I. Introduction and Context

Country Context

1. Indonesia is the fourth most populous country in the world and is rapidly urbanizing. In 1970, the country had a total population of approximately 117 million persons. Of this amount, nearly 20 million were classified as living in urban areas, 17.1 percent of the total population. Based on UN estimates (United Nations World Urbanization Prospects: The 2009 Revision, 2009), the country's total population in 2010 was estimated to be 233 million, of which 103 million reside in urban areas—44 percent of the population rate. Urbanization in Indonesia will continue to be rapid in absolute terms, over the next four decades, the country is expected to add 56 million persons to its urban areas; urban poverty is projected to surpass rural poverty by 2020. There is also a sizeable population that remains part of the rural agricultural sector but travels frequently to urban areas, often for extended stays, and lives in substandard conditions in peri-urban areas. This magnitude of demographic growth will pose significant challenges for central and local governments, especially in terms of the ability to provide adequate basic services under constrained budgets and capacities.

2. Urban poverty remains a serious problem. Despite substantial recovery in the aftermath of the Asian crisis and the recent economic crisis (the growth forecast for 2011 is 6.4% for 2011 and 6.3% in 2012), significant progress in various MDGs, and decreases in poverty levels (# from 17.4 percent in 2004 to 13.3 percent in 2010 # 31 million Indonesians still live below the national poverty line and there is a very large segment of the near-poor. Approximately 110 million Indonesians # or half of all households # live clustered around the national poverty line of $21 per month, remaining highly vulnerable to falling back into poverty. Moreover, inequality is increasing # over the last decade, the Gini coefficient has increased from 31.7 in 1999 to 35 in 2009 # and is higher in urban than in rural areas.

3. Access to services lag. Non-income poverty is also a serious problem and many Indonesians suffer acute deprivation of access to basic services. The proportion of the population with sustainable access to piped water supply has decreased from 36% in 2000 to 23% in 2009. The sanitation situation is even worse # only 2-3% of urban areas have access to sewerage connections, 18% still practice open defecation, while the majority relies on individual/shared toilets (with septic tanks/soak pits that are not treated and seep into the water table). Only 20% of waste is collected and transported to final disposal sites which are often not sanitary-open dumping (Road-map for Water Investments in Indonesia 2010-2015 (forthcoming)). In addition, although 84% of households have secure tenure either by owning or renting, the number of slum areas that have very few services and little security is increasing (UNDP, http://www.undp.or.id/pubs/docs/Let%20Speak%20Out%20for%20MDGs%20-%20EN.pdf).

Sectoral and Institutional Context
4. A nationwide CDD program. In August 2006, the Government of Indonesia launched the National Program for Community Empowerment (PNPM Mandiri). PNPM is the umbrella program that seeks to bring together all community driven poverty related initiatives in Indonesia so that the poor can benefit from improved socioeconomic and governance conditions. PNPM provides direct financial and technical support to poor communities to improve basic infrastructure and social services. Its focus is on empowering communities to make decisions about their investment needs and priorities. PNPM-Urban is designed on the premise that while many urban issues require larger infrastructure solutions (urban public transport, utility-supplied water, piped sewerage and storm drainage, urban roads), community-level infrastructure will better respond to community needs and do so at lower investment cost when it is planned and constructed by communities themselves. PNPM is the largest CDD program in the world, covering all urban wards (PNPM-Urban) and rural villages (PNPM-Rural) in Indonesia. However, PNPM is only one program under #cluster 2# of Indonesia#s 3-cluster strategy to address poverty (Cluster 1 focuses on stabilizing incomes through targeted poverty and social protection programs at the household level # e.g. the CCT program; cluster 2 promotes community level development and empowerment (PNPM-Urban, PNPM-Rural, RISE, PPiP, SPADA); and cluster 3 focuses on micro-level growth through programs that target micro-finance and support to SMEs. A cluster 4 is under discussions and could focus on slum upgrading) - only taken together can these programs reduce poverty.

5. Indonesia's National Strategy for Urban Development. The Government of Indonesia is in the process of preparing a National Urban Policy and Strategy (KSPN) with the objective of strengthening the role of urban development as part of the National Long Term Development Plan (RPJPN) and National Spatial Plan (RTRWN). It is a 15 year strategy that outlines the policies and strategies required for cities in Indonesia to develop as "socio-spatial entities", meaning that the city is viewed as a center of growth linked to other cities and surrounding regions, as well as enabling cities to become more competitive globally. The PNPM-Urban Program is directly aligned with the KSPN, especially its goals of: (a) increasing the role of cities as drivers of economic growth in local, regional and national contexts as well as improving people's welfare and living conditions and (b) improving the quality of urban governance to be more transparent, accountable, and participatory.

6. A long-term partnership with GOI. Alongside KDP in rural areas, UPP began in urban areas in 1999 as a response by the central government to the economic collapse and as a means of injecting resources directly to the poor in urban communities. The driving force for GOI's policy transition from UPP/KDP to PNPM was the desire to institutionalize the proven track record in bottom-up participatory planning into a single CDD-based poverty reduction program (The Presidential Decree stipulates that PNPM should be the umbrella program for all CDD based poverty reduction schemes operated by various ministries) and to expand it to national scale. The Bank has supported and partnered with the Government since the inception of the UPP program. The program now has nationwide coverage; in urban areas, coverage extends to all 11,000 urban wards and 22.3 million beneficiaries (MIS). Including the proposed loan, since 1999 total Bank lending for urban CDD programs in Indonesia would increase to $1.3 billion. Since UPP-1, the program has financed over 31,100 km of small roads, 8,800 km of drainage, rehabilitation of 126,800 houses of the poorest, 164,800 units of solid waste and sanitation facilities, and 9,450 health facilities (Based on the MIS as of August 31, 2011).

7. Strong rationale for continued Bank involvement. Over the last 12 years of the program, the Bank has partnered with GOI in understanding the evolving urban landscape and the needs of the urban poor vis-a-vis what the PNPM program can best deliver. The current PNPM-Urban IV presents an opportunity to build on this successful partnership between the Bank and GOI. The Bank's continued involvement in the program allows GOI to benefit from: (a) the technical expertise and global knowledge in areas such as urban upgrading and service provision, community-driven development (CDD), and disaster risk management (DRM); (b) effective, proven mechanisms to facilitate high quality management and oversight of the program, including project supervision and results monitoring and evaluation; (c) new ideas that push the envelope in terms of targeting the poorest and increasing the program's effectiveness; (d) strong governance controls and fiduciary oversight mechanisms; and (e) continued capacity building for national and local governments and communities to tackle issues facing the urban poor.

8. Addressing findings of previous evaluations. A recent (August 2010) impact evaluation of UPP-2 was carried out by DEC and provides some important insights. It found that UPP-2 had no discernable welfare impact for households in communities that received the program's block grants in terms of the per-capita consumption, access to credit, and impact on assets. Given the relatively modest amounts of per capita investments ($2.50-$5.00/person), this result is not altogether surprising. However, there was a significant decrease in the power of the lurah (village head) as a result of the project, particularly in the poorest areas, which is viewed as a positive impact, given the limited opportunities provided to communities in local decision making processes. This can, perhaps, be explained with the corresponding increase in community participation rates (in both control and treatment areas). The study also showed that access to sanitation increased three percentage points overall and 10 percentage points for the poorest quintile in UPP communities. In addition, access to finance was now more affordable with a two percentage point drop in interest rates for borrowers. Recipients of loans, moreover, tended to be the less affluent, women, and those more connected to the KSM - Kelompok Swadaya Masyarakat, or community group (It is unclear from the study whether this is because the recipients had greater knowledge of the revolving loan fund or because of connections). The study also raised some fundamental questions on governance, the role of facilitators, and links to the government, as these issues were not fully addressed in the evaluation.

9. These and other pertinent questions are being addressed through a study, A Strategic Review of Urban Poverty and Programs in Indonesia, being carried out by RAND which includes a process evaluation of PNPM-Urban. The process evaluation reviewed six key themes: (a) assessing community participation under CDD; (b) quality of infrastructure; (c) capacity building and effectiveness of the facilitators; (d) control mechanisms/governance, including audit functions and use of MIS data; (e) links with local government and sectoral programs; and (f) adequacy of the block grants. It also covered two cross-cutting issues: (a) assessing the Neighborhood Development program; and (b) MIS data quality.

10. The process evaluation found that overall, the program is doing fairly well in terms of achieving its objectives of elected community participation, capacity building and governance improvements (such as the occurrence of regular, well-attended community meetings, physical audits, and external monitoring), as well as in terms of the quality of small-scale infrastructure on the ground. Challenges include ensuring the sustainability of the program's outcomes and the need for improvements in data quality and management. The study also highlighted the importance of continued engagement with local governments and communities to ensure effective implementation and impact.
Relationship to CAS

16. The proposed project is central to the 2009-12 Country Partnership Strategy's (CPS) and the government's strategic priorities. The CPS's core engagement area on community development and social protection explicitly articulates the Bank's commitment to supporting the design and effective expansion of programs that promote more inclusive growth, including CDD programs under PNPM-Urban. The project builds on an ongoing partnership with the GOI that has committed to continuing the program at least through 2014.

II. Proposed Development Objective(s)

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17. The Fourth National Program for Community Empowerment in Urban Areas, PNPM-Urban IV, is a continuation and expansion of the ongoing PNPM-Urban I, II, and III projects. The overall development objective is to improve the living conditions and local governance of the urban poor.

Key Results

18. Key performance indicators include:
   # Kelurahanhs with improved access to infrastructure, economic and/or social services (percentage of total kelurahans receiving a grant);
   # Direct number of project beneficiaries by gender (number) and their satisfaction rates (percentage);
   # Resolution of complaints raised by community members (percentage);
   # Quality (percentage meeting government standards) and cost of infrastructure built compared to non-community procured and built (percentage); and
   # Local government participation in terms of financing (percentage of total cost)

III. Preliminary Description

Concept Description

Project components will include:

19. Component 1: Kelurahan Block Grants (BLM) ($182.5 million). This component would support block grants to kelurahans to support the community boards of trustees (BKM), the socialization process, the formation of the community development plans (CPD) based on which investments would be financed, and coordination of sectoral programs (channeling). CDP investments fall under three categories: (a) physical investments in tertiary infrastructure and community buildings; (b) revolving loan funds provided to the poor who typically do not have access to other sources (Because of the stringent performance requirements for revolving loan funds, few kelurahans qualify and it is expected that less than 2% of the total loan will go toward RLFs); and (c) social assistance, including training and housing rehabilitation, for the poorest. This component would also pilot specialized interventions for women's groups and for the poorest at the neighborhood level in selected areas, chosen in collaboration with local governments that commit to co-plan and co-finance investments with the community groups. The program will be targeted at areas with high population density, high poverty incidence, as well as areas that are disaster-prone, and/or requiring complex interventions.

20. Component 2: Capacity Building for Communities and Local Governments ($45 million). Similar to predecessor projects, this component would finance (i) government-hired facilitators (satker) to carry out social intermediation activities and community training in supporting BKM to develop and implement their CDPs; and (ii) training and capacity building of local governments (lurah and local government) to strengthen their support to PNPM. Specialized training programs will be developed for the lurah (village head) in each kelurahan (ward) as well officials at the kecamatan (sub-district), kabupaten (district), and kota (city) levels. At the kota level, deeper engagement with the mayors will be exploited and learning exchange between cities will be facilitated through a mayors' dialogue on PNPM-Urban. The focus will be on (i) channeling other local government poverty programs through the BKM and (ii) better aligning and incorporating the CDPs into the musrenbang process, i.e., the city's investment plans. In addition, BKM training would be focused on increasing capacity to take on the role of a coordinating and channeling body for all CDD-based poverty alleviation programs.

21. Component 3: Project Management Support ($22.5 million). This component would support the PMU with hiring consultants or service providers (NMC, OSPs, city coordinators, etc) to assist in project implementation. This arrangement would be evaluated and expanded to deal with the new features of the PNPM-Urban IV, especially the program targeted for the poorest areas. In addition, the component would continue to support monitoring and evaluation activities to ensure timely progress reports and annual evaluation reports for feedback to strengthen program implementation; activities could also support capacity building on M&E for the national government.

IV. Safeguard Policies that might apply

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