I. Project Context

Country Context

Indonesia’s poverty rate fell from 23.4 percent in 1999 to 12.5 percent in 2011, but 30 percent of the population hovers around the poverty line and remains vulnerable to falling into poverty. During the global financial crisis, Indonesia outperformed its regional neighbors in terms of economic performance, joining China and India as the only G20 members recording growth in 2009. In 2011, 12.5 percent of households (32.5 million Indonesians) lived below the national poverty line of IDR 233,700 per person per month (around PPP$1.19 per day). However, much of the population is clustered just above this line, and earns about PPP$2.37 per day. Thus living standards remain low for many Indonesians, and relatively small shocks to income and consumption can send them into poverty.

Of the total population living in poverty, 65 percent live in rural areas. Income and employment opportunities in these rural areas remain constrained or non-existent and the rate of coverage and quality of basic services is poor. The rate of incidence of poverty in rural areas is 15.1 percent, compared to 8.8 percent in urban areas. Regional disparities are also pronounced in the rural areas, with the gap between socio-economic development on and off Java apparently widening. Non-income poverty, as demonstrated by the level of access to and the quality of health and education services, continues to be a serious problem.

Service provision and effective local governance are lagging. The reforms following the 1997 Asian financial crisis, including the move from a centralized to a decentralized form of government were expected to lead to improved service provision and to more effective local governance. While recent history has shown a positive trend in terms of economic and political achievements, the transition remains incomplete and the reform process has started to slow. Many of the country’s institutions and local governments are not effective at delivering services in an accountable manner. These shortcomings often prevent the poorest members of society from benefiting more fully from growth and poverty reduction initiatives and risk increasing overall inequality and instability in the long-term.

II. Sectoral and Institutional Context

PNPM: A nationwide CDD program. In 2007 the Government of Indonesia (GOI) demonstrated its commitment to community-led development and to mitigating the potential effects of the Global Financial Crisis by launching the National Program for Community Empowerment (Program Nasional Pemberdayaan Masyarakat, PNPM) through the scale up of the Kecamatan Development Project (KDP) and the Urban Poverty Project (UPP). The coverage of the program in rural areas increased rapidly, from approximately 1,000 sub-districts in 2006 to more than 5,000 sub-districts in 2011. At present the program covers all rural villages (PNPM-Rural) and urban wards (PNPM-Urban) in Indonesia and is one of the largest community-driven development (CDD) programs in the world. When PNPM was launched it integrated a multitude of community level poverty initiatives into a coherent poverty alleviation and governance approach at community level. PNPM is the flagship program under ‘Cluster 2’ of the GOI’s three-cluster poverty reduction strategy. The program seeks to empower communities by giving them control over decision-making and management of their development needs through direct financial and technical support to improve basic infrastructure and access to services.

The core PNPM program now covers 70,000 villages and continues to perform well despite some of the implementation challenges that the program has faced in its rapid scale up to national coverage in 2008. Several peer-reviewed quantitative assessments have demonstrated significant impact in terms of effective, attributable poverty reduction. The main findings confirm that: (a) benefits are heavily skewed to the poor - the two lowest quintiles of the participating population receive the largest share of project benefits; (b) benefits are significant - household expenditures among the poor increased by an average of 11 percent as a result of project investments, benefitting approximately 45 million poor people; (c) benefits are sustained, physical assessments of PNPM/KDP built infrastructure found that 85 percent of the infrastructure built by communities was in good to very good condition five years after its completion, and impact simulations found that after three years the majority of benefits came from increased economic activity attributable to the investments made by the program, not from project grants; (d) benefits are shared - labor composition in PNPM programs averages 40-70 percent (which is on the high end of global measurements). PNPM created over...
20 million person-days of paid employment, and PNPM’s focus on financing public rather than private goods ensures that investments benefit a broad range of poor people; (e) investments are efficient - infrastructure built by communities is 30-50 percent cheaper than building it through normal government systems; and (f) adverse impacts are minimal - a resettlement review of 50 percent of the participating districts found no cases of adverse impacts from involuntary resettlement. Reviews also found no examples of adverse impacts associated with ethnic minorities. Environmental impacts are largely confined to poor site management.

More remains to be done, however. There is little sign of PNPM’s participatory planning and improved governance procedures being adopted into the working of Local Governments or in front line sector service delivery. PNPM’s high rates of women’s participation (48%) in particular did not turn into changed roles for women in other programs. In addition, impact evaluations found diminishing returns to PNPM investments in wealthier sub-districts, where access to services is more likely the binding constraint than lack of tertiary infrastructure. Furthermore, PNPM’s revolving loans to women’s groups, which account for approximately 20 percent of the program, are not sustainable in the long-term.

The massive scaling-up of PNPM presents major institutional challenges. The implementing agency, Directorate General of Village and Community Empowerment (PMD), within the Ministry of Home Affairs (MOHA), has not yet fully adjusted to the program’s massive scale-up over a short period of time. Basic processes of recruitment, training, and site visits have struggled to cope with a sudden tripling or even quintupling of the number of staff who need to be trained, deployed, and reviewed. While hands-on implementation support to PMD has helped mitigate governance and fiduciary risks and build more robust management systems, continuous attention to the quality of project management is required.

