burden in addition to a higher construction cost. They will require bigger operation and maintenance budgets in the long run. When this happens, the overall fiscal capacity of the regional government would be unnecessarily undermined by the inefficient facilities, leaving fewer funds to provide other services to the citizens. The facility’s operation and maintenance often is underfunded, resulting in deterioration and poorer functionality.

3. Governance and Corruption

84. In the context of the RDA operation, the issue of corruption and governance arises along two separate lines. The first concerns the mechanism of loan processing, resulting in approvals of financing for socially inefficient, overly designed projects and/or unfeasible project proposals that lead to nonperforming loans. Even though the RDA theoretically funds local initiatives, this is not entirely the case in practice. Discussions with government officials at the subproject location revealed that subproject identification in some cases involved a central ministry. Subproject appraisals were not conducted thoroughly, and often failed to filter out unrealistic assumptions underlying the project design and project costs.

85. The second issue concerns the off- and on-budget nature of the RDA system. While it was clearly stated that subprojects could be financed out of the MOF’s regular budget or out of the funds accumulated in the RDA from previous loan repayments, information given to OEM suggests that in most cases the approved subproject proposals were allocated from the MOF budget. No data was available on the number and value of lending financed out of the off-budget RDA funds. A staff member of the Directorate of Subsidiary Loan Management stated that the funds accumulated in the RDA were transferred to the State Treasury Account on a regular basis, but the pattern, interval, and data on the amount of the transfers were not indicated. This raises an issue of accountability concerning RDA funds management. In view of
this, the recommendation that the RDA needs to be either off- or on-budget, not partially off- and on-budget, was relevant.

B. Lessons

86. The OEM identifies the following key lessons:

(i) **Need for more effective use of project preparatory TA findings.** The project preparatory TA highlighted the lack of an enforcement mechanism for RDA loan recovery, inadequate staffing for RDA operations, and operational inefficiency. However, ADB did not give enough consideration to these aspects and processed the loan on the premise that the envisaged new RDA decree would address these issues. More in-depth and careful assessment of the project preparatory TA outputs could have led to an option of waiting to submit the project to the Board for approval until the decree was issued and clear steps had been taken to address the policy and institutional weaknesses.

(ii) **Need for proper risk analysis and risk-mitigation measures.** The success of the RDAP was contingent on the envisaged RDA decree being adopted. However, the RRP did not analyze the risk associated with a potential delay in issuing this decree. No risk-mitigation measures were put in place, making the RDAP vulnerable to such a risk.

(iii) **Need for better handling of an underperforming project.** The OEM concluded that an effective system was not put in place within ADB to take responsive action to restructure or cancel the underperforming loan.

(iv) **Need to integrate project-related tasks into executing agencies’ core operations.** The eligibility criteria for RDAP subprojects largely followed those in place for the RDA. However, the RDAP appraisal required more, particularly regarding economic analysis and social assessment, interagency coordination, and translation of subproject documents into English. As a result, DPPP staff became more and more dependent on the ADB consultants in handling the RDAP, and the envisaged technical transfer did not materialize. The project should be designed to allow the consulting work supporting project implementation to be integrated into executing agencies’ core operations to maximize the TA’s effects.

(v) **Difficulty in establishing a robust intergovernmental onlending mechanism.** As empirical studies across countries and the RDAP experience demonstrate, establishing a functional intergovernmental onlending mechanism is a challenge. Taking this into account, ADB should give extra attention to economic and financial analyses of subprojects, as well as the capacity of concerned central and local governments to support such an onlending mechanism.

C. Follow-Up Action

87. No specific follow-up actions were identified for the borrowers and for ADB.
## PROJECT FRAMEWORK

<table>
<thead>
<tr>
<th>Design Summary</th>
<th>Project Targets</th>
<th>Project Monitoring Mechanisms</th>
<th>Assumptions/Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Goals</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>1. Improve access to basic urban infrastructure and services.</td>
<td>1. The Project is estimated to benefit directly about 25–30 urban centers, with investment in one of the following subsectors: (i) water supply (ii) terminals (iii) markets (iv) wastewater (v) solid waste</td>
<td>1. Socioeconomic surveys and demand analysis completed as part of the subproject investment appraisal. 2. Project completion reports (PCR).</td>
<td>1. Ministry of Finance will carry out the first stage of institutional development for regional development account (RDA) as envisaged in the new RDA decree, and support the long-term evolution of RDA. 2. The Government will carry out the urban sector development plan for the Sixth Five-Year Development Plan (REPELITA VI).</td>
</tr>
<tr>
<td>2. Help the Government achieve its urban sector policy and development priorities by supporting decentralization and the use of loan financing.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>B. Purpose (Immediate Objective)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Improve the availability of long-term credit to local governments and enterprises to finance locally initiated urban investments.</td>
<td>1. (i) About 25–30 local governments/enterprises participate. (ii) $68 million available for credit finance. (iii) Appraisal procedures strengthened. (iv) Monitoring of loans portfolio improved. (v) Repayment rate over 85%.</td>
<td></td>
<td>1. Local governments have the capacity to identity and implement viable projects, and continue to monitor their operations. 2. Local governments apply for RDA funding, commit counterpart funding, and repay the loan on a timely basis. 3. Local government approves increased tariffs and user fees to recover the investment costs.</td>
</tr>
<tr>
<td>2. Support RDA as a revolving municipal facility and its further institutional development; promote the financial institutional autonomy of local governments.</td>
<td>2. (i) Local governments identify, prepare, implement, and operate urban infrastructure and services. (ii) Local governments contribute at least 25%of the subproject costs, and borrow the balance.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Design Summary

<table>
<thead>
<tr>
<th>Comments and Outputs</th>
<th>Project Targets</th>
<th>Project Monitoring Mechanisms</th>
<th>Assumptions/Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>C.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Credit line to local governments.</td>
<td>$68 million credit finance available.</td>
<td>Project progress reports.</td>
<td>Local governments and central Government commit counterpart funding to the Project.</td>
</tr>
<tr>
<td></td>
<td>2. Relending at an interest rate of no less than 11.5% plus commitment fees.</td>
<td>Annual review missions.</td>
<td>Local government willing to finance municipal investment by loans.</td>
</tr>
<tr>
<td></td>
<td>3. Maximum repayment period of 20 years.</td>
<td>Pre-implementation, midterm, and PCR review.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4. Maximum grace period of 5 years.</td>
<td>Disbursements of loan funds.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>1.</strong> Credit line to local governments.</td>
<td><strong>1.</strong> $68 million credit finance available.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>2.</strong> Relending at an interest rate of no less than 11.5% plus commitment fees.</td>
<td><strong>2.</strong> Annual review missions.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>3.</strong> Maximum repayment period of 20 years.</td>
<td><strong>3.</strong> Pre-implementation, midterm, and PCR review.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>4.</strong> Maximum grace period of 5 years.</td>
<td><strong>4.</strong> Disbursements of loan funds.</td>
<td></td>
</tr>
<tr>
<td>2. Implementation and institutional support to (i) RDA, (ii) regional development banks, and (iii) local governments.</td>
<td>Project management support to assist in overall project implementation.</td>
<td>Project progress reports.</td>
<td>Timely recruitment of consulting services.</td>
</tr>
<tr>
<td></td>
<td>Subproject support to local government, and appraisal support for Ministry of Finance.</td>
<td>Review missions.</td>
<td>Government commitment to institutional strengthening of RDA.</td>
</tr>
<tr>
<td></td>
<td>Institutional development for RDA and local governments.</td>
<td>Pre-implementation, midterm, and PCR surveys.</td>
<td>Experienced, committed consultants are hired.</td>
</tr>
<tr>
<td></td>
<td>Training program for regional development banks and financial intermediaries.</td>
<td>Consulting services submitted for ADB review.</td>
<td></td>
</tr>
</tbody>
</table>

## D. Inputs

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Infrastructure investments.</td>
<td>$68 million.</td>
<td>Appraisal reports of selected subprojects.</td>
<td>The Executing Agency will appoint its management and implementation support consultants in a timely manner.</td>
</tr>
<tr>
<td>2. Consulting services.</td>
<td>$4.6 million International: 110 person-months. Domestic: 375 person-months.</td>
<td>Overall implementation schedule and work plan.</td>
<td>Local governments will recruit their own consultants for detailed design.</td>
</tr>
<tr>
<td></td>
<td>$90 million (including interest during construction and contingencies).</td>
<td>Procurement contract submitted for ADB review.</td>
<td>Local governments will carry out contract bidding and award in a timely manner.</td>
</tr>
<tr>
<td>3. Total cost.</td>
<td>$50 million.</td>
<td>Credit agreement above $2 million submitted for ADB approval.</td>
<td>The local government and central Government will provide counterpart funds and disburse ADB’s loan funds in a timely manner.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>PCR reviews.</td>
<td></td>
</tr>
</tbody>
</table>

## KEY PROJECT FINANCIAL DATA

### Table A2.1: Project Costs by Component Under Loan 1501-INO

<table>
<thead>
<tr>
<th>Item</th>
<th>At Appraisal</th>
<th></th>
<th>At Operation Evaluation</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign</td>
<td>Local</td>
<td>Total</td>
<td>Foreign</td>
</tr>
<tr>
<td><strong>Part A: Infrastructure Investment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>0.0</td>
<td>6.5</td>
<td>6.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Civil Works</td>
<td>8.9</td>
<td>31.6</td>
<td>40.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Equipment and Materials</td>
<td>10.8</td>
<td>10.2</td>
<td>21.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Detailed Design and Construction</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Supervision</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal (A)</strong></td>
<td>19.7</td>
<td>48.3</td>
<td>68.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Part B: Project Implementation and Institutional Development</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project Implementation</td>
<td>1.6</td>
<td>1.1</td>
<td>2.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Institutional Development and Training</td>
<td>1.0</td>
<td>0.9</td>
<td>1.9</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Subtotal (B)</strong></td>
<td>2.6</td>
<td>2.0</td>
<td>4.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Interest During Construction</td>
<td>7.7</td>
<td>9.7</td>
<td>17.4</td>
<td>2.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>30.0</td>
<td>60.0</td>
<td>90.0</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Notes:

2. Rupiah conversion to dollars uses an exchange rate of Rp9,197, based on BPKP audited rupiah disbursements from loan proceeds for onlending, which is the average of the conversion of dollar proceeds for onlending for civil works subprojects and the dollar disbursements for civil works given in the basic data.
3. Civil works local costs include local government contribution of costs ineligible for loan funding plus 25% of eligible costs, based on the subproject appraisal reports.
4. Local government-incurred interest during construction was calculated assuming that the loan amount was disbursed linearly over 1 year and the actual grace period of the Loan Agreement. The interest rate was 11.5%.

Sources: Project completion report submitted by Direktorat Pengelolaan Penerusan Pinjaman (DPPP). DPPP reconfirmed the data at Operation Evaluation Mission.
Table A2.2: Fund Allocation Under the Regional Development Account Project
($ million)

<table>
<thead>
<tr>
<th>Item</th>
<th>At Appraisal</th>
<th>At Operations Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign</td>
<td>Local</td>
</tr>
<tr>
<td><strong>External Source</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ADB</td>
<td>30.0</td>
<td>20.0</td>
</tr>
<tr>
<td><strong>Internal Sources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central Government</td>
<td>0.0</td>
<td>23.0</td>
</tr>
<tr>
<td>Local Government</td>
<td>0.0</td>
<td>17.0</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>0.0</td>
<td>40.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>30.0</td>
<td>60.0</td>
</tr>
</tbody>
</table>

ADB = Asian Development Bank.

Notes:
2. Central Government funding includes $1.35 million for replacing ADB loan proceeds in three regional development account loans (Polewali Mamasa, Kediri, and Mandailing Natal) that did not fully disburse at the close of the Regional Development Account Project in November 2002.
3. Local government contributions, as required by Keputusan Menteri Keuangan (Minister of Finance decree) 347 and explained in the subproject appraisal reports.

Source: Project completion report submitted by Direktorat Pengelolaan Penerusan Pinjaman (DPPP). DPPP reconfirmed the data at Operation Evaluation Mission.

Table A2.3: Allocation of Loan 1501-INO
(ADB Portion Under the Regional Development Account Project)
($ million)

<table>
<thead>
<tr>
<th>Item</th>
<th>Original Allocation</th>
<th>Last Revised Allocation</th>
<th>Amount Disbursed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civil Works</td>
<td>21.00</td>
<td>10.00</td>
<td>4.48</td>
</tr>
<tr>
<td>Equipment and Materials – ICB</td>
<td>13.00</td>
<td>1.00</td>
<td>—</td>
</tr>
<tr>
<td>Equipment and Materials – LCB</td>
<td>5.00</td>
<td>2.00</td>
<td>—</td>
</tr>
<tr>
<td>Consulting Services</td>
<td>3.30</td>
<td>1.00</td>
<td>0.89</td>
</tr>
<tr>
<td>Interest During Construction</td>
<td>7.70</td>
<td>3.00</td>
<td>2.37</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>50.00</strong></td>
<td><strong>17.00</strong></td>
<td><strong>7.74</strong></td>
</tr>
</tbody>
</table>

— = not available, ICB = international competitive bidding, LCB = local competitive bidding.

Table A2.4: Project Costs and Sources of Funds at Subloan Approvals
Under Loan 1501-INO

<table>
<thead>
<tr>
<th>No.</th>
<th>Subproject</th>
<th>Rp Million</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>ADB(^c)</td>
<td>Central Govt</td>
</tr>
<tr>
<td>1.</td>
<td>PD Pasar Jaya Minggu, Cipete, Palmerah, Glodock, and Perniagaan Markets(^b)</td>
<td>9,608.8</td>
<td>58,797.0</td>
</tr>
<tr>
<td>2.</td>
<td>Kota Surakarta Singosaren Market</td>
<td>7,279.2</td>
<td>6,423.0</td>
</tr>
<tr>
<td>3.</td>
<td>Kabupaten Ponorogo Bus Terminal</td>
<td>2,724.5</td>
<td>2,275.5</td>
</tr>
<tr>
<td>4.</td>
<td>PD Pasar Jaya (Petojo Ilir and Jembatan Lima Markets)</td>
<td>11,788.8</td>
<td>11,160.2</td>
</tr>
<tr>
<td>5.</td>
<td>Kabupaten Aceh Tenggara Kutacane Market</td>
<td>2,744.7</td>
<td>2,288.3</td>
</tr>
<tr>
<td>6.</td>
<td>Kabupaten Barito Kuala Handil Bhakti Market</td>
<td>3,780.1</td>
<td>3,569.9</td>
</tr>
<tr>
<td>7.</td>
<td>Kabupaten Mandailing Natal Panyabungan Market(^b)</td>
<td>4,045.5</td>
<td>3,389.5</td>
</tr>
<tr>
<td>8.</td>
<td>Kabupaten Polewali Mamasa Polewali Market(^b)</td>
<td>4,238.4</td>
<td>5,588.9</td>
</tr>
<tr>
<td>9.</td>
<td>Kabupaten Kediri Kandangan Market(^b)</td>
<td>2,554.1</td>
<td>2,148.9</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>48,764.1</td>
<td>95,641.2</td>
</tr>
</tbody>
</table>

ADB = Asian Development Bank, BUMD = Badan Usaha Milik Daerah (regional government-owned enterprise), Govt = government, PD = Perusahaan Dagang (trading company), RDA = regional development account.