Including the proposed loan, total Bank lending for the rural KDP/PNPM program since 1998 will amount to almost US$3.5 billion. Since the first implementation of KDP, the program has financed the construction of more than 100,000 km of rural roads; 17,000 small bridges; 40,000 clean water systems; and the rehabilitation or construction of 43,000 schools and health facilities. It has also supported more than 301,000 business activities conducted by women.

In addition to investment lending, the Bank supports Indonesia’s community based poverty program by managing a multi donor support facility that provides technical assistance and strategic inputs to PNPM. The PNPM Support Facility (PSF) focuses on improving the quality of the delivery of PNPM as well as providing flexible capacity to test innovative demand side approaches to poverty reduction and service delivery. The facility now also focuses particularly on building the capacities of Government and Civil Society Organizations (CSOs) to take on more of its role. Grant funding provided through the PSF is used to build Indonesian capacity for large-scale poverty reduction, with the aim of making the program a sustainable operation. Capacity building programs supported by the facility engage a broad range of partners, including national and local governments, universities and research centers, CSOs and grassroots initiatives. Grant funding also supports a number of innovative pilot operations, including:

(a) PNPM Generasi. PNPM Generasi is a community-based CCT program that uses performance-based block grants to increase community utilization of basic health and education services and promote closer interaction between community groups and front-line service providers. An impact evaluation shows significant impact on twelve education and health target outcomes.

(b) PNPM Green. PNPM Green is an environmental pilot program for PNPM-Rural that utilizes block grants and technical assistance to promote community investments in renewable energy and natural resource management. The program is moving from a focus on financing inputs in the form of specific green sub-projects towards incentivizing results and addressing the overall village development process, placing particular importance on participative natural resource mapping, and planning local green growth strategies.

(c) Local Government Capacity Development. This program tests the effectiveness of social accountability processes and tools (‘soft’ incentives) to improve local government responsiveness in community-level service delivery. The Local Government Capacity Development (LGCD) is a coordinated program of analytics, TA and small-scale field experiments that explores how to further strengthen PNPM as a platform which supports collaboration between communities, local governments and sectors to address governance and service delivery gaps at the district level. The LGCD program will begin testing a number of practical approaches and tools, ranging from community scorecards to toolkits for pro-poor budgeting, and continue to sponsor a multi-stakeholder dialogue on how community institutions can more effectively engage with supply-side decision making.

(d) PNPM Peduli. The program, recognizing the findings of impact evaluations that PNPM’s broad brush approach was not reaching marginalized groups and individuals, works through CSOs to further social inclusion principles through CSO engagement. The program works through national CSOs that are awarded grants to reach and empower the most marginalized, including street children, landless farmers, HIV and AIDS survivors, sex workers, indigenous peoples and many others.

Moving forward, the Government is in the final stages of a wide ranging consultation process to articulate the roadmap for PNPM up to the end of the current administration in 2014 and beyond. The Roadmap is one, ultimately, of integrating the operating principles of PNPM into regular government operations, thus strengthening accountability mechanisms at the community level, above and beyond the sphere of the program itself. There are interim twin goals of strengthening the program’s integration both horizontally (among PNPM projects and with sectoral programs) and vertically (with sub-national governments), though details of how and in what way this would be sequenced remain to be elaborated. Related to this, a potential future is outlined in which there may only be a single ‘PNPM’ budget instrument, but it may be flexible enough to allow for different types of funding sources and development outcomes. Action areas currently described in the Roadmap include:

(a) effective integration of PNPM programs at the local level; (b) strengthening the roles and capacity of PNPM facilitators, including their linkage with sector agencies; (c) strengthening the capacity of local level institutions and clarification of the legal framework; (d) adoption of core PNPM principles in the functioning of local government, including the integration of development planning and budgeting; and (e) good governance and downward accountability.

The Bank’s analytical and operational portfolio supports the implementation of the Government’s Roadmap. Particular attention goes to:

(a) Continued poverty impact: Now that the program is at national scale, the challenge increasingly is to make sure that the program achieves its objectives for as many people as possible and at reasonable cost. Another important issue is maximizing impacts of PNPM’s block grant investments, through for example, varying the size of block grants based on criteria that capture the multidimensionality of poverty and incentivizing communities to utilize basic services. Key focal areas include: (i) customizing/differentiating PNPM’s platform to maximize impact on specific poverty priorities, adjusting for different needs, priorities, capacities; (ii) leveraging the impact of Indonesia’s social protection programs through stronger linkages with its community empowerment programs; and (iii) building on the revolving loan funds scheme in PNPM to enhance support to livelihoods.
(b) Improved accountability: While significant reforms and decentralization have taken place in Indonesia, a relationship of generalized trust between citizens and reliable, responsive institutions of the state remains somewhat embryonic. At present, PNPM provides one of the few platforms at the village level for information sharing, collection of complaints and grievances, bottom-up reporting, and a direct interface between communities and frontline services providers through PNPM Generasi. Key focal areas include: (i) rebalancing asymmetries of information including via innovative ICT tools; (ii) identifying incentives and roles for both communities and service providers in the co-production/co-delivery of services; and (iii) testing and scaling up effective mechanisms to improve local level governance, foster better downward accountability and transparency, including channels for recourse and grievance redressal.