\(^a\) ADB was to finance only Minggu, Cipete, and Palerah markets.

\(^b\) Regional Development Account Project closed before disbursement was completed. The RDA substituted the undisbursed balance from its own funds.

\(^c\) ADB loan amounts (that were disbursed in $) in Rp terms were calculated using the Rp/$ rates at ADB’s subloan approvals.

Source: Data submitted by Direktorat Pengelolaan Penerusan Pinjaman to the Operations Evaluation Mission.
Table A2.5: Actual Disbursements Under Loan 1501-INO
(Rp million, unless otherwise specified)

<table>
<thead>
<tr>
<th>Subproject</th>
<th>Approved RDA Loan</th>
<th>Disbursement from RDA</th>
<th>Central Government</th>
<th>ADB(^a) ($’000)</th>
<th>ADB(^b) ($’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PD Pasar Japa Minggu, Cipete, Palmerah, Glodock, and Perniagaan Markets(^a)</td>
<td>68,405.8</td>
<td>60,324.4</td>
<td>50,715.6</td>
<td>9,608.8</td>
<td>1,224.2</td>
</tr>
<tr>
<td>Kota Surakarta</td>
<td>13,345.2</td>
<td>13,334.2</td>
<td>6,061.0</td>
<td>7,273.2</td>
<td>748.3</td>
</tr>
<tr>
<td>Kabupaten Ponorogo Bus Terminal</td>
<td>5,000.0</td>
<td>4,995.0</td>
<td>2,270.5</td>
<td>2,724.5</td>
<td>268.0</td>
</tr>
<tr>
<td>PD Pasar Jaya Petojo Ilir and Jembatan Lima Markets</td>
<td>22,949.0</td>
<td>21,751.5</td>
<td>9,962.8</td>
<td>11,788.8</td>
<td>1,180.7</td>
</tr>
<tr>
<td>Kabupaten Aceh Tenggara Kutacane Market</td>
<td>5,033.0</td>
<td>3,522.4</td>
<td>1,601.1</td>
<td>1,921.3</td>
<td>204.2</td>
</tr>
<tr>
<td>Kabupaten Barito Kuala Handil Bhakti Market</td>
<td>7,350.0</td>
<td>7,321.0</td>
<td>3,540.9</td>
<td>3,780.1</td>
<td>405.8</td>
</tr>
<tr>
<td>Kabupaten Mandailing Natal Panyabungan Market(^b)</td>
<td>7,435.0</td>
<td>7,416.7</td>
<td>5,288.2</td>
<td>2,128.5</td>
<td>236.7</td>
</tr>
<tr>
<td>Kabupaten Polewali Mamasa Polewali Market(^b)</td>
<td>6,583.0</td>
<td>6,579.8</td>
<td>5,162.8</td>
<td>1,417.1</td>
<td>157.2</td>
</tr>
<tr>
<td>Kabupaten Kediri Kandangan Market(^b)</td>
<td>4,682.6</td>
<td>3,746.1</td>
<td>3,235.3</td>
<td>510.8</td>
<td>56.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>140,783.6</strong></td>
<td><strong>128,991.1</strong></td>
<td><strong>87,838.2</strong></td>
<td><strong>41,153.1</strong></td>
<td><strong>4,481.8</strong></td>
</tr>
</tbody>
</table>

ADB = Asian Development Bank, RDA = regional development account.
\(^a\) ADB financed only Minggu, Cipete, and Palerah markets.
\(^b\) Regional Development Account Project closed before disbursement was completed. The RDA substituted the undisbursed balance from its own funds.
\(^c\) ADB loan amounts (that were disbursed in \$) in Rp terms were calculated using the Rp/$ rates at ADB’s subloan approvals.

Source: Data submitted by Direktorat Pengelolaan Penerusan Pinjaman to the Operations Evaluation Mission.
Table A2.6: Terms and Status of Subloans
(Rp million, unless otherwise specified)

<table>
<thead>
<tr>
<th>No.</th>
<th>Borrower</th>
<th>RDA Approval Date</th>
<th>RDA Loan Amount</th>
<th>Interest Rate (%)</th>
<th>Tenor and Grace Period (years)</th>
<th>Disbursed</th>
<th>Current Outstanding</th>
<th>Arrears</th>
<th>Asset Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PD Pasar Jaya</td>
<td>RDA-302 19 Oct 98</td>
<td>68,405.8</td>
<td>11.5</td>
<td>6.0 (1.5)</td>
<td>60,324.4</td>
<td>8,067.0</td>
<td>0.0</td>
<td>Good</td>
</tr>
<tr>
<td>2</td>
<td>Kota Surakarta Singosaren Market</td>
<td>RDA-304 17-Jun-99</td>
<td>13,345.2</td>
<td>11.5</td>
<td>20.0 (5.0)</td>
<td>13,334.2</td>
<td>12,888.7</td>
<td>0.0</td>
<td>Good</td>
</tr>
<tr>
<td>3</td>
<td>Kabupaten Ponorogo Bus Terminal</td>
<td>RDA-305 25-Jun-99</td>
<td>5,000.0</td>
<td>11.5</td>
<td>13.0 (1.0)</td>
<td>4,995.0</td>
<td>2,705.6</td>
<td>0.0</td>
<td>Good</td>
</tr>
<tr>
<td>4</td>
<td>PD Pasar Jaya</td>
<td>RDA-306 25-Oct-99</td>
<td>22,949.0</td>
<td>11.5</td>
<td>9.5 (2.5)</td>
<td>21,751.5</td>
<td>9,322.1</td>
<td>0.0</td>
<td>Good</td>
</tr>
<tr>
<td>5</td>
<td>Kabupaten Aceh Tenggara Kutacane Market</td>
<td>RDA-309 15-Feb-01</td>
<td>5,033.0</td>
<td>11.5</td>
<td>10.0 (1.0)</td>
<td>3,522.4</td>
<td>3,522.4</td>
<td>3,588.3b</td>
<td>Bad</td>
</tr>
<tr>
<td>6</td>
<td>Kabupaten Barito Kuala Handil Bhakti Market</td>
<td>RDA-310 10-Apr-01</td>
<td>7,350.0</td>
<td>11.5</td>
<td>10.0 (2.0)</td>
<td>7,321.0</td>
<td>6,798.1</td>
<td>5,332.1c</td>
<td>Bad</td>
</tr>
<tr>
<td>7</td>
<td>Kabupaten Mandailing Natal Panyabungan Market</td>
<td>RDA-313 15-Jul-01</td>
<td>7,435.0</td>
<td>11.5</td>
<td>10.0 (1.0)</td>
<td>7,416.7</td>
<td>6,105.3</td>
<td>2,409.1d</td>
<td>Questionable</td>
</tr>
<tr>
<td>8</td>
<td>Kabupaten Polewali Mamasa Polewali Market</td>
<td>RDA-314 25-Sep-01</td>
<td>6,583.7</td>
<td>11.5</td>
<td>10.0 (1.0)</td>
<td>6,579.8</td>
<td>4,170.1</td>
<td>0.0</td>
<td>Good</td>
</tr>
<tr>
<td>9</td>
<td>Kabupaten Kediri Kandangan Market</td>
<td>RDA-320 14-Jun-02</td>
<td>4,682.6</td>
<td>11.5</td>
<td>10.0 (1.0)</td>
<td>3,736.1</td>
<td>3,121.7</td>
<td>0.0</td>
<td>Good</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td>140,783.6</td>
<td></td>
<td></td>
<td>128,991.1</td>
<td>47,378.9</td>
<td>11,329.5</td>
<td></td>
</tr>
</tbody>
</table>

PD = *Perusahaan Dagang* (trading company), RDA = regional development account.

a The RDA portfolio has five categories: (i) Good (loans with no arrear or arrears of less than 60 days), (ii) Good But Need Attention (loans with arrears of 60 days to 6 months), (iii) Not Quite Good (loans with arrears of 6–12 months), (iv) Questionable (loans with arrears over 12 months), and (v) Bad (same as Questionable).

b This includes a principal payment of Rp1.483.3 billion, an interest payment of Rp1.494.4 billion, and commitment and penalty charges of Rp610.7 million.

c This includes a principal payment of Rp2.614.64 billion, an interest payment of Rp1.860.7 billion, and a penalty charge of Rp856.7 million.

d This includes a principal payment of Rp1.526.3 billion, an interest payment of Rp636.5 million, and a penalty charge of Rp246.3 million.

Source: Direktorat Pengelolaan Penerusan Pinjaman.
SUBPROJECT PROFILES

A. PD Pasar Jaya (Phase I: Renovation of Three Markets)

1. Background

1. PD (Perusahaan Dagang [trading company]) Pasar Jaya was established in 1966 as a regional government-owned enterprise (Badan Usaha Milik Daerah, or BUMD) with the corporate mission of providing a clean, safe, comfort, and environmental oriented traditional and modern market as well as meeting a complete, fresh, cheap, and competitive goods and service needs. Since its establishment, PD Pasar Jaya has been fully owned by the Special Capital Region of Jakarta or Daerah Khusus Ibukota (DKI). The regional regulation stipulates the company's four main functions are to (i) design, build, and maintain market buildings; (ii) manage markets together with their facilities and completions; (iii) guide traders and markets; and (iv) assist in creating price stability and distribution smoothness of goods and services in the markets. The company is an autonomous entity managed by three executive board members recruited from the private sector: president director, director of administration, and director of operations.1 These three directors are accountable to the governor of DKI Jakarta through the supervisory board of PD Pasar Jaya comprising three members. The governor of DKI Jakarta, upon consultation with the local parliament, appoints the supervisory board members. The governor also appoints the executive board members as per nomination by the supervisory board. The current director of operations was recruited from the private sector based on his extensive experience in managing markets.

2. At the start of operations in 1966, PD Pasar Jaya inherited 51 markets from the DKI government. From 1966 to 1990, the DKI government built an additional 100 markets, and transferred them on a grant basis to PD Pasar Jaya. Since 1990, DKI Jakarta has not built any new market and has not approved PD Pasar Jaya to do so. Therefore, the management of 151 markets2 has been the main task of PD Pasar Jaya for the past 26 years. Though PD Pasar Jaya legally owns 151 markets, it is not allowed to use them as collateral for bank borrowing by regulation. Under this budget constraint, PD Pasar Jaya has sought private sector partners to renovate these markets. As a result, 16 markets were renovated and have been managed jointly with private sector partners. However, more than 100 markets are more than 20 years old and in a traditional form; most of them require major renovation. The company employed 2,241 persons at the end of 2004, after the reduction of 700 staff in 2003. However, management believes 500 staff would be enough to manage the 151 markets, suggesting operational inefficiency remains in the company. While management considers privatization a viable option, the DKI Jakarta government did not accept that approach.

3. Due to civil unrest on 15 May 1998, shortly after a presidential election in March of that year and following an economic crisis set off in September of the previous year, several markets of PD Pasar Jaya were burned down. In response, the company applied for loans through the Regional Development Account (RDA) for reconstruction/rehabilitation of seven markets in two phases. In the first phase, the Ministry of Finance (MOF) approved loans through RDA for the renovation or reconstruction of five markets: Cipete, Glodok, Minggu, Palmerah, and Perniagaan markets. MOF could utilize the Regional Development Account Project (RDAP)

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1 Reference to the Regional Regulation of DKI Jakarta Number 6 dated 21 July 1992 on Market Management in DKI Jakarta (legalized by the Minister of Home Affairs based on Decree Number 511, 231-234 dated 2 March 1993).
2 The 151 markets have 98,507 business outlets and an occupancy rate of over 92%. Besides business outlets in the markets, car parks, advertisement space, and rest room management are the PD Pasar Jaya’s sources of income.
from the Asian Development Bank (ADB) for the former three markets but not for the latter two due to noncompliance with the procurement procedures required under the RADP. In the second phase, MOF approved the loan for reconstruction/rehabilitation of two other markets: Petojo Ilir and Jembatan Lima markets. MOF utilized the RDAP for the renovation of these two markets.

2. Design and Implementation Performance of the Subproject

a. Cost, Financing, and Schedule

4. The costs for renovation and reconstruction of the five markets were estimated at Rp89.8 billion in the feasibility study conducted in 1998 (Table A3.1). On this basis, MOF approved the loan for Rp68.4 billion on 19 October 1998 through the RDA with an interest rate at 11.5% and maturity of 6 years, including the grace period of 1.5 years. To finance part of this RDA loan, ADB approved the loan of $1.2 million (Rp9.6 billion equivalent)\(^3\) through the RADP for renovation of Cipete, Minggu, and Palmerah markets. The renovation of Minggu and Cipete markets took 5 months from January 1999, and their operations started in June 1999. The construction of Palmerah Market took 5 months from April 1999, and its operations started in September 1999. The construction of these three markets was not delayed. The actual costs for the three markets were Rp17.7 billion compared with the feasibility study estimated of Rp40.2 billion. In contrast, the actual total costs for the other two market that were not funded under the RDAP were Rp76.8 billion compared with Rp49.6 billion at the feasibility study.

Table A3.1: Project Cost and Financing for Phase I

(Rp billion)

<table>
<thead>
<tr>
<th>Project Cost</th>
<th>At Feasibility Study</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minggu Market</td>
<td>16.8</td>
<td>7.2</td>
</tr>
<tr>
<td>Cipete Market</td>
<td>9.3</td>
<td>6.7</td>
</tr>
<tr>
<td>Palmerah Market</td>
<td>14.1</td>
<td>3.9</td>
</tr>
<tr>
<td>Glodok</td>
<td>25.2</td>
<td>76.8</td>
</tr>
<tr>
<td>Perniagaan</td>
<td>24.4</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>89.8</strong></td>
<td><strong>94.6</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Means of Financing</th>
<th>At RDA Approval</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>RDA</td>
<td>68.4</td>
<td>60.3</td>
</tr>
<tr>
<td></td>
<td>9.6</td>
<td></td>
</tr>
<tr>
<td>RDAP (ADB)</td>
<td>9.6</td>
<td></td>
</tr>
<tr>
<td>MOF</td>
<td>58.8</td>
<td>50.7</td>
</tr>
<tr>
<td>PD Pasar Jaya's own fund</td>
<td>21.4</td>
<td>34.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>89.9</strong></td>
<td><strong>94.6</strong></td>
</tr>
</tbody>
</table>

\(^3\) Based on the exchange rate at drawdown from the special account on 24 April 2000.
b. Projected and Actual Outputs

5. **Minggu Market.** The subproject was a renovation of a two-block market, which was burned down during a riot on May 1998. Each block has a four-story building with 81 shops in Block E and 51 shops in Block F. The tenant occupancy rate is almost 80%, and the remaining 20% of the shops are committed. Of the tenants on the first level, 80% sell gold, electronics, textiles, and others. No shops sell perishable goods in this building. A department store and supermarket occupy the second, third, and fourth floors. The proposed and actual infrastructure plan had no major differences, except for the number of shops. The projected design indicated 138 shops, whereas the completed buildings had only 132.

6. **Cipete Market.** The subproject was a renovation of a building affected by the riot in May 1998. The market has a two-story building in A, C, and D blocks and three levels in B block. The building has 428 shops, and a tenant occupancy rate of 87%. Almost half of the tenants sell perishable goods, with other shops selling automobile spare parts and other goods. Operating hours begin at 4 a.m. and end at 5 p.m., except for the automobile spare parts section, which is open from 9 a.m. to 5 p.m. The proposed subproject included a supermarket with 630 shops. At completion, however, it did not include a supermarket and had only 496 shops.

7. **Palmerah Market.** The subproject was a renovation of a market burned during the riot in May 1998. The market has four-story building and basement level, with 890 shops. The basement level having 509 shops and the first level has 260 shops. The department store owns the first level and part of the second level. The other part of the second level has 117 shops and the fourth level has three shops. The tenant occupancy rate is only 75%, with more than half of the shops selling perishable goods. The operating hours begin at 8 a.m. and end at 9 p.m. The proposed subproject included 690 shops with a billiard room, theater, and 15 units of shop houses. At completion, however, it had 890 shops, but no billiard room, theater, or shop houses.

![Figure A3.1: Palmerah Market](image_url)

3. Outcome and Sustainability

8. The Operations Evaluation Mission (OEM) conducted a field inspection of the three markets funded under Phase I. The assessment in this section is based primarily on the rapid inspection supplemented by the data submitted by PD Pasar Jaya. The following are the outcomes and sustainability observed from the three Phase I markets.

9. **Employment.** The three markets (Minggu, Cipete, Palmerah) generated a total of 4,407 jobs. About 90% of market managers and security personnel are male, whereas 80% of the
department store employees are women. Minggu Market has a total of 849 persons working: 52 market managers, 21 security guards, 318 shop tenders, 258 department store employees, and 200 product promotion women. Cipete Market has a total of 1,321 persons working: 10 market managers, 11 security guards, and 1,300 shop tenders. Palmerah Market has a total of 2,237 persons working: 68 market managers, 15 security guards, 2,000 shop tenders, and 154 department store employees.

10. **Customers.** The three markets (Cipete, Minggu, Palmerah) attract a total of 8,150 customers daily. In Minggu Market, 5,000–7,000 customers come every day, with more than 10,000 people during the peak season. Probably due to the many customers they have to serve, the proportion of market managers and security guards is the highest among the three markets (9%). In Cipete Market, 10–350 customers come every day, with a decline in customers during from 5:30 a.m. to 10 a.m. In Palmerah Market, 1,000 customers come every day, with more than 2,000 during peak season.

11. **Operation and Maintenance.** The water is supplied from the groundwater using pumps to supply all the buildings. The electrical supply and connections among buildings are well maintained. The national electric company provides the electricity, and only the department stores have a generator to cover the electrical loss during peak hours. Electricity billing varies from Rp10 million in Palmerah Market to Rp198 million in Minggu Market. A telephone line is available in the management office. A public telephone is also available in the area, except in Palmerah Market. The maintenance in general was good. Repairs usually take 2 weeks to 1 month from the time the damage is reported, depending on the severity.

12. A cleaning service agency is contracted to manage solid wastes. The garbage is picked up every day by an arm roll truck with 3 cubic meters capacity without delay as the traders are keen for timely pickup because of the smell. Cipete Market contracts with the cleaning service agency to keep the perishable market area sanitary. The cleaning service agency maintains toilet sanitation; a user’s fee of Rp1,000 per person is collected by the market managers every month. The department stores have their own arrangement to clean their sanitary sections. The subproject drainage system connects with the secondary drainage behind the building to prevent overflowing. The drainage system is fully functional and generally in good condition, though garbage was still present inside the drainage.

13. The fire hydrant system is neither well-maintained nor adequate, and is equipped only with a hand extinguisher. In Palmerah Market, a reel hose box was available at each level, but no hoses were inside. The market managers did not know if the fire department or PD Pasar Jaya is responsible for the fire control system for public safety.

14. The parking area is not adequate in Minggu and Cipete markets. The top floor was inadequately designed as a parking space in Minggu Market, while a large part of the allocated parking space in Cipete Market is being used by the spare part shops to repair cars. These two markets have limited parking spaces for cars and motorcycle. Palmerah Market, on the other hand, has sufficient parking space, and it is managed well by a contracted agency.

15. The OEM did not discern any major environmental risks from information provided by PD Pasar Jaya.
B. City Surakarta (Renovation of Market)

1. Background

16. Singosaren Market is in Surakarta City, Central Java. In 2004, Surakarta City had a population of 505,153, with 48% male and 52% female. The local government of City Surakarta’s Market Department (Dinas Pengelolaan Pasar or DPP) manages 38 markets. The market department has 505 employees, 121 people working as Pegawai Negeri Sipil (local government employee or PNS), and 384 people working as Pegawai Harian Lepas (honorary employee or PHL).

17. The market department earns regular revenue through these markets, which are generated through market retribution, parking area retribution, advertisement tax, land and building tax, and cinema tax. Therefore, when the old Singosaren Market was burned down during the riot in May 1998, they lost their regular income earning of Rp792.2 million per fiscal year.\(^4\) Vendors and other market-related workers also lost their earning opportunities. In response to the market vendor’s request to rebuild their market, as well as for the local government to retrieve back their lost revenue, City Surakarta decided to apply for the RDA loan.

18. Of the 38 markets, only three (including Singosaren Market) are profitable, and generate 65% of the market department’s total revenue. In 2005, the actual market-related revenue was Rp3.3 billion, better than the targeted Rp2.9 billion. For 2006, it is targeting Rp3.3 billion in revenue.\(^5\) A few years ago, establishing an autonomous agency specializing in managing the 38 markets, such as in the case of PD Pasar Jaya in Jakarta, was discussed. However, the feasibility was not confirmed.

19. Over the past 10 years, Surakarta City had constructed three small markets with their budget to accommodate the street vendors off the street, mainly as social welfare provision. City Surakarta is renovating two of its markets, hoping they will become profitable. City Surakarta is open for private sector partnership in renovating the old market. The mayor wants to construct a modern market on the outskirts of the city.

2. Project Design and Implementation

20. Singosaren Market was established during the pre-colonial period. With the concept of public-private partnership, a private company (PT. Matahari Mas Sejahtera) rehabilitated the building in 1990 through a 20-year build-operate-transfer contractual agreement. However, the market was burned down during civil unrest on 15 May 1998, and PT. Matahari Mas Sejahtera no longer provided funds for rehabilitating the Singosaren Market.

21. The objective of the reconstruction of the Singosaren Market was largely to rehabilitate the economic activities of the market vendors/workers who had lost their places for business operation after the market burned down. At the strong request by the market vendors, City Surakarta decided to apply for a loan from the RDA. To ensure that the market vendors come back, Surakarta City requested the Singosaren Vendor Association to sign an agreement letter that they will move in and pay the rental fee of Rp700 per square meters (m\(^2\)) once the market reopens.

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\(^4\) As per the feasibility study of this subproject.
\(^5\) Information received during OEM meeting.
22. Surakarta City went through a technical assessment to understand the level of damage caused by the fire. The assessment revealed that renovation and structural strengthening were needed. Therefore, the scope of work to rehabilitate the four-story Singosaren Market included architectural, structural, mechanical, and electrical works. Shops, a department store, cinema, playground, and parking area were to occupy the building on a land area of 4,800 m². As the market already existed, economic internal rate of return (EIRR) was not recalculated before reconstruction.

23. The feasibility study conducted in 1999 projected the cost to renovate Surakarta markets at Rp22.9 billion, comprising a Rp14.1 billion loan with matching local government funds of Rp8.8 billion. The matching local government funds included Rp8.3 billion land valued cost. At that time the land was considered an eligible contribution to the minimum requirement of 25% counterpart funding.

24. On 17 June 1999, MOF approved a loan for Rp13.7 billion through the RDA with an interest rate of 11.5% and maturity of 15 years, including a grace period of 5 years. To be part of this RDA loan, ADB approved the subloan for the equivalent Rp7.2 billion through the RDAP. While finalizing the loan approval, an ADB financial analyst found out that MOF had approved the RDA loan before ADB’s approval for the use of RDAP, contrary to the Loan Agreement (schedule 5 paragraph 3).6

25. Surakarta City was able to contract the work at a slightly lower price of Rp13.3 billion. The reconstruction of the Singosaren Market took 8 months, and restarted its operation in 2001. Implementation performance was satisfactory with no cost overruns and delays. During the construction, ADB’s municipal development consultant monitored the site and suggested that the contractor and Surakarta City be more careful with dust particles, as they might cause harm to the nearby food vendors surrounding the construction site.7 The actual reconstruction cost was Rp22.2 billion, marginally less than the feasibility study’s estimated cost of Rp22.9 billion.

26. Currently, the Singosaren Market has full tenant occupancy. A national department store chain rents and manages two of its floors, the top floor parking facility, and children’s playground. Cinemas occupy half of the second floor. The market department of the local government directly operates and manages only the ground floor. Approximately 15% of the ground floor is perishable markets, and remaining areas are small booths that sell cellular phones, fast food, and garments. The operating hours are from 9 a.m. to 9 p.m.

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6 The Loan Agreement of RDAP stipulated that the first three subprojects (and any subprojects exceeding the equivalent of $5 million) required ADB approval prior to the approval by MOF.

3. Project Outcome and Sustainability

27. For Singosaren Market, the vendors demanded the reconstruction to provide them with a space to operate their businesses in a sheltered environment. Not only were they provided with a place to operate, their rental fees also are cheaper than the other privately owned market space. However, this raises the question whether the local government is the most efficient market operators given that only three of 38 markets in City Surakarta are profitable.

28. **Financial Internal Rate of Return (FIRR).** The result of the financial recalculation showed that the FIRR for Singosaren Market is 10.7%, compared with projected 12.6% in the subproject appraisal report (SPAR) and 15.0% in the project completion report (PCR). The PCR’s market retribution revenue valuation was optimistic. The OEM found that market retribution revenue is lower than stated in the PCR.

29. **Employment.** The market department of the local government allocates five managers, five technicians, and 10 security personnel to the Singosaren Market.

30. The Singosaren Market created about 1,500 jobs, of which 30% are filled by men and 70% are filled by women. Matahari employees accounted for approximately 1,000 of the employees, of which 80% are female. The feasibility study projected 2,095 employees, or 595 employees less than actual operation. However, the actual number of employees provided to the OEM was a rough estimate by the market manager.

31. The lease contract for the tenants is for 3 years. Normally, 90% of the tenants paid their rents on time. The rents have not increased since 2001, despite rising energy costs. City Surakarta has been shoudering the increased cost.

32. Taxi and becak (tricycle) drivers wait in front of the market to provide transportation to customers after they come out of the shops. There are small stands and street vendors selling snacks, bags, and newspapers along the market streets.

33. **Customers.** The market manager reported that Singosaren Market is popular among the people in Surakarta due to its historical legacy and its strategic location. Approximately 5,000 customers come to shop per day during the week, and 7,000 customers on Saturdays. Comparative figures on the number of customers using the old market were not provided. The market manager said that the emergence of privately owned supermarkets is reducing the
number of customers that come to shop at traditional markets (15% decrease in Surakarta, 40% decrease nationwide).

34. **Operation and Maintenance.** The physical conditions of the subproject are relatively good, well-maintained and serviced. This should be kept so especially since two floors are occupied by a nationwide chain department store. Operation and maintenance (O&M) cost consists of electromechanical equipment, building maintenance, cleaning services, security services, and electricity. While the budget allocation for the O&M was insufficient in the past, the new mayor has increased the allocation. The O&M budgets are approved as a lump sum for all the markets, rather than allocated per market. Minor repairs, such as changing a light bulb, can be done instantly. Major repairs, however, must be requested through the market department of City Surakarta, which slows the repair process.

35. **Environmental Risk.** The market department is responsible for solid waste management. Garbage is collected twice a day. The cost for the solid waste management has risen, increasing the budget burden for the local government. The OEM did not discern any major environmental risks from information provided by PD Pasar Jaya.

4. **Fiscal Performance of Surakarta City**

36. By national measures, the fiscal performance of Surakarta City has been good. The fiscal capacity expanded more than threefold between 1999 and 2004. In addition, the revenue structure shows that the city is developing into a more stable fiscal entity supported by more diverse revenue sources. While central Government transfers are the largest source of revenues, as is the case for almost all local governments, the share (50% in 2004) is significantly below the national average of more than 70%. In the first 5 years of decentralization (1999–2004), the areas that showed large increases included (i) own-source revenue, which grew more than fivefold from Rp11 billion to almost Rp60 billion; (ii) shared revenue, which increased almost fivefold from Rp.7.5 billion to Rp35 billion; and (iii) other revenues, which leaped from Rp143 million to more than Rp47 billion. At the same time, the loan portfolio increased less than 50%. These indicate that the city is in good fiscal shape and improving.

37. On the expenditure side, the figures between 1999 and 2004 were not easy to compare. Besides, the available data do not allow for a sufficiently in-depth analysis. The expenditures in 1999 were disaggregated into routine expenditures and development expenditures, concealing what activities/inputs were funded. Likewise, the 2004 expenditures were disaggregated into (i) civil service expenditures, (ii) public service expenditures, and (iii) local government expenditures. No conclusive statement can be made based on these disaggregation. By national measure a less than 60% share of central Government transfer imply that a smaller proportion of the total budget is committed to personnel expense (the hold-harmless component of Dana Alokasi Umum (DAU). The direct implication of this is greater freedom and autonomy for the Surakarta City to manage its finances, which allows the city to respond more effectively to the citizens’ needs and demands for services.

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8 While the classification used in the 1999 budget personnel expenses and overhead is covered by the routine expenditure, and which leave the development expenditure to support service provision and formation of capital, the 2004 classification is less obvious. Given the magnitude of the transfer, with the largest share to DAU, one would expect that at least half of it (about Rp120 billion) was tied to civil service salary, mostly teachers, in which case, personnel expenses are probably not limited to civil service expenditures alone. This means public service expenditures could contain personnel expenses, particularly for teachers.
38. The performance of the RDA loan portfolio that the City of Surakarta received to rebuild the Singosaren Market has been satisfactory. Loan repayments are current with no arrears, as confirmed by the Finance Division of the City of Surakarta and MOF.

C. Ponorogo District (Construction of Bus Terminal)

1. Background

39. Ponorogo District in the province of East Java has a population estimated at 915,000 in 2005. The main economic activity of district Ponorogo is agriculture, which accounted for about 35% of its 1996 gross domestic product. The average per capita income for 1996 was Rp922,000.

40. Ponorogo District government's accomplishments for the past 10 years on urban infrastructure included the development of 13 markets. The construction of the markets was not considered financially viable enough to apply for an RDA loan. Other prioritized urban infrastructure needs were the provision of clean water and relocation of the bus terminal. After deciding on the subproject, Ponorogo District focused on financial viability to repay the loan and did not emphasize EIRR.

2. Project Design and Implementation

41. The only bus terminal in Ponorogo has been functioning as the hub of public transportation, servicing interdistrict, intercity, and interprovince transportation. The old Ponorogo bus terminal was used by buses (54 passenger capacity), minibuses (24 passenger capacity), and non-buses (9 passenger capacity). The Ponorogo Bus Terminal is the final destination for most of the long- and medium-distance buses coming from Western Java. Local government officials reported that the old bus terminal was creating traffic congestion and pollution as it was located in the center of the city. Therefore, they decided to apply for the RDA loan to relocate the bus terminal to the outskirts of the city. The new bus terminal is in District Ponorogo, 10 kilometers south of the city center.

42. A team composed of members of various departments of the local government (planning, revenue, transport, public works, and finance) conducted a feasibility study in 1998, as no budget was available to hire external consultants. According to the ADB consultant's engagement completion report, ADB's municipal development specialist “reviewed and analyzed the feasibility study, and supported the Local Government on strengthening the basic technical supporting data and other technical matters. Then together with Senior Management Advisor the Municipal Development Specialist supported the Local Government by improving and translating the feasibility study from Bahasa Indonesia to English, and then prepared the corresponding Subproject Appraisal Report and Executive Summary.” (footnote 7) Local government officials reported that the results of the appraisal study by the ADB consultant did not vary significantly from the feasibility study, except for updating a few unit costs and assumptions. Local government officials did not provide a clear answer regarding the conduct of the needs assessment.

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9 AKAP ( Antar Kota Antar Propinsi – Inter City Inter Province) and AKDP ( Antar Kota Dalam Propinsi – Inter City Inner Province).
43. Terminal type/sizes\textsuperscript{10} are determined based on the passenger capacity and frequency of the bus in accordance with the guidelines provided by the Ministry of Transportation. Based on the assessment, Ponorogo bus terminal became a Type A terminal, requiring more than 5 hectares of space. At 54,000 m\textsuperscript{2}, the new bus terminal is more than five times the size of the old terminal (10,000 m\textsuperscript{2}).

44. In choosing the land for the new bus terminal, accessibility of the buses/passengers and land price were considered. A local government official said the location of the subproject site, 10 kilometers from the city center along the bus route highway, was chosen based on the land availability and cost. The site used to be an irrigated paddy field owned by the village and one individual.

45. The new bus terminal was designed to include (i) main facilities (vehicle tracks and maneuver area for public transportation, management office building, passenger lobby and vehicle shelters, control tower); (ii) supporting facilities (parking space for passenger/operator vehicles, toilet, clinic, restaurant/canteen, post and telephone corner, mosque, kiosk arcade, workshop and car wash, building connection roofs, and checkpoint post); (iii) additional facilities (announcement boards, direction guides, garden, pond, water tower, fence); and (iv) utilities (power/energy, water system, communication system, fire hydrant).

46. The infrastructure and facilities require more than 20 years capacity demand, 20 years economic life for the building, effective operation hour about 17 hours daily (4 a.m. to 9 p.m.), security during peak times 1.5 times the ordinary day, space for management office to be 60% of the passenger lobby, and space for restaurant/canteen and kiosk to be 30% of the passenger lobby.

47. The cost to construct the new bus terminal was projected at Rp8.4 billion during the subproject appraisal report in 1999. This comprised a loan for Rp5 billion with matching local government funds of Rp3.4 billion. The matching local government funds included Rp1.3 billion land value cost. Based on the project completion report (Appendix 13, para 17), land could be considered an eligible contribution to the minimum requirement of 25% counterpart funding.”

48. On 25 June 1999, MOF approved the loan of Rp5 billion through the RDA with an interest rate at 11.5% and maturity of 13 years, including a grace period of 1 year.

49. Bus terminal construction started in March 1999 and was completed in February 2000. The terminal started its operation on April 2000\textsuperscript{11}/24 January 2001.\textsuperscript{12} The Ponorogo bus terminal operation manager mentioned that the technological risk was very low during construction. The implementation performance was satisfactory without any cost overruns or delays. The construction cost of the Ponorogo bus terminal was Rp8.42 billion, compared with Rp8.43 billion at appraisal.

50. The subproject appraisal report projected 9,004 beneficiaries of the subproject: 6,724 passengers, 2,119 drivers/assistants, 128 vendors, 23 terminal employees, 10 cleaners and parking personnel.

\textsuperscript{10} Type A (≥ 40 passengers per unit, ≥ 10 hectares); Type B (≥ 20 passengers per unit, ≥ 5 hectares); Type C (≥ 10 passengers per unit, ≥ 10 hectares).

\textsuperscript{11} Date informed by local government officials.

\textsuperscript{12} Date informed by bus terminal operation manager.
3. Project Outcome and Sustainability

51. **FIRR.** The OEM recalculated the FIRR of this subproject at 3.0%, compared with 12.7% envisaged at appraisal and 1.8% calculated in the PCR. The number of passengers using the terminal has decreased significantly following the national decline in passengers using public transportation. The lower-than-expected number of users compared to the assumption used at appraisal explains the significantly lower revenue generated relative to the projected earnings. In conjunction with the development of this new terminal, the local government issued more than 400 licenses for the buses—four times the number of licenses that had been issued for the old bus terminal. The actual number of buses using the terminal was well below the number of licenses issued.

52. **Employment.** The subproject created about 960 jobs: 100 terminal employees, 360 vendors for shops/restaurants, and 500 bus drivers/assistants. The total number of jobs created was far below the projection of 2,280. Although the number of terminal employees and vendors exceeded the projection, the number of bus drivers/assistants was far below the projected 2,119. As the terminal operates 24 hours a day, officers and security staff organize themselves into three shifts, resulting in three times the projected number being employed. The bus terminal also has 189 shops, almost triple the 66 shops envisaged at appraisal, as a private company constructed another building with additional shops. Local government officials said the reasons for the decreased number of buses are (i) negative changes in government policy for subsidized fuel and spare part prices for commercial vehicles; (ii) reduction of government regulation on bus tariff per kilometer, which resulted in the closure of many bus companies; and (iii) reduction of passengers using the bus.

53. In addition to the vendors from the old terminal, more new vendors were able to move in due to increased number of shops that a private developer built. The new bus terminal not only provided employment opportunities within the terminal, but several informal shops also are flourishing along the street. The once quiet rice paddy has become an economically active area.

54. **Shopping activity.** At the new terminal, however, has not reached the level of the old one. The chairman of the Vendor Association of the Ponorogo Bus Terminal mentioned that the customers that come to shop are now mostly limited to bus passengers, whereas they had more non-passenger customers when they were located in the city center.
55. The old bus terminal on prime land remains idle, which is a negative impact for the District Ponorogo.

56. **Passengers.** The number of passengers using the bus terminal was far below the projected 6,724 people a day.\(^{13}\) Local government officials said the reasons for fewer-than-expected passengers are (i) change in transportation mode as more people have personal vehicles and motorbikes, and (ii) relocation of the new bus terminal to the outskirts of the city.

57. Intercity and interprovince buses park in the same terminal building. Each bus is given only 3–5 minutes to pick up its passengers, then must move on for the next bus. Therefore, according to terminal employees, the buses only get 15% of their capacity on average, and sometimes must leave without any passengers. One of the bus crew reported that some passengers were asked to pay more than the normal tariff, as most of the buses are privately owned and operational costs are increasing.

58. Based on the number of actual passengers that use the bus terminal, the facility seems too big. The bus terminal operation manager said the bus terminal where he was assigned previously (Bungurasih in Surabaya city) is three times larger than that of the new Ponorogo bus terminal, but has 20 times more passengers. Based on his experience, the bus terminal operation manager reluctantly agreed that the current bus terminal is oversized.

59. **Operation and Maintenance.** During the OEM, most of the subproject was operating with minimum maintenance. O&M costs consist mainly of electromechanical equipment, as well as various maintenance and other services (building maintenance, cleaning services, security services, and electricity) which account for 70% of the total annual O&M cost. The bus terminal operation manager reported that the available funds were inadequate to maintain the facilities fully. It sometimes takes time for Transportation Department of the local government to act on requests made for major repairs. A case in point is a request made to renovate the office door and window for which no response was received.

60. The bus track in the terminal is not in good condition. Some of the areas had been damaged because the original construction of land fill (embankment) was not prepared well. The local government official reported that, since the site originally was an irrigated paddy field, the contractor had to stabilize the land base with sand gravel, but failed to do so.

61. The water source of the bus terminal is pumped groundwater. Electricity is sourced from the national electric company, and the electric connection between the buildings has been maintained well. The management office has one telephone. The premise has no public telephones, as the telephone company has not repaired the broken phone. About four telecommunications shops are around the area, each with three telephones.

62. The terminal is surrounded by a drainage system to prevent storm water overflow and floods. The drainage system is well maintained, but garbage was seen inside. Other facilities, such as the announcement board, sound system, television, direction guide, and fence, were well maintained. However, the garden was not well maintained. The terminal does not have a spare parts shop, as indicated in the subproject appraisal report.

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\(^{13}\) The number of passengers was not provided by local government officials or terminal operation managers.
63. The fire hydrant system is not adequate. Only hand extinguisher is available at the terminal location. For public safety, the terminal should be equipped with more fire extinguishers.

64. **Environmental Impact.** The bus terminal area is kept clean by 20 cleaners contracted from the cleaning service agency. The shops in the bus terminal contribute payments for the cleaning. The toilets, which are kept clean, charge a user fee of Rp1,000 per person. The garbage truck picks up garbage twice a week with an arm roll truck with a capacity of 3 m$^2$. A sludge truck is contracted every 2 months except during peak season when it is called once a month. Local government officials reported no serious environmental impacts after the completion of the new bus terminal.

4. **Fiscal Performance of Ponorogo District**

65. The fiscal performance of Ponorogo District has improved since decentralization. Overall fiscal capacity at current prices has almost quadrupled. Total income has increased from Rp115 billion in 1999 to Rp418 billion in 2004. Although own-source revenue as a percentage of overall income remains small, with Pendapatan Asli Daerah amounting to Rp25 billion in 2004, it has grown consistently and rapidly since 1999. Although dependence on central Government transfers is still significant, this is a healthy development for the overall fiscal autonomy. Local government financing (or local government loans in the old statistics) was another element that increased significantly within the district budget between 1999 and 2004. No clarification was available about the number loans or what the financing was used for.

66. In line with the improving district fiscal capacity over time, debt servicing—at least for the RDA loan for bus terminal construction—has been on time. As of June 2006, the status of RDA loan payment was satisfactory with no arrears, as substantiated by the district's finance division and MOF. A more detailed comparative analysis is not easy to do since the budget statistics were changed recently. Beginning in 2004, new local government financing was no longer classified as recurrent and development, and disaggregated figures were not readily available for assessment.

67. Despite these positive developments, district government officials still believed that fiscal transfers from the central Government should remain the backbone of the district's fiscal capacity. This attitude was reflected in the management of the RDAP-funded investment, as the poor performance of one of the biggest investment projects in the district in a few years did not generate a significant degree of concern.
KEY UNFULFILLED LOAN COVENANTS

<table>
<thead>
<tr>
<th>Covenant</th>
<th>Reference in Loan Agreement</th>
<th>Status of Compliance at Operations Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subproject Appraisal</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cost-effective solution.</strong> Each subproject shall have been based on a proper consideration of technical options, and the cost-effective solution shall have been prepared.**</td>
<td>5.5(v)</td>
<td>Partially complied with. Least-cost solutions were not presented in feasibility studies.</td>
</tr>
<tr>
<td><strong>Financial and economic analysis.</strong> For revenue-generating investments, the subproject’s financial viability shall have been examined and a sensitivity analysis prepared. For subprojects that do not generate revenue, an economic analysis shall have been undertaken.**</td>
<td>5.5(ix)</td>
<td>Partially complied with. Economic analysis was not conducted at appraisal of most subprojects.</td>
</tr>
<tr>
<td><strong>Risk analysis.</strong> Subproject risks shall have been identified, including permit and land acquisition requirements, and processes to be addressed in order to minimize risks.**</td>
<td>5.5(x)</td>
<td>Not complied with. Risk analyses were not presented in feasibility studies.</td>
</tr>
<tr>
<td>Benefit Monitoring and Evaluation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Borrower shall ensure that a comprehensive program acceptable to ADB is implemented to monitor the technical performance and social and economic benefits of the Project, especially to the poor and women. The BME indicators and procedures shall first be tested with respect to data availability and other constraints and revised, if necessary, and institutionalized as part of the management information system of the agencies involved. The program shall be developed and coordinated by MOF, with input from level II governments and their agencies. The Borrower shall cause the Project implementing agencies concerned to undertake future maintenance of the system and collection and analysis of data.</td>
<td>5.13</td>
<td>Not complied with. MOF’s project completion report states that the implementation consultants prepared BME indicators, but no requirement exists for BME monitoring in RDA’s loan agreements. BME is not being carried out by sub-borrowers.</td>
</tr>
<tr>
<td>The Project’s implementing agencies shall assemble relevant baseline data and monitor subsequent changes as a basis for evaluating the success of the Project. Annual reports, including recommendations for improvements, shall, where appropriate, be furnished to ADB, through MOF, throughout the Project’s implementation period and for 1 year after the submission of the project completion report referred to in Section 4.07 of the Loan Agreement.</td>
<td>5.14</td>
<td>Not complied with.</td>
</tr>
<tr>
<td>New Regional Development Account Decree</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Borrower shall provide ADB with a copy of the draft RDA decree and take into account ADB’s comments prior to its finalization. In finalizing the draft decree, the Borrower shall take into account any recommendation made by the consultants responsible for carrying out the technical assistance referred to in Recital (B) to the Loan Agreement. The Borrower shall also ensure that no provision under the new RDA decree or any other law or government regulation prevents the implementation of the Project as provided hereunder.</td>
<td>5.16</td>
<td>No evidence is available of policy dialogue the between the Government and ADB as to the RDA Decree issued in 2000.</td>
</tr>
<tr>
<td>Covenant</td>
<td>Reference in Loan Agreement</td>
<td>Status of Compliance at Operations Evaluation</td>
</tr>
<tr>
<td>----------------------------------------------</td>
<td>-----------------------------</td>
<td>-----------------------------------------------</td>
</tr>
<tr>
<td>Regional Development Account Lending Rates</td>
<td>5.17</td>
<td>Not complied with, but considered to be incapable of fulfillment because of the economic crisis, whose effects on the interest rate had not been entirely removed by the time of project closure.</td>
</tr>
</tbody>
</table>

The Borrower shall align over time RDA’s lending rate to level II governments and their enterprises to market levels and to the Sertifikat Bank Indonesia rate by December 31 2000.

Source: Operations Evaluation Mission.
EVOLUTION OF THE REGIONAL DEVELOPMENT ACCOUNT

A. Background

1. The urban population in Indonesia increased by 4.5% during the 1980s, more than twice the population growth rate nationally, and the growth was expected to continue and even accelerate in the following years. However, the pace of the urban infrastructure development did not keep pace with the growth of the urban population as expected. Real per capita investment in urban services (in 1983/84 prices) declined from around Rp12,000 in 1988/1989 to Rp8,000 in 1991/1992.1 The World Bank estimated that the 1990 infrastructure investment backlog for the four main subsectors of pipe water, sewerage, urban roads, and drainage was at least $5 billion.2 In response, the Government issued the Statement of Policies for Urban Development in 1987. This statement, among other things, established the guiding premise that the responsibility for urban services provision and financing rested with the provincial and municipal governments (generally referred to as local governments).

2. One of the objectives under the statement of policies was to increase the use of debt financing for appropriate development investments that have long-term benefits. The Regional Development Account (RDA) was established formally in 1991 along that policy through a Minister of Finance Decree3 following the initiation and preparation beginning in the late 1980s. The RDA was established as a revolving fund intended to promote decentralization and financial autonomy within the local governments through loan financing for urban infrastructure development. Further, it was intended to function as an alternative lending institution to provide long-term loans to the local governments and local government-owned companies to support investment in urban infrastructures.

B. Operations During the Pre-Decentralization Period (1991–1998)

3. RDA was funded out of the central Government general budget. The Directorate of Subsidiary Loan Management (DSLM), as the unit responsible for managing the RDA in the Ministry of Finance (MOF), proposed the amount of funds in yearly budgeting cycle based on the accepted subproject proposal approved for funding in the respective budget year. This ensured that funding for the RDA was on budget. Repayments, however were deposited into a separate account established with Bank Indonesia,4 and therefore were off budget. As a result, the RDA was not operating strictly as revolving funds, but as mix between off- and on-budget funds. On the recipient side, particularly among local government borrowers, loan proceeds were treated as revenues and budgeted as parts of the overall local government budget. Loan repayments were budgeted accordingly as part of the expenditures in the respective year the payments were due.

4. At inception, the RDA was confined to providing loans to regional governments and their enterprises to finance investment in urban infrastructure. To initiate a loan, prospective borrowers discuss the feasibility report of the proposed project with BAPPENAS. Following concurrence by BAPPENAS, the prospective borrowers submit loan proposals accompanied by the feasibility report to the DSLM for evaluation. Besides the feasibility report, the prospective borrowers were required to submit financial and technical feasibility studies.

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4 Bank Indonesia is the country’s central bank.
borrower also must submit financial statements supporting by relevant data, covering the previous 3 years, to substantiate the prospective borrower’s capacity to repay the loan. For a local government borrower, a recommendation by the Governor was also required.

5. A subunit within the DSLM conducts financial and technical analyses of the proposal submitted by the prospective borrowers, and reports the evaluation results and makes a recommendation to the director of DSLM. Director of DSLM then recommends acceptance of the proposal to the director general; concurrence by the director general entails a recommendation to the minister for approval. As soon as the proposal is approved in principle by the minister, the DSLM invites the prospective borrowers to discuss in detail the terms of the borrowing and prepare loan agreements. Based on the approval and mutual agreement between DSLM and the prospective borrowers, MOF then allocates the loan on a project-by-project basis in the ministry’s budget for disbursement.

Table A5.1: Summary of RDA Loan Status in December 1999
(Rp million)

<table>
<thead>
<tr>
<th>Borrower Category</th>
<th>No. of Loan</th>
<th>Cumulative Disbursement</th>
<th>Cumulative Maturities</th>
<th>Arrears</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reg. Govt.</td>
<td>159</td>
<td>255,554</td>
<td>128,392</td>
<td>58,026</td>
</tr>
<tr>
<td>Solid Waste Co.</td>
<td>6</td>
<td>7,795</td>
<td>4,344</td>
<td>3,745</td>
</tr>
<tr>
<td>Urban Markets</td>
<td>1</td>
<td>16,936</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>PDAM</td>
<td>225</td>
<td>911,569</td>
<td>248,749</td>
<td>118,375</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>391</strong></td>
<td><strong>1,191,855</strong></td>
<td><strong>381,485</strong></td>
<td><strong>180,144</strong></td>
</tr>
</tbody>
</table>

Co. = company, PDAM = Perusahaan Daerah Air Minum (local government water supply enterprise), No. = number, RDA = Regional Development Account, Reg. Govt. = Regional Government.


6. As of December 1999, the RDA had approved and disbursed 391 loans to the provinces, local governments, solid waste companies (PDK), government-owned market companies, and local water supply companies (Perusahaan Daerah Air Minum [PDAM]). Loans to PDAMs constituted the largest part of overall lending, with 225 of the 391 loans made by RDA, followed by loans to local governments (111 loans) and provincial governments (48 loans). Loan repayment was poor in general. Table A5.1 shows disbursement, maturities, and arrears for all categories of borrowers. The cumulative maturities by the end of 1999 of Rp381.5 billion were 32% of the cumulative disbursement. Borrowers repaid slightly more than half of the cumulative maturities, leaving more than 47% of the cumulative maturities (Rp.180.1 billion) in arrears.

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5 To accomplish this, the concerned subdirectorate normally organized a discussion involving the prospective borrower, and representatives from Bappenas and Directorate General of Budget. The recommendation was based on the result of the meeting.

7. Previous studies offered a number of explanations for the poor RDA performance: (i) the lack of capacity within MOF to manage the scheme, (ii) fiscal performance of the borrowers, and (iii) moral hazard. In addition, borrowers tended to perceive the loan as grants from the central Government. The lack of capacity within RDA management to assess loan proposals properly resulted in the funding of inadequately justified projects. These projects—poorly designed technically, and based on inadequate real demand and overly optimistic revenue projections—resulted in poor fiscal performance, which contributed to the poor loan repayments and arrears.

8. In conjunction with moral hazard, Varley’s report\textsuperscript{7} indicates that the use of proof of compliance or noncompliance with repayments of prior loans by DSLM as a control mechanism for approving or not approving RDA loans had made several borrowers return for additional loans even before the grace period of the previous loan expired. Further, he suggests that the absence of covenants in loan agreements linking disbursement to performance and certain policy and action requirements to enhance the cost recovery of the investments also contributed to the poor performance. In addition, human resource capacity and the operational budget in the DSLM were inadequate to support monitoring activities during project implementation and communication with the borrower during the repayment period.

9. The lack of institutional capacity within MOF to manage the lending scheme was identified, leading to assistance by the United Nations Development Programme (UNDP) to support the implementation of the RDA.\textsuperscript{8} The lack of capacity continued during the period, despite the capacity building efforts involving training and technical assistance (TA) from a number of development partners, including United States Agency for International Development (USAID)\textsuperscript{9} and the Asian Development Bank (ADB).\textsuperscript{10} Technical assistance was ineffective, functioning more as a substitute than a complement to the existing staff who needed training and strengthening. The poor track record of RDA in institutional building and loans administration should have been considered before investing in the program. The injection of investment capital into the scheme might have prolonged the life of a poor and losing program that otherwise would have been forced to restructure itself earlier.

C. Operations During the Post-Decentralization Period (1999 to date)

10. The decentralization era began with the enactment of Law 22/1999 on Regional Governance (amended to become Law 32/2004) and Law 25/1999 on Fiscal Balance Between Central and Regional Governments (amended to Law 33/2004). The new laws and regulations have effected significantly the operation of the RDA. Except for Regulation PP 54/2005 on the new Government Regulation on Regional Government Borrowing, more operational legal products are still under development. In the meantime, the substantive content of the previous Minister of Finance Regulation of 2001 remains valid. The new decentralized environment has


\textsuperscript{8} Price Waterhouse-Siddik, UNDP’s contractor for the TA, was assigned to (i) develop an organization structure and staffing plan; (ii) develop a system design, including a proposal appraisal and approval mechanism; and (iii) conduct RDA staff training.

\textsuperscript{9} USAID has provided TA and investment funds for infrastructure investment through the Housing Investment Guarantee Loan Programs since 1989. See, for instance ADB. 1996. Report and Recommendation of the President to the Board of Directors on a Proposed Loan and TA Grant to Indonesia for the Regional Development Account Project. Manila.

not promoted the growth of RDA loans; the number of loans has not changed significantly. In informal conversations, Government official in other ministries seemed unaware that the RDA was still operational. Although it still exists, the RDA has reduced significantly, if not stopped, lending capital to regional governments and their enterprises. DSLM officials hesitantly mentioned that one loan was approved in 2006.

Table A5.2: Regional Development Account Loans Performance
(As of 31 March 2006)

<table>
<thead>
<tr>
<th>Borrowers and Performance Classification</th>
<th>Number of Loans</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Regional Government Borrowers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Well performing</td>
<td>108</td>
<td>100</td>
</tr>
<tr>
<td>- Needing attention</td>
<td>12</td>
<td>11</td>
</tr>
<tr>
<td>- Less performing</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>- Doubtful</td>
<td>10</td>
<td>9</td>
</tr>
<tr>
<td>- Nonperforming</td>
<td>76</td>
<td>71</td>
</tr>
<tr>
<td><strong>Local Water Supply Companies (PDAM)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Well performing</td>
<td>215</td>
<td>100</td>
</tr>
<tr>
<td>- Needing attention</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>- Less performing</td>
<td>12</td>
<td>6</td>
</tr>
<tr>
<td>- Doubtful</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>- Nonperforming</td>
<td>186</td>
<td>87</td>
</tr>
<tr>
<td><strong>Solid Waste Treatment Companies</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Nonperforming</td>
<td>6</td>
<td>100</td>
</tr>
</tbody>
</table>

PDAM = Perusahaan Daerah Air Minum (local government water supply enterprise).
Note: Well performing means no arrears or having arrears for less than 6 days; needing attention means having arrears between 6 days and 6 months; less performing means having arrears between 6 months and 12 months; doubtful and nonperforming means having arrears more than 12 months.

11. No evidence is available to suggest that the performance of the loans approved recently has improved. Table A5.2 shows that the situation has not changed much in the past 4 years. More than 70% of the loan portfolio to the regional governments, and more than 85% of the loan portfolio to the local water supply companies, were categorized as nonperforming. Another report focusing on loan repayments by 206 PDAM borrowers is summarized in Table A5.3. As the table shows, almost half of the borrowers had repaid less than 5% of the cumulative amount due by 31 March 2006. Indeed, footnote 7, main text suggests that recent investment of substantial resources by Government, development partners, and lending agencies to improve the onlending system, plus enactment of some new regulations on subnational borrowing, is unlikely to improve the outcome substantially. Again, the root of the problems seems to be human resource capacity and the lack of an incentive system to promote good governance. Employment standing and promotion, for instance, are not directly related to performance of loan projects under a person’s responsibility. Besides, the personnel who handle the appraisal process often did not have sufficient technical background to perform the duty. Aside from inaccurate analysis of the financial internal rate of return (FIRR), they hardly conducted any analysis of the economic internal rate of return (EIRR).  

11 In 2006, Lewis presented data on all regional government borrowing, including the subsidiary loan agreement and RDA, up to 2004, which showed 838 loans. This is not significantly different from the 809 regional government loans in 1999, including SLA and RDA. A table that the OEM obtained from DP3 shows the number of RDA as of March 2006 was only 206 loans.

12 Conceptually, the RDA facility is supposed to prioritize support for investment initiatives showing high EIRR rather than those with high FIRR, which should be left to the private sector on the grounds of commercial viability.
Table A5.3: PDAM Loan Repayments as Percentage of Amount Due  
(As of 31 March 2006)

<table>
<thead>
<tr>
<th>Repayment as Percentage of Cumulative Amount Due</th>
<th>Number of PDAM</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water supply companies (PDAM)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Repayment between 0–5%</td>
<td>102</td>
<td>49</td>
</tr>
<tr>
<td>- Repayment between 5–25%</td>
<td>39</td>
<td>19</td>
</tr>
<tr>
<td>- Repayment between 25–50%</td>
<td>19</td>
<td>9</td>
</tr>
<tr>
<td>- Repayment between 50–75%</td>
<td>15</td>
<td>7</td>
</tr>
<tr>
<td>- Repayment between &gt; 75%</td>
<td>31</td>
<td>16</td>
</tr>
</tbody>
</table>

PDAM = Perusahaan Daerah Air Minum (local government water supply enterprise).  

12. Repayment administration remains another big weakness, and the willingness to use all the available instruments to promote repayments is not evident. Consultants and TA to support RDA strengthening often recommended the use of an intercept mechanism to ensure repayments. The instrument is indeed given the available formal instruments covered by the law and regulations on regional government borrowings. However, the instrument never has been used.

D. External Assistance

13. The implementation of the RDA since its inception has benefited from the support of external assistance. UNDP’s assistance, which was executed by Price Waterhouse-Siddik beginning in January 1988, was among the earliest. Shortly after, the Harvard Institute of International Development stepped in to provide advice at the policy level, and helped shift the emphasis of the UNDP-funded consultants to implementation of the RDA scheme. Following these inputs, USAID provided TA support, which later was supplemented by capital investment originated from the Housing Funds.

14. ADB provided a project preparatory TA (TA 2500-INO) to conduct a study leading to the Regional Development Account Project (RDAP). The TA identified some issues facing the RDA at that time, including staff capacity and institutional capacity. The project preparatory TA noted that the staff involved in RDA loan evaluation had many other duties, which made simultaneously performing effective loan appraisal difficult. At the time, the aim was to institutionally strengthen the scheme by transforming the RDA into a wholesale lending facility involving the regional development banks (Bank Pembangunan Daerah or BPD) to operate as retail lenders. This direction of reform was contained in the draft MOF decree, which effectively shifted the burden of detailed loan appraisal to the BPDs. Along this line, the project preparatory TA concluded and recommended that RDA loans made previously to the local governments, as well as subsequent loans to be made to BPDs, be segregated into a separate management and financial system.

15. Together, ADB’s subsequent TA (2699-INO) and the RDAP represented perhaps one of the most significant external inputs to the scheme. In the latter stage of RDAP

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implementation, ADB fielded a staff consultant\textsuperscript{14} to assess the operational management of the RDA by the Directorate of Subsidiary Loan Management. Based on a thorough analysis on the RDA performance and a comprehensive review on the previous major reports on the matter, the consultant concluded that the RDA concept was not capable of fulfilling its initial objectives. The consultant further recommended the development of a separate and new institution to assume the functions that the RDA system was intended to serve. The consultant also proposed more capacity building investment focused on this new institution. A transition mechanism toward this new institutional setup would involve selected commercial and regional development banks assuming responsibility for providing retail lending to local governments and enterprises. The dedicated staff were expected to conduct the detailed loan appraisal more efficiently.

16. Besides the ones that strictly supported the development of the RDA, other TAs and capital investments supported the development of regional government lending, notably the subsidiary loan agreement (SLA). World Bank and ADB had been providing capital investment support through a number of project loans since the early 1990s. Among the numerous TAs geared to institutional strengthening, ADB’s TA 3935-INQ\textsuperscript{15} in Indonesia was perhaps the most recent. The TA identified problems associated with the RDA, including the slow and inefficient loan processing and funds disbursement, as well as poor project development that led some projects being settled without evaluating the real need of the regions. The poor record of loan repayments was caused by the selection of bad projects that lacked repayment capacity, and moral hazard stemming from most of regional governments borrowers seeing the loans as subsidies.

E. Remaining Issues

17. The RDA scheme has come a long way since its inception in 1988 and formal establishment in 1991. The amount of funds channeled in the past 15 years has not been very significant though. Total outstanding debt (RDA plus SLA) of regional governments and their enterprises was Rp4,178 billion, or around 0.2% of the central Government’s outstanding debt in the same year (footnote 7, main text). The bulk of the lending took place before the decentralization era, with only a few loans approved after 2001. Despite the long history and the many inputs that have gone into the institutional strengthening, the performance of the RDA system remains unimpressive. Although the variety and dimension of problems facing RDA implementation undoubtedly changed over time, the fundamental issues remain the same. These include (i) long lead times to prepare for a project and loan, (ii) financing of bad projects resulting from weak project appraisal processes, and (iii) the poor loan repayments. Political support for the initiative also seems to have weakened, with increasingly stronger voices in the House of Representatives favoring closing the program.

18. The parties involved lack skills and understanding to come up with economically sound decisions. Feasibility evaluations have been based largely on FIRR rather than EIRR, resulting in a tendency to approve subprojects that are commercially viable. However, the FIRR criterion cannot capture projects that are not commercially viable (low FIRR), but have larger social dimensions. Equally important, the funding of high FIRR and commercially viable projects defeats the purpose of achieving fiscal autonomy by crowding out private investment.


19. Varley (footnote 14) articulated the roots of the problems constraining the system from benefiting fully from the intervention, including (i) the lack of human resource capacity to learn effectively to acquire skills from the consultant, and (ii) the absence of an appropriate incentive system to promote performance. The weak record of the effectiveness of institutional capacity building implemented to strengthen RDA management since its inception in the late 1980s has caused a reasonably high level of doubt regarding the feasibility of revamping the institution to assume responsibility to deliver credible credit services to regional governments.

20. Governance and accountability are other important issues lingering from the implementation of the RDA. The issue of corruption and governance arises along two separate lines of thought. The first concerns the mechanism of loan processing that resulted in approvals of financing for socially inefficient, overdesigned projects and/or unfeasible project proposals, which led to nonperforming loans. Although the RDA theoretically funded local initiatives, discussions with government officials at the subproject location revealed that in most cases subproject identification involved central ministries, BAPPENAS, MOF, or Ministry of Public Works. Subproject appraisals were not thorough enough, and often failed to filter out unrealistic assumptions underlying the project design and project costs.

21. The second concerns the off- and on-budget nature of the RDA system. While it was clearly stated that subproject loans could be financed out of the MOF budget or out of the funds accumulated from previous loan repayments, most of the approved subproject proposals seem to have been allocated in the MOF Budget. No data was available on the number and value of lending financed out of the off-budget RDA. A staff member of DSLM stated that the funds accumulated in the off-budget account were transferred to the State Treasury Account regularly, but failed to indicate the pattern, interval, and the data on the amount of transfer. This raises the issue of accountability concerning RDA funds management. In light of this, the recommendation that the RDA needs to be either off-budget or on-budget, not partially off- and on-budget, was relevant.

22. Finally, the fundamental issue the Government has not addressed concerns how the RDA system will develop in the future. At the conclusion of TA 2699-INO, the Government was considering the alternatives recommended by the consultants. The thinking within MOF apparently has not changed significantly since then; no indication of progress one way or the other was found. The one thing that seems clear, however, is that the building of capacity to conduct thorough technical and financial appraisal has not shown significant progress, despite a number of initiatives supported by external assistance since the inception. In the absence of this capacity—and this alone is not sufficient in itself to support the RDA management at MOF—it is difficult to expect significant improvement in lending performance.

23. In conjunction with that, since a total reconsideration of the roles of MOF in the RDA system proved difficult, exploring a new system involving an independent agency (private and state-owned commercial bank) to manage retail lending to the regional governments and their enterprises might be advisable. RDA management at MOF could team up with BAPPENAS to administer the grant element for a mixed credit scheme, combining commercial bank lending at commercial rates and central Government grants. The amount of grants could vary depending on the nature of the individual investment project to prevent crowding out of private investment, while promoting cost recovery.
DECENTRALIZATION OF THE PUBLIC ADMINISTRATION AND FINANCE

1. The Government of Indonesia started implementing its decentralization policy in January 2001 following the enactment of Law 22/1999 and Law 25/1999, which recently were replaced by Law 32/2004 on Regional Governance and Law 33/2004 on Fiscal Balance Between Central Government and the Regions. These serve as the legal basis and prescribe the concept of decentralization and regional autonomy. The objectives of decentralization are threefold: (i) enhanced development equality, (ii) improved prosperity of citizens, and (iii) enhanced democratization through increased local participation.

2. Laws 22/1999 and 25/1999 stipulated a 2-year time frame to allow for necessary ground work before it came into effect by May 2001. However, the date was advanced to 1 January 2001 to align with the beginning of the new fiscal year.

A. Features of the Indonesian Decentralization

3. The main features of decentralization in Indonesia include the devolution of a wide range of public service delivery to the local government, districts, and cities; and the strengthening of the elected local government representatives. Law 32/2004 prescribes regional autonomy based on principles of democracy, community participation, and empowerment, as well as recognition and appreciation of potential and diversity of the regions. Although the new law gives substantially more functions to the province compared to the former Law 22/1999, the emphasis of the decentralization remains at the local level. The principles of broad autonomy for the local level as stipulated in Law 22/1999 (Article 7) is maintained in the new Law 32/2004 (Articles 10 and 14).

4. Regions maintain control over their finances, civil service, and organization structure. In accordance with this, the regions are responsible for a wide range of related matters, including planning, financing, implementation, monitoring and evaluation, and maintenance. With this broad autonomy, local governments essentially are no longer part of a chain of command that in the past went from the President down to the level of village head. Following the enactment of Law 32/2004, people elect the head of regional governments directly without needing clearance from the higher level of government. They also are now accountable to the voters through their local representatives.

5. Revenues and expenditures are to be contained in the local government budget, which reflect the policy and priority of public service provision by the local governments. The budgeting process is independent—approval by the higher level of government before the local government budget enactment is based on evaluation in broad terms only to make sure that the draft budget (i) represents a sustainable expenditure plan given the local fiscal capacity, (ii) is in

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1 In this paper, the terms region and regional refer to provincial (Level I) and/or district/city (Level II) governments, while the term local or local government refers strictly to district/city (Level II) government.
3 The fiscal year was changed in 2000 from an April–March to January–December cycle.
4 This put the policy in stark contrast with the previous policy that emphasized deconcentration to the province level as stipulated by the previous legal framework for regional government, Law 5/1974. The new Law 32/2004 slightly softens the swing between the deconcentration emphasis to devolution to the local government, as prescribed by Law 22/1999, by giving more functions to the province.
5 To finance expenditure, regional governments are allowed to borrow domestically and from abroad. While the old law (25/1999) allowed foreign borrowing though the central Government, the new law (33/2004) only allows two-step borrowing.
line with the national priorities as stipulated in the national medium development plan and annual circular by the Minister of Home Affairs, and (iii) is consistent with public interests. In this context, the central Government positions itself as a facilitator to support and improve capacities within the local governments.

6. Functions are devolved to the local government with resources originated from a variety of sources, as stipulated by the law on Fiscal Balance Between Central and Regional Governments (Law 33/2004). Both laws prescribe a scheme to (i) promote and empower regional economic capabilities; and (ii) create a just, rational, proportional, transparent, participatory, and accountable financing system. Besides that, the laws also aim to develop a funding system that reflects the division of functions among levels of government and reduce funding gaps.

7. Regional government revenues consists of “own revenue” (known as Pendapatan Asli Daerah), equalization funds, and other revenues. Equalization funds broadly include shared revenue and grants from the central Government. Shared revenues are originated from regional government’s share of the property tax and property transfer tax revenues, and the regional government’s share of proceeds from natural resources exploitation. Grants from the central Government are awarded in two broad schemes, namely general of unconditional grants or Dana Alokasi Umum (DAU) and specific or conditional grants or Dana Alokasi Khusus (DAK). Other revenue includes funds originated from the central Government that are channeled to the regions to implement specific tasks on behalf of the central Government, known as assistance tasks or Tugas Pembantuan.

8. DAU is the primary means of fiscal transfer from central to local government. It constitutes almost 30% of the annual national budget, and contributes 70%–90% of district government revenue. According to the definition in Law 32/2004, DAU is intended for fiscal capacity equalization among districts. However, since about 50% is tied up for personnel expenses resulting from decentralization of most public service functions to the local government, DAU has trouble functioning effectively as equalization funds. After deducting the 10% lump sum allocation from the remainder, about 40% is left to serve as equalization funds. This is insufficient, given the variation of shared revenues between the natural resource rich region/districts and the ones without natural resource endowment.

9. DAK is a conditional grants program, intended primarily for purposes that DAU could not address systematically. DAK funds are meant to cover the financing gap faced by the local government in meeting its obligatory functions. It is also intended to stimulate additional spending to support implementation of national policy priorities. DAK applies to seven sectors, including education, and 11 priorities. Law 32/2004 requires matching funds for DAK of at least 10%. The national Parliament allocates DAK funds by the using three categories of criteria. First, funds are allocated based on fiscal capacity, i.e., districts below the national average in terms of fiscal capacity are eligible for DAK. Second, funds are allocated according to specific criteria, including special region (e.g., Papua and Aceh), regions suffering from food crises, and districts at the borders. Third, funds are allocated based on technical criteria, which include the number of schools and/or hospitals needing rehabilitation and renovation, as determined by the relevant line ministry.7

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6 Pendapatan Asli Daerah literally means regional government’s own revenues originated from local taxes, proceeds from regional government-owned corporations, and other non-tax revenues.

7 The Ministry of National Education is to confirm the number of schools needing rehabilitation, while the Ministry of Health is to confirm the number of hospitals.
B. Implementation and Achievement

10. The overall result of the first 5-year implementation has been mixed, though evidence of improvements has emerged over time. Despite the lingering problems at preparatory stage, and the incomplete regulatory framework at the time the autonomy took effect at the beginning of FY2000, the implementation has been relatively smooth. The Government decentralized much of the public service responsibility to the local government within 1 year, followed by almost doubling the regional share in the state budget, reassigning about two thirds of central Government employees to regional governments, and handing over service facilities to the regions. Measured against the objectives of decentralization, the country is making good progress. Many achievements are manifested in good practices. Despite the problems and obstacles that still need to be addressed, efforts by all levels of government to make decentralization work are becoming increasingly fruitful.

11. Based on a series of appraisals, the Asia Foundation found, among others, that after 1 year of decentralization policy implementation, local governments in most regions were coping well with the additional responsibilities that had been thrust upon them, though some are not. Public services survived, and in some ways expanded. Contrary to widely shared pessimism, local governments seem to be paying attention to public services and are committed to improving service delivery. In some cases, local governments even are developing fresh initiatives to serve the interests of vulnerable groups, including women, children, and the elderly. Local governments also have coped with the immediate problem of integrating a large number of transferred staff, who had been supporting institutions attached to central ministries. However, they addressed this issue mostly by reorganizing and restructuring the agencies and units without downsizing them. The same study found an increasing awareness of the importance of people’s participation in local governance. Further, it revealed that local government agencies are increasingly committed to improving service delivery, and are feeling the pressure from citizens to do so.

12. A recent Survey on Governance and Decentralization 2004 conducted by the University of Gajah Mada and the World Bank shows that most Indonesians perceive public services to have improved after decentralization. The majority of the population acknowledged public services improvements in the areas of health (65%), education (60%), and local administrative services (59%). However, the same population perceives declining quality in police services (64%). Even though the findings are generally encouraging, an in-depth analysis is required to confirm whether the quality of the public services has improved fundamentally. Such an analysis is important given that the same survey shows that corruption and inefficiency are lingering public service issues. More than 36% of the respondents said they had to bribe to get services.
get basic services they were entitled to, and that the elites and those well-connected to civil servants got better access to basic public services.

13. Achievements have been less significant in policy and decision making at the local level. This particularly relates to how policies are formulated and decisions are made at the local level, as well as how the central Government conducts its policy review function and the role of the province in the review process. The policy and program formulation process differs only slightly from the practices that prevailed before decentralization—i.e., the state still dominates the process and the top-down approach is still prevalent. While decision making has shifted from the central Government to the local government, central Government technical ministries and agencies still strongly influence policies, programs, and activities in many sectors, notably education and health. The enhanced role of the local parliament is among developments that are well appreciated. Under decentralization, the local parliament plays a very important role in decision making.

14. Public participation remains somewhat limited, despite changes in approaches and institutional setting. While the demand for more participatory policy making is increasing, the public’s capability to influence the policy makers is still low. Often, public and civil society are invited to participate so late in the process that only marginal feedback is possible. Doing so could enable the regional government to carry out the process more efficiently and synchronize among policies at different levels more easily. However, this could be at the expense of the genuine people’s needs and aspiration which might not be reflected well in the policies and programs.

14 Although planning is conducted from the bottom up, no obvious instrument is available to ensure that input from the grassroots is incorporated and reflected in the budget. All too often, when the budget policy fails to reflect the will of the people as voiced in discussions at village and subdistrict levels, the disclosure of the general policies and priorities comes too late for the community and civil society to provide further input to rectify it. Discussions with local government officials in Surakarta and in Ponorogo did not indicate significant levels of community participation. Further, decision making leading to borrowing from the Regional Development Account to invest in the market and terminal infrastructures did not seem to have involved the community. The community clearly was not involved in Ponorogo, where the terminal was considered too large and too far from the city by people interviewed by the Operations Evaluation Mission.
PROGRESS OF THE FISCAL DECENTRALIZATION

1. Indonesia’s intergovernmental fiscal system devolves resources consisting of equalization grants to cover the functions devolved through decentralization. Resources transferred by the central Government represent on average more than 90% of regional government revenues. This transfer comprises (i) general grants, or Dana Alokasi Umum (DAU); (ii) conditional or specific grants, or Dana Alokasi Khusus (DAK); and (iii) shared revenues, or Dana Bagi Hasil (DBH), consisting of shared taxes and shared proceeds from natural resources exploitation. Local government’s own revenues, or Pendapatan Asli Daerah (PAD), on average constitute less than 10% of the total revenues. It also gives regions limited taxing authority.

2. To improve fiscal autonomy, more assignment of revenue-generating authority is needed to give the regional governments incentives to strengthen their fiscal capacity towards self-funding of services to the public. Further, better access to investment capital to finance the provision of services, particularly in the areas where cost recovery is possible, would be instrumental. Subsidiary loan agreements and regional development accounts, and to a lesser extent regional development banks, have provided regional governments with access to capital investments. However, their performance has not been encouraging. The system is plagued with weaknesses, and the loan repayments have been disappointing.

A. Intergovernmental Fiscal Relations

3. While intergovernmental fiscal relations in general take place between all levels of government, this report covers only those between central and regional (province and local) governments. Before decentralization, resources were transferred from central to regional governments through earmarked grants. Decentralization and fiscal balance laws passed in 1999 and revised in 2004 changed the nature of transfer system from one dominated by earmarked grants to one employing general grants. The new system also gave regions more access to borrowing. The new fiscal system was strengthened by Law 34/2000 on regional taxes and regional levies, which gave local governments the right to levy their own taxes.

4. The DAU represent on average 70% of the overall regional government revenues, and are de facto the main thrust of the local government finance. Next to DAU is DAK and shared revenue originating from tax revenues and natural resource-based revenues, which total approximately 20%. The remaining, which account for less than 10%, comes from local governments’ own revenues originating from regional taxes and levies, and proceeds from regional government-owned enterprises.

5. The new fiscal balance Law 33/2004 requires the DAU to be at least 26% of central Government revenues.\(^1\) Of the aggregate amount, 10% is divided across all 33 provinces with the remaining 90% allocated to the more than 460 local governments. Allocations for individual regional governments are driven by a formula that consists of a basic allocation, calculated based on total salaries of civil servants in the region, and the fiscal gap. Shared revenue, or DBH, is generated from taxes (land and building, land transfer, and personal income taxes) and natural resources (forestry, general mining, fisheries, oil mining, natural gas mining, and geothermal mining). Own-source revenue, or PAD, is generated from regional taxes, levies and charges, and proceeds from the management of assets, including regional government-owned enterprises.

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\(^1\) The preceding Law 25/1999 required at least 25% of total central Government revenue.
B. **Financial Autonomy of the Regional Governments**

6. Decentralization in Indonesia is focused on an expenditure side characterized by the absence of significance taxation by the regional governments. The whole system of regional financial management is covered by the Government regulation and the Minister of Home Affairs regulation, both derivatives of Law 32/2004. The regional government financial management cycle begins with planning, which by Law 25/2004 must be consistent with national-level planning. The planning authority at the regional level prepares regional long-term development plans, referring to the national long-term development plan. Based on this long-term plan, a popularly elected head of regional government develops a medium-term development plan reflecting his or her vision, policy, and program. This plan has to be consistent with the national medium-term development plan.

7. In reference to RPJMD, the regional planning office develops a draft regional government work plan, which regional government units use as a basis for preparing draft work plans for their respective units. Discussion of the RKPD with the regional parliament results in a mutual agreements on general policy and direction, and on priorities and program ceiling appropriation. The two agreements are the basis for the SKPD to budget the proposed program and activities. The regional budget process must be in line with the national priorities, as set out in the circular issued by the Ministry of Home Affairs. This circular is not the only control instrument, however. As stipulated by Law 32/2004 and PP 58/2005, as well as Permendagri 13/2006, the draft budget has to be reviewed and approved by the government “one step above” before it is enacted.

8. Regional government’s accountability system involves internal audit system, external audit, regional parliament, and audit by the Ministry of Home Affairs. At the end of the fiscal year, the regional government submits financial report to the Supreme Audit Agency for audit. The head of the regional government is required to respond to all the qualification the BPK might give resulting from the audit it performs before submitting the audited report to the regional parliament.

C. **Fiscal Performance of Central and Regional Governments**

9. Fiscal performance is measured in terms of (i) development in the overall fiscal capacity, i.e., whether the overall fiscal capacity has increased or decreased as a result of decentralization; (ii) whether the regional governments receive sufficient financial resources to cover the expenditures needed for the functions they are expected to perform, i.e., whether the devolved resources cover all the devolved responsibilities; (iii) how equal the new intergovernmental fiscal system distributes financial resources among regional governments; and (iv) how fiscal dependency has evolved during fiscal decentralization.
## Table A7: Pre- and Post-Decentralization Fiscal Structure of Surakarta and Ponorogo

<table>
<thead>
<tr>
<th></th>
<th>Ponorogo</th>
<th>Surakarta</th>
<th>Ponorogo</th>
<th>Surakarta</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1999</td>
<td>2004</td>
<td>1999</td>
<td>2004</td>
</tr>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Last Year Surplus</td>
<td>115,223</td>
<td>418,765</td>
<td>122,884</td>
<td>390,121</td>
</tr>
<tr>
<td>- Own Revenue (PAD)</td>
<td>3,673</td>
<td>24,287</td>
<td>11,043</td>
<td>34,819</td>
</tr>
<tr>
<td>- Shared Revenue (DBH)</td>
<td>7,609</td>
<td>286,217</td>
<td>7,470</td>
<td>223,545</td>
</tr>
<tr>
<td>- Transfers (DAU, DAK)</td>
<td>97,028</td>
<td>50,402</td>
<td>71,558</td>
<td>47,409</td>
</tr>
<tr>
<td>- Other Incomes</td>
<td>234</td>
<td>33,279</td>
<td>143</td>
<td>24,565</td>
</tr>
<tr>
<td>- Loan</td>
<td>1,249</td>
<td></td>
<td>16,699</td>
<td></td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td>114,383</td>
<td>418,765</td>
<td>122,884</td>
<td>390,121</td>
</tr>
<tr>
<td>- Routine Expenditures</td>
<td>82,070</td>
<td>68,357</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Development Expenditures</td>
<td>32,313</td>
<td>54,527</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Civil Service Expenditures</td>
<td>69,841</td>
<td>53,364</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Public Service Expenditures</td>
<td>277,702</td>
<td>238,078</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Local Government</td>
<td>71,222</td>
<td>98,679</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**DAK = Dana Alokasi Khusus, DAU = Dana Alokasi Umum, DBH = Dana Bagi Hasil, PAD = Pendapatan Asli Daerah.**

Sources: Published fiscal data of Surakarta City and Ponorogo District.

10. The overall fiscal capacity has generally improved following decentralization. A 1002 study by the Asian Development Bank (ADB)\(^2\) suggests that the aggregate data, as well as data on the studied province and local government, show an increase in real revenues at all levels of government. The DAU is more than double the previous government transfers to the provinces, and more than four times the size to the local government. In line with this, the fiscal capacity in Ponorogo and Surakarta has increased significantly in the past 7 years. Table A7 shows that overall fiscal capacity (at current prices) increased by more than three times in Surakarta and by almost four times in Ponorogo between 1999 and 2004. In the same period, transfers from the central Government increased by about three times in both districts. Ponorogo grew other revenue components, notably the own-source revenue component, more than Surakarta.

11. The question of whether the devolved financial resources are sufficient to cover the devolved responsibility is not easy to answer. The World Bank,\(^3\) presumably assuming the same quality of services as during the pre-decentralization era, argues that enough revenues seem to have been devolved at the aggregate level to match the transferred responsibilities. Resource sufficiency at the aggregate level, however, conceals the large variation of fiscal capacity among regions. In the 2002 study (footnote 2), ADB shows the huge variation in the own-source revenues among districts and cities—the poorest district has only Rp50,000 receipt per capita per year, while the richest has close to Rp5,000,000, a ratio of nearly 100:1 even after the

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decentralization. The revenues remain unequal even after redistribution through the DAU, with the richest district receiving more than 50 times as much as the poorest one, and the poorest regions having only 20% of the per capita revenue of the average (footnote 4).

12. The DAU made little contribution to improving the distribution of income across regional governments. ADB (2002) footnote 2, offers three reasons for the ineffectiveness of the DAU in mitigating revenue inequality across regions. First, the “need index” included in the formula assigns a 40% weight to assets price, which is likely to be positively correlated with the current level of income. Second, the “need index” pertaining to income gap measures gives less weight to the number of people living in poverty than that pertaining to how poor (which possibly small in number) the people living in poverty in the respective region. The third and probably most important explanation for the lack of distributive achievement of the recent DAU is that the allocation was restricted by the need to give regions sufficient funding to pay for the devolved government employees, which is known as the “hold harmless” clause.

13. In terms of the proportion of own-source revenues in the total revenues of the regional government, decentralization effectively has increased fiscal dependency among the regional governments. In Surakarta and Ponorogo, even though the share of own-source revenues remains small, they increased by around six times between 1999 and 2004. Nevertheless, central Government transfers remain the largest share at almost 70% in Ponorogo and 60% in Surakarta in 2004. This heavy dependence on transfers from the central Government could undermine accountability. It exposes the local government to risks associated with fiscal volatility at the center, and reduces autonomy in regional financial management.

D. Delivery of Public Services

14. One of the ultimate objectives of fiscal decentralization is to develop the regional government capacity to provide better services to the people. In practice, however, improvements in public services have not been obvious, at least until recently. Evidence from recent studies is divided, though later findings are encouraging. Proximity of local government to the people contributes to efficiency and better matching of public initiatives with popular aspirations. However, the great potential this represents is offset partly by the lack of skills among the local government staff. Although the transfers have more than compensated the cost of delivering devolved public services, the services have not increased as much. Another explanation for the less-than-expected improvements in service delivery is the lack of specifics in the assignment of functions and responsibilities among levels of government, coupled with the absence of a standard by which quality of services can be measured. Clarity of assignment and services standards, in the form of minimum service standard, are fundamental to achieving better services, while maintaining operational efficiency.

E. Capacity Building in the Regional Government

15. To varying degrees, regional governments are facing capacity constraints due to the quality of human resources they inherited from the pre-decentralization era. Feedback from the

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4 Much of this variation is due to revenues originated from natural resource sharing. Another source of inequality is the distribution of personal income tax, from which some regions receive none.
5 The “hold harmless” clause is expected to be phased out in 2008.
6 Discussions in Surakarta and Ponorogo during a field visit to the subproject indicated that fiscal decentralization has translated into a more accurate and timely articulation of the needs of the citizens, as well as more efficient financial management.
7 ADB and other development partners are supporting the facilitation of the minimum service standard.
field visit to the subprojects in Surakarta and Ponorogo indicated the same high level of concern over human resource quality. The long-term challenge facing the country is to find the best ways to improve the capacity of the regional governments’ human resources to support decentralization. This is particularly important following the long period of centralized governance, which produced less proactive regional government officials who tend to wait for instruction from the center. With this background, when the system changes take place at the national level, responses at the regional level unsurprisingly lag behind.

16. A wide range of inputs have gone into the institutional building efforts to support the implementation of decentralization in Indonesia. Some international agencies have been engaging central and regional government institutions to work on capacity building. Among multilateral agencies, the United Nations Development Programme, ADB, and the World Bank have provided technical assistance and investments to support capacity building in line with the decentralization. Among bilateral agency, Deutsche Gesellschaft für Technische Zusammenarbeit (German Agency for Technical Cooperation), Canadian International Development Agency, United States Agency for International Development), and the Australian Agency for International Development have provided substantial inputs.
EVALUATION OF TA 2699-INO:
INSTITUTIONAL STRENGTHENING OF THE REGIONAL DEVELOPMENT ACCOUNT

A. Background

1. In conjunction with the Regional Development Account Project \(^1\) (RDAP), the Government of Indonesia asked the Asian Development Bank (ADB) for an advisory technical assistance (TA) grant to assist in formulating a long-term strategic plan for the Regional Development Account (RDA). The TA also was to help in preparing RDA for the transition to an autonomous financial intermediary providing credit to local governments and their enterprises for urban development projects. In response, ADB approved TA 2699-INO\(^2\).

2. The Bureau for Regional Finance Analysis (BAKD), under the Agency for Financial and Monetary Analysis (AFMA) of the Ministry of Finance (MOF), was the Executing Agency for the TA. In line with the 1999 decentralization legislation, AFMA was split, and BAKD was placed under Directorate General for Fiscal Balance (DGFB) in 2001. In 2004, the Agency for Research on Economic, Financial and International Cooperation (Bapekki) was created, and most of the former BAKD functions were transferred to this agency.

3. The Operations Evaluation Mission (OEM) assessed this TA based on a review of the consultant reports; and interviews with the representatives of Bapekki and Directorate of Subsidiary Loan Management in MOF, and the National Development Planning Agency (BAPPENAS). Partly due to the reorganization of MOF, as described in para. 2, the OEM could not meet with the former BAKD staff who worked with the consultants of this TA. This significantly limited the scope of evaluation.

B. Design and Implementation

1. Purpose and Scope

4. The purposes of TA 2699-INO were to (i) review the Government’s policies and the RDA’s role in financing urban investments and supporting regional development; (ii) analyze the options for transforming the RDA into an autonomous financial intermediary fund to local governments and their enterprises, and outline an action plan; (iii) review and assess financial intermediaries, including regional development banks (Bank Pembangunan Daerah [BPD]), as conduits of local governments; and (iv) consider the Government’s plan to move the RDA’s interest rate closer to the market rate and assess the implications, if any, on the affordability of the RDA’s lending to potential borrowers. The loan included capacity building for immediate improvement of the RDA, while the TA explored long-term development of the RDA.

5. At appraisal of the RDAP, the Government considered a two-step approach in institutional development of the RDA. In the first stage in 1997, MOF planned to issue a new RDA decree to (i) delink the Government’s budget allocation process from RDA subproject approvals, which would significantly increase RDA autonomy; (ii) set in motion the transformation of the RDA into a wholesale financing facility by shifting direct responsibility for loan approval, monitoring, and collections to select BPDs and/or other financial institutions; (iii) increase interest rates toward market rates; and (iv) provide liens on the property tax revenues

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\(^1\) ADB. 1996. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance to the Republic of Indonesia for the Regional Development Account Project*. Manila.

of local governments in case of default on RDA loans, which would improve the long-term financial viability of regional lending. The second stage would involve the establishment of the RDA as an autonomous financial intermediary independent of MOF, which would require a presidential decree and substantial institutional strengthening. A long-term strategic plan for the RDA being developed under this TA was to be the impetus, especially for the institutional development of the second stage.

2. Consultants and Scheduling

6. An international consulting firm, in association with a national consulting firm, was selected following evaluations of technical proposal submitted by the five short-listed consulting firms. The skill mix and duration of work of the consultant team are summarized in Table A8.1. The consultant services originally were scheduled to start in mid-October 1997 and conclude by 30 July 1998. Due to country’s economic and political situation, which had affected the work of the consultants, their services were extended for 2 months to 30 September 1998. This extension involved the following minor changes in the scope of the services: (i) an increase in international consultants’ inputs, including the team leader, by 4.25 person-months in total; and (ii) an increase in national consultants’ inputs by 2.6 person-months in total. The final consultant report was submitted in January 1999.

<table>
<thead>
<tr>
<th>TA Staffing</th>
<th>Planned Person-Months</th>
<th>Actual Person-Months</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>International</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Team Leader/Financial Institution and Economic Development Specialist</td>
<td>7.00</td>
<td>8.75</td>
<td>1.75</td>
</tr>
<tr>
<td>Banking Specialist</td>
<td>4.00</td>
<td>5.50</td>
<td>1.50</td>
</tr>
<tr>
<td>Municipal Funds Specialist 1</td>
<td>3.00</td>
<td>3.00</td>
<td>0</td>
</tr>
<tr>
<td>Municipal Funds Specialist 2</td>
<td>3.00</td>
<td>4.00</td>
<td>1.00</td>
</tr>
<tr>
<td><strong>Total International</strong></td>
<td><strong>17.00</strong></td>
<td><strong>21.25</strong></td>
<td><strong>4.25</strong></td>
</tr>
<tr>
<td><strong>National</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legal Specialist/Banking/Company Law</td>
<td>5.00</td>
<td>5.00</td>
<td>0</td>
</tr>
<tr>
<td>Urban Finance Expert</td>
<td>6.00</td>
<td>7.30</td>
<td>1.30</td>
</tr>
<tr>
<td>Banking Expert</td>
<td>5.00</td>
<td>6.30</td>
<td>1.30</td>
</tr>
<tr>
<td><strong>Total National</strong></td>
<td><strong>16.00</strong></td>
<td><strong>18.60</strong></td>
<td><strong>2.60</strong></td>
</tr>
</tbody>
</table>

Source: Project files.

3. Outputs and Outcomes

7. As envisaged in the terms of reference, the consultants submitted the following policy papers: (i) Interest Rates for Urban Infrastructure Lending, (ii) Financial Intermediation for Urban Infrastructure Finance in Indonesia, and (iii) Institutional Structures Review. Besides these, the consultants also prepared Urban Sector Policy Review and Financial Structures and Financial Institutions working papers, Report on Case Studies of RDA and SLA Loans in Arrears, and Guidelines for Loan Administration. Following submission of working papers and policy papers, the consultants facilitated working group discussions during the TA involving all members of the

8. The recommendations for institutional development were suitably organized into near- and longer-term actions. The near-term action recommendations were fairly good, practical, and appropriately oriented towards solving the problems facing the RDA. The first recommendation was for the RDA to limit loans to those without arrears in their previous borrowing. This recommendation was given in view of the increasing number of borrowers in arrears, and was intended to stimulate portfolio restructuring to improve overall RDA lending performance. However, the Government took almost 2 years following the completion of the TA to adopt this recommendation, which was incorporated in the Ministerial Decree No. 347a/KMK.017/2000 on Management of RDA, issued in August 2000.

9. To improve future lending performance, the consultant also recommended that the RDA staff conduct field appraisal following desk evaluation of the proposal to verify all the assumptions underlying the feasibility assessment conducted by the applicant. This important recommendation does not seem to have been implemented systematically. The OEM could not find evidence of such close scrutiny of the RDA loan proposal, and none of the subprojects visited by the OEM recalled any such field appraisal by RDA staff. Successful implementation of this recommendation would require the availability of technically capable staff to undertake technical and financial appraisal of prospective investment projects, which apparently the RDA did not have.

10. The consultant also recommended that the Government develop principles for rescheduling of RDA loans, and publicize and apply them transparently. Discussions with the Government officials showed that many of them agreed that this was very important, and that clear guidelines were needed to enable the RDA to address the issue of mounting arrears, particularly among the Perusahaan Daerah Air Minum (local government water supply enterprise [PDAM]) borrowers. Nevertheless, the recommendation was not implemented until recently. More than 5 years lapsed before the principles were incorporated in the Ministerial Decree No. 107/PMK.06/2005 on Settlement of Government Receivables Originated from subsidiary foreign loans, investment funds account, and RDA, issued in June 2005.

11. Finally, for near-term action, the consultant recommended that the RDA apply different terms of borrowing for different project circumstances. This was an appropriate recommendation since applying a "one-size-fits-all" principle for a scheme like the RDA would defeat the fundamental purpose of its inception. While the RDA was intended to support and promote development of urban infrastructure with potential of operating on cost recovery principles, it was not suppose to limit its lending to commercially viable projects. More concessional terms of borrowing are needed by those projects with greater externality and social agenda contents. The OEM did not find any indication that the Government has systematically applied the principles.

12. The longer-term recommendations concern the future institutional structure of RDA management. The consultants’ recommendations on this matter were narrowed down to two options to substantially reform the RDA. The first option was to develop a mechanism to lend money "wholesale" to other financial institutions, such as BPDs and state-owned and private commercial banks. In turn, they would channel the funds as loans to local governments and their enterprises. The second option was to develop a municipal financial intermediary (MFI),
established as a PT Persero, to mobilize funds from the capital markets/other sources and lend money directly to local governments and their enterprises.

13. The BAKD representative and OEM consider the consultant recommendations reasonable. However the environment was not right for such recommendations, given that MOF at the time of TA inception during the financial crisis (in late 1997) had ruled out the possibility of using BPD as a vehicle for RDA loans. Even though the consultants were promoting the second option as a better alternative, the Government was reluctant to make any decision on RDA reform in the aftermath of the financial crisis. To date, the Government has not adopted any significant RDA reform measures. As result, the RDA portfolio has improved little, and its lending has faded. Moreover, lack of transparency in financial transactions between the RDA and the State Treasury Account remains a critical issue, undermining the accountability concerning RDA fund management.

C. Performance Assessment

1. Overall Assessment

14. Overall, this TA is rated as unsuccessful (Table A8.2). This overall rating reflects weighted averages of the individual ratings for four criteria: relevance (20%), effectiveness (30%), efficiency (30%), and sustainability (20%). Individual criterion ratings are in whole numbers from 0 to 3, in increasing order of project performance. As discussed in detail in paras 15–23, this TA is rated as partly relevant, less effective, and inefficient, with less likely sustainability.

Table A8.2: Overall Performance Assessment of RDAP

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Assessments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Relevance</td>
<td>1</td>
</tr>
<tr>
<td>2. Effectiveness</td>
<td>1</td>
</tr>
<tr>
<td>3. Efficiency</td>
<td>0</td>
</tr>
<tr>
<td>4. Sustainability</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total Rating</strong></td>
<td><strong>0.7</strong></td>
</tr>
</tbody>
</table>

RDAP = Regional Development Account Project.

\[ 3 \text{ Highly successful} > 2.7; 2.7 \geq \text{ successful} \geq 1.6; 1.6 > \text{ partly successful} \geq 0.8; \text{ unsuccessful} < 0.8. \]

Source: Operations Evaluation Mission.

2. Relevance

15. The TA is rated as partly relevant.

16. At the time of RDAP appraisal, the Government considered a two-step approach in institutional development of the RDA. This TA was to be impetus, especially for the institutional development of the second stage. In this way, the TA was to complement the RDAP. This plan was contingent on the progress of RDA reforms of the first stage through issuance of a new RDA decree in 1997. Facing the financial crisis, however, the Government decided not to pursue the new RDA decree in 1997. Evidently as a consequence, the initial plan did not materialize.

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3 For example, irrelevant = 0, less relevant = 1, relevant = 2, and highly relevant = 3.
17. RDA lending virtually was halted following the financial crisis that led to a sharp depreciation of the rupiah and higher interest rates in general. As these happened, the direction of institutional changes suddenly became less clear. Some of the options previously available, including the roles for RDPs in channeling loans to local governments and their enterprises, disappeared. Given the Government's continued commitment to reforming the RDA system, as reported by the TA Inception Mission fielded in December 1997, ADB kept the scope and design of this TA intact. Under the circumstances, especially considering the cancellation option of the RDAP was left out of the Government's options at an early stage of RDAP implementation, this TA remained relevant at least at the time of TA inception. However, during RDAP implementation, the Government's interest in fundamental reform of the RDA appears to have faded. This observation is based on the following: (i) BAPPENAS subsequently proposed the cancellation of the RDAP to MOF (whereas MOF did not accept this proposal), and (ii) the long-awaited issuance of the RDA decree in 2000 did not lead to any fundamental change in the RDA.

3. Effectiveness

18. The TA is rated as less effective.

19. The TA contributed to some policy changes in RDA management. The Government partly adopted the more practical near-term recommendations, although they came late in the day. However, the TA was unsuccessful in coming up with recommendations capable of fundamentally improving the RDA and strengthening the institution. This discounted the overall TA effectiveness significantly.

20. The OEM noted that the consultant was working in a difficult situation that was significantly changed from when the TA was conceived. Aside from the crisis environment of that time, the consultant had to navigate between differing opinions among senior Government officials. The matter was complicated further by the Executing Agency of this policy development-oriented TA being separated from the Executing Agency of the RDAP. The available records on TA activities indicated hardly any active involvement of middle management and/or technical staff within the Directorate General of Financial Institution, who were responsible for managing the RDAP and manage the RDA.

4. Efficiency

21. The TA is rated as inefficient in view of the significant underutilization of TA outputs and little progress on RDA reform.

22. The Government subsequently adopted some of the near-term measures recommended under this TA. However, some of these measures also were recommended by the project preparatory TA consultant and/or RDAP (Part B) consultants. The staff consultant fielded at the later stage of RDAP implementation, as well as a subsequently implemented TA, came up with similar recommendations.

5. Sustainability

23. The TA is rated as less likely sustainable. The future operations of RDA remained uncertain because (i) few RDA loans have been approved in recent years, while the progress in restructuring of nonperforming RDA loans has been slow; and (ii) no road map has been prepared for reclamation of the RDA.
On 9 July 2007, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

1. We appreciate OED's evaluation of the Regional Development Account (RDA) Project. Management acknowledges that the project did not meet its overall intentions and development objectives due to a multiplicity of factors that included issues of design, executing agency capacity and external factors such as the financial crises of 1997–1998. The project was originally designed to (i) improve long-term credit to local governments and enterprises to allow financing of locally initiated urban investments through support for the RDA as a revolving municipal facility and (ii) to promote financial and institutional autonomy of local governments.

2. While Management agrees that more comprehensive due diligence during the preparatory phase and improved project design may have yielded better results, in our opinion these factors only partially explain the project's overall performance. The role of external factors contributing to the project's sub-optimal results, such as the financial crises, the economic, political and social upheavals following the crises and decentralization is given insufficient attention in the assessment and evaluation report. We need to acknowledge and give due recognition to the fact that the project was approved just prior to the financial crises (1996) and implemented during one of the most difficult economic, fiscal and social periods in Indonesia.

3. Despite the challenges of project development and implementation in the post-crises and post-decentralization period in Indonesia, lessons drawn from the RDA project have fed into our urban sector operations in Indonesia. In recent years, following the decentralization and greater regional autonomy in the country, ADB has not been utilizing the approach of general credit lines for financing of municipal infrastructure. Lessons from the RDA combined with the many complex policy and implementation issues surrounding onlending and ongranting from central to local government levels has led to a shrinking of ADB's portfolio of large urban sector projects in Indonesia. More recent projects have adopted community-driven development (CDD) approaches for financing urban-based community infrastructure. This approach enables funds to be channeled directly to villages permitting better fund utilization, greater ownership and a higher degree of transparency. The CDD approach also enjoys high-level acceptance by both government and the beneficiaries.