(c) Social justice and inclusion: These are essential dimensions of any poverty reduction effort, so that resulting benefits are sustainably distributed and basic rights are realized, ironing out the socioeconomic disadvantages of particular groups. Better articulation of social dynamics and the dimensions of exclusion at the local level, and testing of effective operational instruments to respond, whether through adjustments to a program such as PNPM, or via other modalities, will be needed to overcome patterns of exclusion and to create greater opportunities for participation of the most vulnerable in development processes. Key focal areas include: (i) supporting reforms that promote inclusion and empowerment of marginalized groups; (ii) improving targeting to address the needs (institutional, social, financial) of poor rural women; and (iii) improving PNPM’s effectiveness in Indonesia’s most disadvantaged and poorest regions.

(d) A supportive enabling environment: This encompasses primarily (though not exclusively) the role of government in providing resources, ensuring capacities and creating a policy, regulatory and administrative environment conducive to the goals of the Government’s PNPM Roadmap. While community empowerment can increase demand for (and, to some extent, delivery of) better services and governance, it needs complementary efforts to foster a supporting and enabling environment, with adequate core systems, financing and accountable institutions. Key focal areas include: (i) identifying critical local level institutional arrangements that underpin sustainable local development and good governance to support the proposed reforms; (ii) investing in PNPM core functions and systems; and (iii) identifying regulatory constraints and/or necessary policies to further consolidate community empowerment and its linkages to ensure improved budgeting, planning and implementation processes.

III. Project Development Objectives
11. The PDO for the proposed project is: For villagers in PNPM-Rural locations to benefit from improved local governance and socio-economic conditions.

IV. Project Description

Component Name
Kecamatan Grants
Community Empowerment and Facilitation
Implementation Support and Technical Assistance

V. Financing (in USD Million)

<table>
<thead>
<tr>
<th>Component Name</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>For Loans/Credits/Others</td>
<td></td>
</tr>
<tr>
<td>Borrower</td>
<td>3850.00</td>
</tr>
<tr>
<td>International Bank for Reconstruction and Development</td>
<td>650.00</td>
</tr>
<tr>
<td>Total</td>
<td>4500.00</td>
</tr>
</tbody>
</table>

VI. Implementation
Institutional and implementation arrangements for PNPM-Rural 2012-2014 build on successful elements of the existing structure of PNPM-Rural. PNPM-Rural implementation occurs across five levels: the national, provincial, district, sub-district, and village levels. A Joint Secretariat is being established at national level that will facilitate the better integration of the management of the different PNPM programs, including PNPM-Rural, PNPM Generasi, and PNPM Green. The Secretariat will operate under PMD.

Responsibility for project implementation will remain with the Directorate for Village and Community Empowerment (PMD), under MOHA. PMD will continue to be supported through the deployment of a combination of National Management Consultants (NMC), Regional Management Consultants (RMC) and field-based facilitators. Once proposed investments are identified by the communities, these communities become responsible for implementation and oversight. Guidelines for project implementation are detailed in the Operations Manual (OM), which is continuously updated to a format that meets the Bank’s standards and requirements. A more user-friendly manual will be prepared at the end of the preparation for PNPM 2012-2014.

VII. Safeguard Policies (including public consultation)

<table>
<thead>
<tr>
<th>Safeguard Policies Triggered by the Project</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental Assessment OP/BP 4.01</td>
<td>✗</td>
<td></td>
</tr>
<tr>
<td>Natural Habitats OP/BP 4.04</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Forests OP/BP 4.36</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Pest Management OP 4.09</td>
<td></td>
<td>✗</td>
</tr>
<tr>
<td>Physical Cultural Resources OP/BP 4.11</td>
<td></td>
<td>✗</td>
</tr>
</tbody>
</table>
Indigenous Peoples OP/BP 4.10
Involuntary Resettlement OP/BP 4.12
Safety of Dams OP/BP 4.37
Projects on International Waterways OP/BP 7.50
Projects in Disputed Areas OP/BP 7.60

VIII. Contact point

World Bank
Contact: Susanne Holste
Title: Lead Social Development Specialist
Tel: 62-21-314-81
Email: sholste@worldbank.org

Borrower/Client/Recipient
Name: Government of Indonesia
Contact: Rahmat Waluyanto
Title: Director General for Debt Management, Ministry of Finance
Tel: 62-21-3841067
Email: rwaluyanto@dmo.or.id

Implementing Agencies
Name: DG Community and Village Empowerment, Ministry of Home Affairs (MOHA)
Contact: Tarmizi Karim
Title: Director General
Tel: (62-21) 794-2373
Email: ppkpmd@yahoo.com

IX. For more information contact:
The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop