

PL-ARA-015

XD

62750

A.I.D. EVALUATION SUMMARY - PART I

- 1. BEFORE FILLING OUT THIS FORM, READ THE ATTACHED INSTRUCTIONS.
- 2. USE LETTER QUALITY TYPE, NOT "DOT MATRIX" TYPE.

IDENTIFICATION DATA					
A. Reporting A.I.D. Unit: Mission or AID/W Office (ES# _____) <u>EPSO/Indonesia</u>		B. Was Evaluation Scheduled in Current FY Annual Evaluation Plan? Yes <input checked="" type="checkbox"/> Slipped <input type="checkbox"/> Ad Hoc <input type="checkbox"/> Evaluation Plan Submission Date: FY _____ Q _____		C. Evaluation Timing Interim <input checked="" type="checkbox"/> Final <input type="checkbox"/> Ex Post <input type="checkbox"/> Other <input type="checkbox"/>	
D. Activity or Activities Evaluated (Use the following information for project(s) or program(s) evaluated; if not applicable, list title and date of the evaluation report.)					
Project No.	Project /Program Title	First PROAG or Equivalent (FY)	Most Recent PACD (Mo/Yr)	Planned LOP Cost (000)	Amount Obligated to Date (000)
497-0357	Agriculture and Rural Sector Support	1987	11/90	63,000,000	43,000,000

ACTIONS			
E. Action Decisions Approved By Mission or AID/W Office Director Action(s) Required	Name of Officer Responsible for Action	Date Action to be Completed	
1. Cease use of the additionality formula as a criteria for ARSSP disbursements (AID)	D.N. Merrill	4/1/89	
2. Develop a negative list of appropriate uses of ARSSP funds for GOI guidance in their project budgeting (AID)	Paul Scott	2/1/89	
3. Develop a GOI reporting system that reflects activities undertaken under the ARSSP agenda items (joint)	P. Gajewski	4/1/89	
4. To the extent feasible, begin targeting ARSSP support according to evaluation recommendations, beginning with IFY 89/90 (joint)	P. Gajewski	4/1/89	
5. Proceed with amendment to ARSSP to add more funds and operate through IFY 90/91 (AID): - develop new policy agenda for ARSSP amendment (granted) - allocate IFY 90/91 funds using the targeting approach (joint)	D.N. Merrill	8/31/89	
6. Develop a special fund to support innovative activities related to policy analysis, formulation and implementation (joint)	P. Gajewski	4/1/89	

APPROVALS			
F. Date Of Mission Or AID/W Office Review Of Evaluation:		(Month)	(Day) (Year)

G. Approvals of Evaluation Summary And Action Decisions:				
Name (Typed)	Project/Program Officer	Representative of Borrower/Grantor	Evaluation Officer	Mission or AID/W Office Director
	M. Hammett	M. L. ...	N. Greeley	D.N. Merrill
Signature				
Date	10/17/89		2/25/89	10/17/89

- a'

A B S T R A C T

H. Evaluation Abstract (Do not exceed the space provided)

The project aims to provide budget support to key ministries of the Government of Indonesia (GOI) which are active in the agriculture and rural sector policy reform process. This mid-term evaluation was conducted by a USAID/I team on the basis of a review of project documents and interviews with officials of the GOI, USAID, and other donors concerned with ARSSP, Indonesian rural policy, or both. The purpose was to assess progress to this point regarding project implementation and management, and to set priorities for future activities. The evaluation was organized into three main areas: 1- the policy agenda, and progress towards achieving the goals set forth in it; 2- disbursement and monitoring of ARSSP budget support; and 3- USAID management of the ARSSP program.

It was concluded that progress on the policy agenda exceeded expectations held at the time the program was conceived. Some of the agenda items had been completely met (i.e., pesticide subsidy elimination and transport licensing). Some of the agenda items had been partially met (i.e., fertilizer subsidy reductions, agricultural input pricing, investment licensing, and insurance licensing). On some items progress was less impressive (i.e., pension legislation and international trade regulation). However, taken as a package (as ARSSP is intended), the GOI's progress was very positive and merits continued support.

Disbursement of ARSSP budget support funds was found to be uneven and unduly hampered by cumbersome requirements to satisfy the desire to ensure additionality of ARSSP funds to the GOI budget. In some cases it was found that the uneven flow of ARSSP funds caused serious disruptions in GOI agency operations. The evaluation concluded that the formula used to assess additionality should not be used in the future.

Management of ARSSP was found not to be less staff intensive than other modes of assistance. Reduction in staff-intensity was due to delays in bringing staff on-board, rather than reduced need for staff. In the future, as ARSSP staff become more involved in the policy dialogue that underpins ARSSP, staff requirements will increase. It is recommended that an additional position be added to the ARSSP staff for program and budget monitoring.

The evaluation concluded that ARSSP should be amended, responding to the recommendations of the evaluation, increasing funding and extending the PACD to March 31, 1992

C O S T S

I. Evaluation Costs

1. Evaluation Team		Contract Number OR TDY Person Days	Contract Cost OR TDY Cost (U.S. \$)	Source of Funds
Name	Affiliation			
Chris Hermann	USAID/W	25		
Gladys Nott	Consultant	25	14,978	ARSSP TA
Steve Tabor	Consultant	25	15,736	ARSSP TA
2. Mission/Office Professional Staff Person-Days (Estimate) _____		3. Borrower/Grantee Professional Staff Person-Days (Estimate) _____		
_____ 25 _____		_____ 15 _____		

b'

A.I.D. EVALUATION SUMMARY - PART II

S U M M A R Y

J. Summary of Evaluation Findings, Conclusions and Recommendations (Try not to exceed the three (3) pages provided)

Address the following items:

- | | |
|--|--|
| <ul style="list-style-type: none"> • Purpose of evaluation and methodology used • Purpose of activity(ies) evaluated • Findings and conclusions (relate to questions) | <ul style="list-style-type: none"> • Principal recommendations • Lessons learned |
|--|--|

Mission or Office:

Date This Summary Prepared:

Title And Date Of Full Evaluation Report:

Purpose of the evaluation and methodology used

The midterm evaluation was undertaken to assess progress of the ARSSP program to provide guidance on future activities under the program. It was felt by USAID/Indonesia that a midterm evaluation was essential because the type of assistance represented by ARSSP is unique to the mission and to the region. Therefore, it was anticipated that a midterm report could provide valuable input into ongoing program activities and into the decision whether or not to amend the program for the future.

Information for the evaluation was gleaned from interviews with USAID, GOI, and other donor personnel, and from a review of the program files and other documents relevant to the program.

Findings and conclusions

- Though there were intentionally no conditionality provisions in this program, the Government of Indonesia's progress on the ARSSP policy agenda has been far greater than was expected for this point in the program. For some items (e.g., pesticide and fertilizer subsidy reductions, inter-insular transport deregulation, banking reform, etc.) policy reforms have surpassed expectations, while for other items reform progress has been less rapid. However, it is clear that overall progress on policy reform has exceeded AID's expectations at the outset of ARSSP.

- It is impossible to prove a causal relationship between AID assistance through ARSSP and policy reform; however, the negotiation of the policy agenda and AID commitments to use of ARSSP funds to finance the implementation of such reforms imply that an important link has been established. Though much remains to be done in the area of agricultural and financial sector policy, ARSSP has contributed to the policy reform process by:

a) providing key officials with resources to support policy research, analysis, and review which reportedly generated reform proposals and helped broaden the consensus for policy change;

S U M M A R Y (Continued)

b) financing study tours to provide exposure to alternative policy regimes;

c) providing support for the start-up of the Integrated Pest Management program as an alternative to high-pesticide use crop management;

d) financing technical research on key areas such as fertilizer response, to support adjustments in agricultural input pricing policy; and

e) filling a niche in donor program assistance by focusing attention on agricultural incentive issues.

- Formulation of the ARSSP agenda raised the level of policy dialogue between the GOI and AID to focus on sectoral or sub-sectoral issues -- a considerably higher level than the previous focus of discussions. Project experience, existing analytic work in some areas, and credibility with the GOI contributed to formulation of the agenda.

- The policy agenda items are of varying importance, utility, and precision. Future policy agenda items should be developed carefully and focused on specific areas of interest, while maintaining the broad "menu" approach to setting the agenda that permits activities in more than one sector of the economy.

- Initially, ARSSP was to provide short-term "bridging" support to the development budget to tide the Government over during a period of budgetary shortfall as they implemented their subsidy reduction and revenue mobilization measures. AID applied budget support to the budgets of agencies AID considered important to its project portfolio. It was not intended that these funds be used for policy support; rather as support to the development budget, which served in turn as part of a general multi-donor effort to support the policy reform process. What AID discovered during implementation was that it was possible to use a portion of the budget support funds to assist implementation of the policy changes decided upon by the Government. The team believes that such "targeted budget support" is the best and highest use of budget support, and that it should constitute the bulk, if not all, of such uses of AID-provided funds in future program assistance. Accordingly, the GOI's programming of ARSSP budget support should increasingly focus on activities that directly pertain to the objectives of the program. Further, active AID participation in the identification and proposal of GOI programming options to advance policy and institutional reforms in the agriculture and financial sectors is recommended to the extent it can be appropriately done.

S U M M A R Y (Continued)

- The team finds that the Mission's effort to ensure "additionality" of support to selected agencies vis-a-vis fluctuations in the Government's development budget as a whole, while well intentioned, is impossible to achieve, a waste of time and effort, and should be abandoned.
- The team concludes that the common view that D.A. sector program assistance requires relatively less staff per dollar than project assistance is greatly exaggerated. To be effective in facilitating policy change, D.A. sector program assistance requires nearly as much staff, if not as much, as project assistance. It was over-optimistic to think that there were relatively lighter policy analysis or budget monitoring requirements. Accordingly, ARSSP was understaffed until recently. What is true, however, is that the mix of skills required changes and that more J.C.C.-type policy analysts in addition to USDH are needed. At the same time USDH and FSNDH are also needed to manage the program and give direction to the policy dialogue. The team recommends that one additional person with an accounting and information systems background be hired.
- As ARSSP cuts across various Mission offices, the role of each office in policy analysis, support to ARSSP agenda items from projects, program administration, and contribution to an ARSSP information management system needs to be formalized and clarified. ARSSP will not work except as a team effort that includes many offices.
- The team finds that project assistance remains essential for effective program assistance; that projects alone are an insufficient source of analysis needed for policy based program assistance because program assistance has its own policy analysis requirements; and that targeted program assistance fills a niche in the Mission's program instruments because it is able to do some important things differently and more quickly than project assistance.
- The Mission finds itself in a tricky area between pure program assistance (cash grant or C.I.P.) and project assistance, and the recommendations of this evaluation to move toward "targeted budget support" take it slightly nearer to the project mode. Even though this area has difficulties in terms of the program-project spectrum and in terms of accountability (projects are tighter), it also has the potential to make a contribution to policy implementation that, dollar-for-dollar, could well be greater than other donors' program assistance. AID would be the only donor with this kind of fund for financing policy implementation costs, and the implementation costs in any event are more commensurate with the amount of money AID has available, in contrast to the sizeable contribution to the budget that comes from other donors' program aid.

S U M M A R Y (Continued)

- ARSSP has laid a sound basis for continued AID support of the policy reform process. This support should build upon the successes of early ARSSP implementation. Continued support in the area of policy reform for agriculture and finance is warranted because of:

a) the demonstrated sincerity of Government to forge ahead with reform;

b) the continuing severe external economic environment necessitating rapid adjustment, and

c) the continuing need to reform policy in order to eliminate disincentives to efficient growth and development.

Thus, the evaluation team recommends an amendment to ARSSP, responding to the recommendations of the evaluation, increasing funding, and extending the PACD to March 31, 1992.

- Please note that this summary highlights primarily the findings and recommendations of interest to the audience following ARSSP as one case study in D.A. sector program assistance. Several other important observations and recommendations pertaining to ARSSP are contained in the body of the report.

Principal recommendations

Principal recommendations of the evaluation are:

- The program should be amended to add new money and extend the life of the program one additional year.
- The additionality formula should be eliminated as a criterion for disbursement.
- Future ARSSP support should be targeted to activities that are directly related to the policy agenda.
- The policy agenda should be updated to account for past accomplishments and changing priorities.
- The EPSO office should add one additional staff to help manage ARSSP.
- Because of the nature of GOI accounting procedures, a list of items whose acquisition with AID-provided funds is not permitted by U.S. law or USAID policy should be conveyed to the GOI.
- A special fund should be established within ARSSP to facilitate fast-turnaround technical assistance for policy analysis and/or policy implementation.

Lessons learned

Principal lessons learned include:

- GOI accounting procedures require that foreign donor funds be traceable to their ultimate expenditure. Thus, generic budget support is not possible in Indonesia.
- Focusing on budget performance of the GOI to ascertain whether or not ARSSP support is "additional" to GOI support, needlessly diverts attention from the more fundamental questions of policy reform.
- Assuming that program assistance through ARSSP would be less staff-intensive than traditional project assistance was over-optimistic.
- Program assistance, such as ARSSP, forces USAID-GOI dialogue to a level not generally observed otherwise. Government policies with broad general impacts are necessarily on the table for discussion.
- USAID must play an important role in determining what GOI activities will be supported by ARSSP. General budget support, even when focused on selected agencies, cannot be expected to be allocated most advantageously absent some degree of USAID collaboration on allocation decisions.

g

ATTACHMENTS

K. Attachments (List attachments submitted with this Evaluation Summary; always attach copy of full evaluation report, even if one was submitted earlier; attach studies, surveys, etc., from "on-going" evaluation, if relevant to the evaluation report.)

Full evaluation report

COMMENTS

L. Comments By Mission, AID/W Office and Borrower/Grantee On Full Report

To a very large degree, the mission has accepted the recommendations of the evaluation team and has proceeded to refine the ARSSP program in line with those recommendations.

- In planning for IFY 1989/90, the mission and the GOI have agreed to eliminate use of the additionality formula and to focus ARSSP funding more directly upon activities specifically related to the ARSSP policy agenda.
- Though the evaluation recommended that ARSSP activities be kept within the Ministries of Finance and Agriculture, the mission has agreed to include the Central Bureau of Statistics in the program for IFY 89/90 since reliable statistics are considered essential to quality policy analysis.
- AID has undertaken to initiate and to participate actively in dialogue with the GOI on policy reform for the agriculture and rural sectors, both within the framework of future ARSSP activities and in the more general sense of what we can agree is needed to be done.
- The technical assistance portion of ARSSP is being used to support a policy analysis support team in the Ministry of Agriculture, and several short term consultants to examine particular aspects of the policy agenda and implementation thereof.
- Within the mission, the EPSO office has begun a major effort to coordinate the activities of policy analysts throughout the mission and to clarify their roles in the policy monitoring process.
- The EPSO office is in the process of better organizing responsibilities for program management and monitoring.
- Permissible uses of ARSSP funds have been made clear to the GOI by providing them a list of items which may not be purchased with USAID grant funds, and by ensuring that all purchases conform to Government regulations pertaining to foreign donor assistance.
- For IFY 1989/90 a special fund has been set aside under ARSSP to provide the capability for special short term projects to support policy initiatives as agreed upon mutually between USAID and the GOI.
- The mission and the GOI have begun the process of preparing an amendment for ARSSP for IFY 1990/91, including discussions on an updated policy agenda.

AGRICULTURE AND RURAL SECTOR SUPPORT PROGRAM
(497-0357)

INTERIM EVALUATION

February 24, 1989

Evaluation Team:

Steve Tabor
Economist/Consultant

Gladys A. Nott
Social Scientist/Consultant

Chris Hermann
U.S. Agency for International Development
ANE/DP/E Team Leader

The cooperation and assistance of numerous officials in Bappenas, the Ministry of Agriculture, Bulog, the Department of Trade, Ministry of Finance and USAID is gratefully acknowledged. Special thanks are also extended to the representatives of major donor agencies for providing information on ongoing and planned special assistance efforts.

Table of Contents

Executive Summary

Acronyms

1.	Introduction: Description and Current Status of the Agriculture and Rural Sector Support Program	1
2.	Development of ARSSP's Program Mode of Assistance	3
2.1	Introduction	3
2.2	Factors Leading to the Program Mode of Assistance	3
	- Findings	3
	- Conclusions	5
	- Recommendations	5
2.3	Formulating ARSSP's Initial Agenda	5
	- Findings	5
	- Conclusions	7
	- Recommendations	7
2.4	Developing the Budget Support Mechanism	8
	- Findings	8
	- Conclusions	9
	- Recommendations	9
2.5	Relationship of Budget Support to the Policy Agenda	9
	- Findings	9
	- Conclusions	10
	- Recommendations	11
3.	Progress Toward ARSSP Policy Objectives	12
3.1	Indonesia's Structural Adjustment Program	12
	- Findings	12
3.2	Progress in Meeting ARSSP Policy Milestones	15
3.2.1	Agricultural Diversification	15
	- Findings	15
	- Conclusions: The Importance of Recent Agricultural Policy Reforms	20
3.2.2	Domestic Resource Mobilization Objective	21
	- Findings	21
	- Conclusions: The Importance of Resource Mobilization Reforms	24
3.2.3	Institutional Change Objective	26
	- Findings	26
	- Conclusions: The Importance of the Institutional Reforms	28
	- Recommendations	29
3.3	Future A.I.D. Strategy	31
	- Findings	31
	- Conclusions	33
	- Recommendations	33

4.	ARSSP's Budget Support	35
4.1	Budget Support Activities	35
	- Findings	35
	- Conclusions	38
	- Recommendations	38
4.2	ARSSP Implementation and Financial Monitoring	39
	- Findings	39
	- Conclusions	44
	- Recommendations	46
4.3	Technical Assistance	47
	- Findings	47
	- Conclusions	47
	- Recommendations	47
5.	ARSSP Management Requirements	48
5.1	Introduction	48
5.2	The Management Requirements of ARSSP in Comparison with Other Modes of Development Assistance	48
	- Findings	48
	- Conclusions	50
	- Recommendations	51
5.3	The Organization, Staffing, and Management of ARSSP- Related Efforts within the Mission, by the GOI, and Coordination with Other Donors	52
	- Findings	52
	- Conclusions	54
	- Recommendations	55
5.4	Usefulness of the Policy Agenda for Monitoring and Evaluation	56
	- Findings	56
	- Conclusions	57
	- Recommendations	57
5.5	Development and Implementation of a Management Information System for ARSSP	58
	- Findings	58
	- Conclusions	60
	- Recommendations	60
5.6	ARSSP's Effect on the Pipeline	61
	- Findings	61
	- Conclusions	61
	- Recommendations	61
5.7	The Relative Merits of ARSSP as a Mode of Development Assistance	61
	- Findings	61
	- Conclusions	62
	- Recommendations	62
6.	ARSSP Amendment	63

Annex I	ARSSP Policy Agenda
Annex II	Special Studies Financed Under ARSSP
Annex III	Additionality Analysis
Annex IV	References
Annex V	Scope of Work

K

SUMMARY OF FINDINGS

1. Though there were intentionally no conditionality provisions in this program, the Government of Indonesia's progress on the ARSSP policy agenda has been far greater than was expected for this point in the program. For some items (e.g., pesticide and fertilizer subsidy reductions, inter-insular transport deregulation, banking reform, etc.) policy reforms have surpassed expectations, while for other items reform progress has been less rapid. However, it is clear that overall progress on policy reform has exceeded AID's expectations at the outset of ARSSP.
2. It is impossible to prove a causal relationship between AID assistance through ARSSP and policy reform; however, the negotiation of the policy agenda and AID commitments to use of ARSSP funds to finance the implementation of such reforms imply that an important link has been established. Though much remains to be done in the area of agricultural and financial sector policy, ARSSP has contributed to the policy reform process by:
 - a) providing key officials with resources to support policy research, analysis, and review which reportedly generated reform proposals and helped broaden the consensus for policy change;
 - b) financing study tours to provide exposure to alternative policy regimes;
 - c) providing support for the start-up of the Integrated Pest Management program as an alternative to high-pesticide use crop management;
 - d) financing technical research on key areas such as fertilizer response, to support adjustments in agricultural input pricing policy; and
 - e) filling a niche in donor program assistance by focusing attention on agricultural incentive issues.
3. Formulation of the ARSSP agenda raised the level of policy dialogue between the GOI and AID to focus on sectoral or sub-sectoral issues -- a considerably higher level than the previous focus of discussions. Project experience, existing analytic work in some areas, and credibility with the GOI contributed to formulation of the agenda.
4. The policy agenda items are of varying importance, utility, and precision. Future policy agenda items should be developed carefully and focused on specific areas of interest, while maintaining the broad "menu" approach to setting the agenda that permits activities in more than one sector of the economy.

✓

5. Initially, ARSSP was to provide short-term "bridging" support to the development budget to tide the Government over during a period of budgetary shortfall as they implemented their subsidy reduction and revenue mobilization measures. AID applied budget support to the budgets of agencies AID considered important to its project portfolio. It was not intended that these funds be used for policy support; rather as support to the development budget, which served in turn as part of a general multi-donor effort to support the policy reform process. What AID discovered during implementation was that it was possible to use a portion of the budget support funds to assist implementation of the policy changes decided upon by the Government. The team believes that such "targeted budget support" is the best and highest use of budget support, and that it should constitute the bulk, if not all, of such uses of AID-provided funds in future program assistance. Accordingly, the GOI's programming of ARSSP budget support should increasingly focus on activities that directly pertain to the objectives of the program. Further, active AID participation in the identification and proposal of GOI programming options to advance policy and institutional reforms in the agriculture and financial sectors is recommended to the extent it can be appropriately done.

6. The team finds that the Mission's effort to ensure "additionality" of support to selected agencies vis-a-vis fluctuations in the Government's development budget as a whole, while well intentioned, is impossible to achieve, a waste of time and effort, and should be abandoned.

7. The team concludes that the common view that D.A. sector program assistance requires relatively less staff per dollar than project assistance is greatly exaggerated. To be effective in facilitating policy change, D.A. sector program assistance requires nearly as much staff, if not as much, as project assistance. It was over-optimistic to think that there were relatively lighter policy analysis or budget monitoring requirements. Accordingly, ARSSP was understaffed until recently. What is true, however, is that the mix of skills required changes and that more J.C.C.-type policy analysts in addition to USDH are needed. At the same time USDH and FSNDH are also needed to manage the program and give direction to the policy dialogue. The team recommends that one additional person with an accounting and information systems background be hired.

8. As ARSSP cuts across various Mission offices, the role of each office in policy analysis, support to ARSSP agenda items from projects, program administration, and contribution to an ARSSP information management system needs to be formalized and clarified. ARSSP will not work except as a team effort that includes many offices.

9. The team finds that project assistance remains essential for effective program assistance; that projects alone are an insufficient source of analysis needed for policy based program assistance because program assistance has its own policy analysis requirements; and that targeted program assistance fills a

niche in the Mission's program instruments because it is able to do some important things differently and more quickly than project assistance.

10. The Mission finds itself in a tricky area between pure program assistance (cash grant or C.I.P.) and project assistance, and the recommendations of this evaluation to move toward "targeted budget support" take it slightly nearer to the project mode. Even though this area has difficulties in terms of the program-project spectrum and in terms of accountability (projects are tighter), it also has the potential to make a contribution to policy implementation that, dollar-for-dollar, could well be greater than other donors' program assistance. AID would be the only donor with this kind of fund for financing policy implementation costs, and the implementation costs in any event are more commensurate with the amount of money AID has available, in contrast to the sizeable contribution to the budget that comes from other donors' program aid.

11. ARSSP has laid a sound basis for continued AID support of the policy reform process. This support should build upon the successes of early ARSSP implementation. Continued support in the area of policy reform for agriculture and finance is warranted because of:

- a) the demonstrated sincerity of Government to forge ahead with reform;
- b) the continuing severe external economic environment necessitating rapid adjustment, and
- c) the continuing need to reform policy in order to eliminate disincentives to efficient growth and development.

Thus, the evaluation team recommends an amendment to ARSSP, responding to the recommendations of the evaluation, increasing funding, and extending the PACD to March 31, 1992.

12. Please note that this summary highlights primarily the findings and recommendations of interest to the audience following ARSSP as one case study in D.A. sector program assistance. Several other important observations and recommendations pertaining to ARSSP are contained in the body of the report.

N

List of Acronyms

- AARD - Agency for Agricultural Research and Development,
Ministry of Agriculture
- A.I.D. - Agency for International Development
- ADB - Asian Development Bank
- ARD - Agriculture and Rural Development Office, USAID
- ARSSP - Agricultural and Rural Sector Support Program
- ATDM - Agriculture and Trade Development Mission
- Bappenas - National Planning Board
- BRI - Rural Credit Bank
- Bulog - GOI Bureau of Logistics
- BUMN, BUMD - State Owned Enterprises
- BPS - Central Statistics Bureau
- CIDA - Canadian International Development Agency
- DIP - The GOI annual budget plan
- EPSO - Economic Policy Support Office, USAID
- FAO - Food and Agriculture Organization, United Nations
- GOI - Government of Indonesia
- IBRD - World Bank
- IFY - Indonesian Fiscal Year
- IGGI - Inter-Governmental Group on Indonesia
- ILO - International Labour Organization, United Nations
- IPM - Integrated Pest Management
- JCC - Joint Career Corps
- Kuppadas - Village Lending Program
- MIS - Management Information System
- MOA - Ministry of Agriculture

- MOF - Ministry of Finance
- MOT - Ministry of Trade
- NBFI - Non-Bank Financial Institution
- OECD - Organization for Economic Cooperation and Development
- PAAD - Program Assistance Approval Document
- PIL - Project Implementation Letter
- P4PM - Duty Drawback Board of the MOF
- PSC - Personal Services Contractor
- PSD - Private Sector Development Office, USAID
- TSP - Triple Super Phosphate
- Simpedes - Village Savings Program
- UNDP - United Nations Development Program
- USAID - United States Agency for International Development
Mission in Jakarta, Indonesia, or the "Mission"
- WB - World Bank

1. Introduction: Description and Current Status of the
Agriculture and Rural Sector Support Program

This report is an interim evaluation of the Agriculture and Rural Sector Support Program (ARSSP) conducted between January 20 and February 24, 1989. Approximately sixteen months have elapsed since the signing of the program agreement in August 1987, with approximately fourteen months of actual program implementation. The two principal elements of ARSSP are: a) support for policy reform in the agriculture and financial sectors, consistent with the Government of Indonesia's (GOI) structural adjustment program, and b) supplemental funding for the development budget of specific agencies within the Ministry of Agriculture, Ministry of Finance and the State Planning Board needed to maintain essential functions and services at acceptable levels. The program agreement provides \$43 million in grant funds combined with \$22.815 million in local currency generations from Indonesia's PL-480 Title I program. To date, \$23.9 million in grant funds have been disbursed; October 31, 1990 is the current program completion date.

ARSSP is A.I.D.'s first attempt to provide non-project, sector/program assistance in Indonesia. ARSSP is an innovative effort by the GOI and USAID/Jakarta to develop new modes of U.S. assistance that are appropriate for Indonesia's economic situation and development management capabilities. It is important, therefore, to evaluate ARSSP at an early stage of its implementation. This evaluation reviews: a) progress to date on the policy agenda ARSSP supports, b) whether the assistance provided is helpful to the GOI in its adjustment efforts, c) the budget support mechanism, and d) ARSSP management. The purpose of the evaluation is to determine whether the program should be continued and, if so, what mid-course changes are needed to improve its operation and effectiveness.

The evaluation concludes that ARSSP is an important and useful means of assisting the GOI to advance its policy reform agenda and, with some needed improvements, of providing quick disbursing, budgetary support during a period of revenue shortfalls and adjustment in the Indonesian economy. When fully implemented, the policy reforms ARSSP supports, combined with improved budgetary support, have the potential to contribute to growth and greater efficiency in the agriculture and financial markets sectors. ARSSP has also encouraged some other donors to consider providing non-project assistance to support Indonesia's economic stabilization and structural adjustment program. An important result of ARSSP has been to raise the level of discussions between the GOI and A.I.D. to sectoral or sub-sectoral policy issues. The evaluation identifies modifications needed to improve the budget support mechanism, policy dialogue and program management.

Section Two of the report reviews the development of ARSSP's program mode of assistance, the process of formulating the policy agenda, the rationale for agency-level budgetary support and the

relationship between the policy agenda and budget support objectives. Section Three examines progress on ARSSP's policy agenda, consisting of the following objectives:

- 1) Agricultural diversification, related agro-processing and more efficient use of agricultural resources are expected to result from:
 - a) establishing input and output prices at levels which encourage both efficiency and expanded production of food and export crops,
 - and b) reducing transportation and licensing costs associated with food and export crops, processing and trade.
- 2) Domestic resource mobilization, referring to more efficient operation of financial markets thereby increasing capital for investment, is to be advanced by:
 - a) expanding banking services at unsubsidized cost levels, and
 - b) mobilizing pension and insurance funds for capital markets.
- 3) Introduction of institutional changes in agriculture and finance by:
 - a) improving planning and implementation of policies and programs that will encourage agricultural diversification, and
 - b) improving management of policy changes related to domestic resource mobilization.

Within these broad areas, a set of specific actions/milestones were identified that, if fully or partially achieved, would reflect progress toward the GOI's policy reform objectives and sub-objectives.

Section Three of the report discusses the economic context and potential significance of these reforms within the broader setting of the GOI's structural adjustment program; reviews progress on the specific policy agenda items ARSSP supports, assesses the significance of the actions taken by the GOI to date and ARSSP's relevance or contribution to the GOI's policy initiatives; and identifies potential areas, agenda items and approaches that A.I.D. might support to assist the GOI's policy reform efforts.

ARSSP has provided budgetary support for nine GOI agencies to date: in the MOA - the Secretary General, the Agency for Agricultural Research (AARD), the Agency for Agricultural Education, Training and Extension (AAETA), the Director General for Food Crops; in the MOF - the Secretary General, the Director General for Monetary Affairs, Financial Training and the Board for Public Finance, Credit and Balance of Payments; and the State Planning Board (BAPPENAS) for developing an integrated pest management program. Section Four reviews the budget support component of ARSSP, the additionality to ARSSP budget support, and the general utility of activities supported by ARSSP.

Section Five assesses: a) the management requirements and staff intensity of ARSSP for the GOI and A.I.D. in comparison to other modes of development assistance, b) the management of ARSSP to

date, including working with the GOI on program implementation, the management information system developed for the program, inter-office coordination and responsibilities, and donor coordination; c) issues pertaining to the advantages and disadvantages of program assistance in comparison to other forms of development assistance.

Section Six outlines some ideas to guide the recommended amendment to ARSSP.

2. Development of ARSSP's Program Mode of Assistance

2.1 Introduction

The program assistance that ARSSP provides combines a budgetary support component assisting key agencies in the MOA, MOF and BAPPENAS and a policy agenda component consisting of institutional and policy reforms in the agriculture and financial markets sectors. ARSSP constitutes program assistance in that budgetary support is directed to the development budgets of GOI agencies and not targeted or programmed by A.I.D. to discrete activities as in standard development projects. Further, ARSSP's major objectives of promoting agricultural diversification and domestic resource mobilization focus on policy and institutional issues at sectoral and sub-sectoral levels in contrast to the typically narrow focus of standard projects.

How ARSSP "supports" or forwards its policy agenda differs from other policy-based programs in that there is no conditionality between disbursements of budgetary support and reform actions (i.e., disbursements are not linked directly to actions on the policy agenda). Rather, budgetary support may contribute to formulation or implementation of reform actions or provide resources to progressive elements within the GOI needed to advance reform ideas or measures. ARSSP's "support" for policy may also include periodic discussions between the GOI and A.I.D. on agricultural and financial markets policy. Thus far, A.I.D. has not become more actively involved than this on policy matters. This type of indirect, low-key approach to policy dialogue reflects the GOI's position that explicit conditionality is an unacceptable basis for donor assistance to the GOI. Given the somewhat unorthodox approach ARSSP follows, a first step in the evaluation is understanding the origins and development of ARSSP's program assistance.

2.2 Factors Leading to the Program Mode of Assistance

- Findings

At least three main factors gave impetus to developing ARSSP's program mode of assistance: a) the decline of oil prices in the early 1980's and the subsequent fall in GOI revenues in IFY 1986/87, b) a threatened cut in USAID/Jakarta's annual budget which was

viewed as giving 'the wrong signal to the GOI about U.S. support for its adjustment efforts, and c) previous A.I.D. project involvement and credibility in the agriculture and financial markets sectors.

Beginning in 1983, the GOI initiated a structural adjustment program in an effort to reduce dependence on oil export earnings and open the economy to market forces. This included substantial devaluation of the rupiah, policy reforms to deregulate key sectors of the economy and significant budgetary cuts, while increasing nonoil exports. With oil prices declining to \$12 to \$13 per barrel in 1986/87, the GOI's real budgetary expenditures fell sharply. The development budget was severely affected, decreasing as a percentage of the GOI's total budget in real terms from 55.1% in 1982/83 to 38.7% in 1986/87. The development budget in 1986/87 reflected a 32% decrease from the preceding year(1). Such precipitous cuts directly impeded operations in essential areas, such as agricultural research, extension and staff training, that might adversely affect rural employment and income growth. A reduced development budget also impedes the GOI's ability to implement policy reforms.

With a shortage of counterpart funding, more project assistance was clearly inappropriate; what Indonesia needed was short-term budget support during a period of adjustment. By 1987, the GOI had demonstrated its commitment to opening the economy to market forces and decreasing its dependence on oil export earnings. A quick disbursing mechanism to augment the development budgets of GOI agencies was considered by A.I.D. as an important and worthwhile use of its assistance.

A second important factor that encouraged the shift to program assistance was a proposed reduction in USAID/Jakarta's annual budget (OYB) from \$45 million to \$30 million per year. The mission successfully argued that the \$45 million level must be maintained. If for no other reason than to maintain good relations with the GOI, it was very important that the U.S. Government demonstrate its support for the GOI during a very difficult period for Indonesia. At one point, the Embassy had even proposed as much \$150 million for ARSSP to emphasize the point and to encourage other donors to also provide special assistance through program lending.

Though the OYB was not cut, AID/Washington made the restored level contingent on developing a policy-based mode of assistance before the end of FY 87 (by August 31, 1987 to meet federal budgeting regulations). This gave the mission approximately seven months to design ARSSP and reach agreement with the GOI. If not, the mission would lose the additional funding.

1. Agriculture and Rural Sector Support Program - Program Assistance Approval Document, Annex 1

Related to A.I.D.' budget issues, by deobligating funds from slower moving agriculture and rural development projects, ARSSP's quick disbursing, budget support mechanism would help liquidate a continuing pipeline problem (i.e., obligated but unspent funds).

In all fairness to the mission, the pipeline was in part due to instructions in the early 1980's (when development assistance levels increased) to fund new projects fully. Nonetheless, the pipeline had become a focus of attention for mission and AID/Washington management, and ARSSP presented a good opportunity to alleviate the problem.

The third element that facilitated moving to program assistance was USAID/Jakarta's long history of involvement in the agriculture sector and, to a briefer extent, in the financial markets sector. A.I.D. projects in these two areas provided insight into the policy constraints in these sectors and also gave A.I.D. credibility with the GOI in these areas. Moreover, at the time when ARSSP was being developed (i.e., beginning in 1987), several key mission staff had very good working relations with selected GOI officials who wanted to advance the de-regulation process. In short, program assistance offered the flexibility in funding (lacking in project assistance) needed to assist these officials to forward their agenda.

- Conclusions

ARSSP was an appropriate shift in A.I.D. programming in response to the economic conditions Indonesia confronted and in support of the GOI's efforts to make necessary adjustments to the economy. However, designing ARSSP and reaching agreement with the GOI was accelerated, and perhaps rushed, due to A.I.D. budgeting requirements, especially given that ARSSP was the mission's first attempt at program assistance in Indonesia.

- Recommendations

The mission's longer-range planning process should anticipate the information, time and staffing requirements for developing policy-based, program assistance.

2.3 Formulating ARSSP's Initial Agenda

- Findings

The ARSSP agenda followed a circuitous, evolving course during its period of development in 1987. ARSSP file documents suggest that USAID/Jakarta first focused on the development budget support requirements of the GOI. However, it was soon concluded that any significant level of funding through program assistance would not be acceptable to AID/Washington without a policy element.

The mission initially planned to concentrate ARSSP on de-regulation of financial markets and private sector development, whereas the GOI at first concentrated on trade reform. However, several proposals made to the GOI about trade reforms, restructuring state-owned enterprises and investment promotion proved unworkable. At that point, the agenda was broadened to include agricultural policy reforms.

Financial reforms supported by ARSSP were reported by former mission staff to have been proposed by MOF officials. A.I.D.'s funding of the Financial Institutions Development project and other private sector development activities, combined with good working relationships with Harvard financial advisers provided additional guidance on this portion of the agenda.

A.I.D.'s longstanding involvement in the agriculture sector assisted in the development of the agriculture portion of the agenda. Equally important, long- and short-term U.S. technical advisors working on the Secondary Crops, Applied Agricultural Research and Agricultural Planning projects provided essential analytic work and information the mission used in its discussions with GOI officials about possible agenda items. The credibility the technical advisors had within the GOI was an important contributing factor.

The process of developing the agenda and the specific actions subsequently used as benchmarks for ARSSP involved numerous discussions between mission staff and GOI counterparts. Of particular importance was the active role the mission director played in vetting ideas with senior GOI officials. To have any possibility of working, the agenda had to be very much a product of the GOI, following their lead as to what actions might be possible and what were not. Apparently, the willingness of senior GOI officials to risk making changes in specific areas, was also instrumental in formulating the agenda.

In direct contrast to the process being conducted in Indonesia, directions from AID/Washington were calling for a highly structured program, specifying exactly the steps that would be taken, estimates of when these actions/benchmarks would be reached and a definition of program "success" as achieving completing (or nearly so) the reform targets in four, if not five, of the five policy areas ARSSP supported.

On the one hand, AID/Washington's pressure for specificity and structure imposed a discipline on the mission to think through more carefully what the program is intended to accomplish and how achievement of reforms would contribute to these objectives. be achieved. On the other had, the level of specificity called for was not possible nor compatible with the GOI's position on donor support for policy and institutional reform, yet the mission had to respond to Washington directives. The compromise solution was to develop a list of milestones that the GOI could accept, derived from the general policy areas ARSSP would support. The agenda of milestones,

however, only reflects GOI intentions or interests; they did not perceive the agenda as a binding contract.

The resulting agenda combines policy and institutional reforms, the significance of which and their implications for program management are assessed in detail in Sections 3 and 5.

- Conclusions

Formulation of the ARSSP agenda raised the level of policy dialogue between the GOI and A.I.D. to focus on sectoral or sub-sectoral issues, which is considerably higher than the previous focus of these discussions. Project experience, existing analytic work in some areas and credibility with the GOI contributed to formulating the agenda. However, the resulting agenda is something of a grab-bag. In some parts of the agenda - pensions and insurance reforms and the copra tax - A.I.D. had no past studies or project experience. Most, if not all, of the agenda items supported by ARSSP were not new ideas, but were issues that had been discussed for some time with the GOI by A.I.D. and other donors. These were, so to speak, policy issues that were "in the air"; ARSSP created the opportunity of providing some funding to help advance their implementation, if only indirectly.

Projects alone are an insufficient source of analysis needed for policy based program assistance. Projects may certainly contribute to the process; alternatively, projects can support the implementation of reforms. To maintain a useful and constructive policy dialogue, the mission needs to be actively engaged in policy analysis in those areas its assistance is concentrated. In time, it would be desirable for ARSSP to carry an increasing share of the analytical work required for policy dialogue.

In retrospect, it is also fair to conclude that AID/Washington's demands for a highly structured program were excessive and complicated the mission's task. However, the agenda of specific milestones did serve A.I.D.'s administrative and management needs.

- Recommendations

- a) The low key, supportive approach followed in developing ARSSP's current agenda and the need for sound policy analysis as the underpinning of policy dialogue and program assistance should guide the mission's future assistance for policy reform.
- b) ARSSP's future policy agenda should be more focused.
- c) The Agency needs to recognize that conditionality and highly structured program assistance is not uniformly applicable in all A.I.D. assisted countries. Less structure and specificity in program assistance at the outset combined with thorough monitoring and analysis of policy actions during the course of program implementation should be viewed as a viable alternative.

2.4 Developing the Budget Support Mechanism

- Findings

In planning ARSSP, A.I.D. analyzed overall GOI budget trends and the declining development budgets of MOA and MOF agencies, the results of which are presented in Annexes One and Three of the Program Assistance Approval Document (PAAD). A.I.D. focused on the development budgets of the Ministry of Agriculture (MOA) and Ministry of Finance (MOF) because a major portion of the mission's portfolio were in these two sectors. However, the analyses of ministry budgets used projected budget levels as opposed to actual expenditures. This affects the absolute values cited, but the overall trends identified were correct. Principal findings of the analyses were:

- the GOI's development budget was sharply reduced across the board;

In the MOA:

- After a period of average real growth between 1979/80 to 1985/86, in 1986/87, the MOA's development budget fell to pre-1979/80 levels in real terms.;

- Project Administration declined the most between 1980/81 and 1986/87;

- Beginning 1982/83, AARD's budget declined at a faster rate than any other division;

- Research Operations experienced significant budget reductions annually beginning in 1983/84; and

- The Director General for Food Crops' development budget fell substantially between 1985/86 and 1986/87.

In the MOF, implementation of policy reforms is largely a staff function paid for through the routine budget, constituting 90% of the MOF's total budget. Between 1985/86 and 1986/87, the MOF's routine budget declined 70%, impairing its ability to implement reforms already announced or in progress.

ARSSP budget support levels for the MOA were estimated based on projected development budgets through 1988/89. 1985/86 levels were to be used as a ceiling capping total budget support levels (i.e., GOI and ARSSP combined). The level for MOF support appears to have been the residual after MOA levels were established.

- Conclusions

The need for short-term budget support during the period of adjustment Indonesia was going through was very clear. The sharp decline in MOF and MOA budgets would impair their ability to maintain important functions, provide counterpart funding for development projects and implement policy reforms. However, the need for continuing non-directive budget support beyond IFY 1989/90 should be substantiated by further analysis including other donor funding available for budget support and the GOI's ability to mobilize more domestic resources.

- Recommendations

- a) All budget support for IFY 1989/90 should be targeted; beyond IFY 89/90, analyze budget requirements to determine whether such support is needed and the most effective use of A.I.D.'s limited resources.
- b) With the amendment to ARSSP, re-examine the distribution of ARSSP support between the MOA and the MOF based on need to design and implement activities pertaining to policy reform.

2.5 Relationship of Budget Support to the Policy Agenda

- Findings

As discussed earlier, conditionality in ARSSP was simply unacceptable to the GOI and arguably unnecessary for providing program assistance. The situation is further complicated by the ambiguity of the relationship between budget support and the policy support element of ARSSP.

The linkage between budget support and the policy agenda has been a contentious issue for program management. Cables between USAID/Jakarta and AID/Washington describe ARSSP budget support as "tiding over" selected GOI agencies during a period when their development budgets were severely reduced. No direct linkage is made between this short-term budget support and the policy agenda made in this communication. Similarly, sections of the PAAD describe the policy and budget support components as separate. For example, the PAAD refers to using "...disbursements of local currency to support adequate expenditure levels of selected budget categories." Elsewhere, however, the PAAD states:

"... the program will provide support for (GOI) efforts by focusing attention on key policy areas and through targeted budget support.";

" ... (budgetary data) will also have utility for ARSSP's evaluation regarding ministerial operations and reforms supported through program funding."; and

" ... the program's impact is contingent on quick injections of local currency on highly attractive terms to provide maximum possible incentive for policy movement and appropriate budget support."

Interviews with current and past USAID/Jakarta staff and GOI officials reflected these conflicting views about the linkage between the budget support and policy components. Even during the course of an interview, some expressed contradictory views on this issue. For example, after being told there is no linkage, several individuals would proceed to point to how effectively ARSSP budget had been used to develop the integrated pest management program (complementary to the elimination of pesticide subsidies) and for studies that forwarded the banking reforms announced in October 1988. The reality is that thus far, the bulk of ARSSP funding has gone for agricultural research that is largely unrelated or at best tangentially related to the policy agenda ARSSP "supports".

As discussed in more detail in Section 4, ARSSP budget support was to be programmed and monitored at the Agency level. A.I.D. was not supposed to be concerned by discrete activities those funds supported. Yet that would be impractical if budget support is to relate even tangentially to the policy agenda. A.I.D.'s own role has shifted from focusing on agency-level budgets to discussing specific activities to be funded by ARSSP. More recently, A.I.D. and the GOI have agreed that even though ARSSP budget support may initially support specific activities within an agency, the funding could be used for any other policy related work of the agency as well.

- Conclusions

The original intention of providing a flexible source of funding for key GOI agencies remains a valid idea for ARSSP's program assistance. However, the present relationship of budget support to policy analysis, formulation and implementation is a crazy-quilt of contradictory written statements, opinions and actual practice. This is in part due to the speed with which ARSSP had to be designed as well as trying to accommodate conflicting views and guidance on what was required for program assistance of this sort. It also reflects the transition in thinking about the purposes and objectives of the program currently underway. As a consequence, GOI agencies are uncertain as to how ARSSP funds are to be used, what level of detail A.I.D. wants reported and how A.I.D. should participate in the programming and monitoring of ARSSP budget support. In short, the ambiguity that surrounds the relationship between the budget support and the policy agenda complicates the management of the program for the GOI and A.I.D.

- Recommendations

a) The degree to which ARSSP funding will be used to support the policy agenda needs to be clarified in the amendment to ARSSP. This should, in turn, lead to adjusting management and monitoring requirements accordingly. Subsequent sections to this report will provide more detailed recommendations to this effect.

b) Future program assistance provided by A.I.D. using a budget support mechanism should clearly specify whether and, if so, how that funding is to be used to advance policy actions.

3. Progress Toward ARSSP Policy Objectives

3.1 Indonesia's Structural Adjustment Program

- Findings

3.1.1 Past Progress

Middle income developing countries are focusing increasing attention on reforming the policy framework to encourage greater private sector participation, increased economic efficiency and a more sustainable level and pattern of public expenditures. In practice, policy reform programs have had a mixed record in contributing to structural adjustment in the developing nations. Policy reform programs have been most successful in cases where macro-management and sectoral policy have been harmonized; where policy reforms have been perceived to be credible and where reforms have persisted in the face of adverse cyclical pressures. Policy reforms have been least successful in cases of endemic inflationary pressure or severe structural imbalances(1).

The policy reform effort in Indonesia is in part an outgrowth of the 1973/74 and 1979/80 oil booms; in part a reaction to the twin exogenous shocks of an oil price collapse and the dollar depreciation of 1985 to 1988; and in part a response to the perceived importance of improving economic management to generate new sources of growth and employment. The petroleum booms of the 1970's left Indonesia with a mild case of 'the Dutch Disease' including an appreciation of the real exchange rate combined with moderately high inflation. This coupled with nominal interest rate ceilings, led to negative real interest rates. In addition, extensive trade protection, a high degree of industrial concentration and capital rationing combined to promote import substitution and discriminate against non-oil exports.

(1). A discussion of the more recent evaluation of policy reform on structural adjustment is contained in M. Kiguel and N. Livatan, "Inflationary Rigidities and Orthodox Stabilization Policies: Lessons from Latin America", World Bank Economic Review, Vol. 2, 1988. A. Drazen and E. Helpman, "Stabilization with Exchange Rate Management.", Quarterly Journal of Economics, 1987. The effects of policy reform and macro-economic management in the Indonesian case is discussed in Ahmad, Sadiq and Basant Kapur, "A short-run Econometric Analysis of the Indonesian Monetary System", (mimeo), January 1989 and Ahmad, Sadiq, "Indonesia: External Shocks, Policy Response and Adjustment Performance", (mimeo) 1988.

Following signs of a deterioration in the external environment, government initiated a series of policy reforms aimed at broadening the economic base, reducing the anti-export bias of trade and capital management, increasing domestic resource mobilization and reducing distortions to efficient resource use. Starting in 1983, Government conducted a maxi-devaluation of the rupiah followed by a managed currency float to increase the competitiveness of the exchange rate. Interest rate controls were removed which resulted in positive real interest rates. A comprehensive revision of the tax system was introduced to broaden the tax base and to replace indirect and implicit distortionary taxes. In addition, Bank Indonesia open market operations were used to restrain growth in the money supply and reduce the rate of inflation.

A combination of exogenous shocks together with the emerging awareness of the importance of policy reform to reducing 'high-cost' pressures in the Indonesian economy, added extra impetus to the drive for policy reform, post 1985(1). The downturn in petroleum prices, combined with the dollar/yen devaluation contributed to a massive increase in debt service obligations and placed heavy strain on the balance of payments.

Furthermore, growth in the traditional production sectors, such as rice production, began to show signs of topping-out while growth in the labor force (3.2%) and population (2.1%) continued unabated. Government reacted with a further maxi-devaluation, tight monetary management, a cancellation of major new development investments and a sharp contraction in public expenditures. In 1986 and 1987 government released the first two major packages of policy reform. These focused on improving the regulatory environment in trade, investment and capital markets. In addition, government began to take measured strides towards reducing the fiscal burden by reducing production subsidies, establishing a user-fee system for irrigation O&M, broadening the VAT tax base and improving collections on income and property taxes.

(1). The recent spate of policy reforms is frequently treated as a reaction to exogenous shocks of 1985 to 1988. Equal emphasis, however, should be given to the far-sighted awareness of Indonesia's economic management team as to the growing inefficiency and ineffectiveness of Indonesia's policy framework for an industrializing, middle-income nation. While the pace of reforms may have been accelerated by the deteriorating external environment, the direction of reform is consistent with changes dating back to 1983.

The donor community rallied strongly in support of Indonesia's macro-economic management and policy initiatives. Assistance levels were more than doubled between 1985 and 1987 in an attempt to help offset pressure on the balance of payments. An increasing share of development assistance was shifted from a project to a program mode in order to increase budgetary flexibility, provide financing to offset the adjustment costs associated with policy reform and to enable government to meet counterpart financing requirements for already committed foreign assistance projects. The USAID Agriculture and Rural Sector Support Program, providing \$63 million dollars of grant support for two years of rupiah financed activities of the Ministry of Agriculture and the Department of Finance, was part of the larger donor effort to endorse Government's program of macro-economic management and efficiency-enhancing policy reform.

3.1.2 Initial Impact of 1987/1988 Policy Reforms

As discussed below, several important policy reforms have been undertaken in 1987 and 1988. These can best be interpreted as continuations of processes initiated in 1983. The policy reforms undertaken in 1987 and 1988 are likely to have a major impact, depending on the pace at which implementation proceeds and the degree to which the private sector perceives that such reforms are in fact credible and unlikely to be reversed. Early indications are that a wide sweep of private sector firms find the reform movement to be both credible and important although they express caution about the government's ability to enforce regulatory changes at all levels of government(1).

The bulk of the reforms are designed to encourage competitiveness and enhance investment incentives. Changes in investment behavior, directly linked to policy reform, are likely to be observed with a lag of two to three years. Furthermore, the appreciation in real interest rates, while effective at mobilizing savings, will place a damper on near-term, policy-induced changes in investment. High, rising real interest rates will be a major constraint to private investment, growth and, in the financial sector, to development of an active long-term capital market. However, the major effects of 1987 and 1988 regulatory reform should be reflected in changes in investment patterns in the early 1990's.

Even when enough time has passed to account for the lags between incentives and investment, it is difficult to distangle the effects of policy reform from macro-economic management, domestic market conditions and external developments in the world economy. In 1987 and 1988, the combination of an increase in growth in the OECD nations, favorable movements in raw material prices, increasing supply utilization rates in domestic production sectors together with stable macro-economic management and lagged reaction to past improvements in the regulatory regime, produced

(1) For example, Business Advisory Indonesia, "Trade Deregulation Impacts on Companies in Six Sectors and Aspects of the Corporate Financial Environment", 1987.

a satisfying economic outlook. GDP increased by 3.6% in 1987 and 3.4% in 1988. Non-oil revenues increased as a contribution to total domestic revenues from 34.1 % in 1983//1984 to 51.7% in 1987/1988. Non-oil revenues are targeted to increase to 68.7% of total domestic revenues in 1989/90. Non-oil exports grew in value from \$6.7 billion in 1986/87 to \$9.5 billion in 1987/88 and \$11.2 billion in 1988/89. Non-oil exports reached 60% of total export earnings in 1988 and are targeted to increase by 16% to \$13 billion in 1989/90.

In agriculture, strong growth was registered in oil palm (11% p.a.) and in shrimp production (18% p.a.), helping to diversify the rural productive base. However, largely as a reflection of unforeseen changes in currency movements, higher interest rates and continued low petroleum prices, debt service requirements continue to mount. Indonesia's debt service reached Rp. 5.1 trillion in 1986/1987; increased to Rp. 8.2 trillion in 1987/1988 and is projected to reach Rp. 10.6 trillion in 1989/90. Total donor assistance inflows exceeded debt service payments by \$1.1 billion in 1988, thanks largely to special assistance inflows of \$2.2 billion. In 1989/90, if special donor assistance inflows of \$2.3 billion are met, then total donor inflows will exceed debt service payments by \$2.3 billion(1). Even with strong growth in non-oil exports, the debt-service ratio is expected to climb from 33% in 1987/1988 to between 35 to 37% in 1988/89, suggesting that continued special assistance is warranted in the near-term and that the economic adjustment process needs to be accelerated.

3.2 Progress in Meeting ARSSP Policy Milestones

3.2.1 Agricultural Diversification

- Findings

The first main policy area identified for reform is in the area of agricultural diversification. The objective of this program area is to "promote agricultural diversification, related agro-processing and (make) more optimal use of resources through increased efficiency and stronger participation by the private sector". A set of more specific pricing and trade sub-objectives are defined to achieve this general objective.

(1). These figures are drawn from the Ministry of Finance, "Budget Tables for 1988/89 Nota Keuangan", from Bank Indonesia export value estimates, and from the budget tables in the draft Repelita V. 1988/89 debt service projections are based on a petroleum price forecast of \$14/barrel and present spot prices are approximately \$3 higher. Should higher prices (\$17) prevail, this would add approximately \$1.65 billion in 1989 revenue. Additional savings will be generated by the early 1989 dollar to yen appreciation. This, however, will be more than offset by the appreciation in Libor since second-quarter 1988.

The sub-objectives and specific milestones in the area of agriculture diversification are as follows: "Pricing: Establish input and output prices at levels which encourage both efficient and expanded production of food and export crops: (a). extend and monitor trade and licensing reforms of 6 May and 25 October, 1986 to include agricultural inputs (i.e. livestock feeds, shrimp larval feeds and product packaging items) needed in the production and processing of agriculture based export items with a view to lowering production costs and increasing trade, (b). reduce pesticide subsidies, (c). review fertilizer subsidy levels and user rates with a view to developing and implementing a strategy to adjust downward fertilizer subsidies in a way that minimizes disruptions in fertilizer demand and crop production, and (d). Assess incentive and disincentive effects of current pricing strategy for rice and non-rice crops and establish pricing levels which maintain appropriate rice production levels and encourage secondary crops production."

The trade sub-objective is "reduce transportation and licensing costs associated with food and export crops processing and trade, thereby stimulating demand for and production of agricultural-processed products: (a). reduce input costs to processing by eliminating the provincial tax on copra, a major smallholder crop (b). review and eliminate unnecessary licenses and other policies which increase the cost of transporting agricultural products between districts and islands, and (c). review local and national licensing limiting investment in agro-business and introduce simplified procedures".

- Milestone: Promoting Efficient Agricultural Trade and Investment

The first agricultural diversification sub-objective is to promote a more simplified, market-driven agricultural trade and investment regime for agricultural inputs. Government has made important contributions to this objective through a combination of continued regulatory reform and concerted implementation of the May 6, 1986 investment reform package. Under the May 6, 1986 package, export-based investors and companies who supply inputs to exporters are allowed rebates on the value-added tax, import duties and surcharges. Records provided by the P4BM (Refund Board) of the Ministry of Finance indicate a significant expansion in the number of food and agriculture based-firms taking advantage of the May 6, 1986 duty drawback procedures. In the December 24, 1987 trade package these export-rebate privileges were expanded to include non-PMA/PMDN (foreign and private large scale firms) companies and eligibility criteria were broadened to firms exporting at least 65 percent of their output. Investment rules for foreign companies were improved by increasing the divestiture period from 10 to 15 years with the possibility of a five year extension. Under the December legislation, foreign investors are allowed to maintain a 95% equity holding if their investment is entirely for export and they are located in a bonded zone.

The November 21, 1988 package of policy reforms on Trade, Industry, Agriculture and Sea Communication removed 301 items from import restriction (from restricted license to general importer license) and lowered tariffs on 17 goods. Non-tariff barriers were eliminated from imports on a number of steel products, plastics, fertilizers, agricultural products and processed foodstuffs. In the case of plastics, fertilizers, steel, and edible oils--the most important of the agro-inputs liberalized, high tariffs and import surcharges replaced non-tariff quantitative restrictions.

Certain regulatory changes have acted to reduce efficiency and competitiveness in agricultural input markets. This would include, for example, the August 1988 Ministry of Trade and Ministry of Cooperatives Joint Decree calling for the replacement of the private wholesalers and retailers of fertilizer by government cooperatives by no later than April 1989. Other regulatory measures which acted to counter-balance positive reform in agricultural inputs trade include the 1988 ban on raw rattan exports and on SIR-50 low quality rubber exports.

Government has also commissioned a study on licensing and regulatory constraints to agro-business investment by the Center for Agro-Economics, Bogor. The major constraints to improvement in the regulatory environment for the agro-input sector are (a) the dominant role of state owned enterprises, (b) the high regulatory priority accorded to safeguarding smallholder interests and (c) the complexity of regulations governing the sale and operation of rural lands.

- Milestone: Reduce Pesticide Subsidies

Government has made a concerted effort to reduce the agricultural subsidy burden. In 1987 pesticide subsidies were reduced by 20% to an average subsidy of 55% of the retail product price. Following a cabinet meeting of 6 October, the pesticide subsidy was reduced to 40 percent of total production costs. On December 1, the Coordinating Minister for Economic Affairs announced the abolition of pesticide subsidies as of January 1, 1989. In January 1989, the Minister for Finance ruled that P.T. Pertani stocks of subsidized pesticides (8 to 14 months worth) would continue to be sold at the pre-desubsidization price to avoid windfall gains from the subsidy removal. Obstacles to a complete reform include (a) concerns voiced over pesticide availability in remote areas and (b) possible environmental hazards following price decontrol.

- Milestone: Correct Fertilizer Price Incentives

Government has also made a concerted effort to reduce fertilizer subsidies by upward price adjustment and by deferring plans for major new capital investments in domestic fertilizer production. TSP prices were increased by 26% to 170 Rp./Kg in October of 1988. All other fertilizer prices were increased by 22% to 165 Rp./kg. This marks the reintroduction (since 1969) of differential nutrient

pricing and signaled government's intent to phase out subsidies faster on the more heavily subsidized phosphatic fertilizers. Due to the effects of a nine percent growth in 1988 domestic fertilizer demand, higher import and domestic production costs and higher world market prices, the financial subsidy to the fertilizer industry and the economic subsidy to the farm community rose rapidly in 1988.

Since 1986 government has relied heavily on off-book, BRI (Rural Credit Bank) financing for the fertilizer subsidy. The budgetary subsidy increased from 667 billion rupiah in 1987 to 863 billion rupiah in 1988. As of end-1988, accumulated unpaid subsidy arrears to BRI totaled close to 900 billion rupiah. The implicit interest subsidy on unpaid arrears would add about another 125 billion rupiah to the 1988 fertilizer subsidy total. Obstacles to reform include (a) cost-push pressures in fertilizer production and distribution, (b) the debt-overhang resulting from three years of partially unpaid subsidies, (c) difficulty in establishing an efficiency-signaling price formula for natural gas to fertilizer manufacturers and (d) uncertainty over the effects of subsidy removal on rice production and farmer incomes.

- Milestone: Sound Agricultural Pricing Policies

In agricultural pricing, government has undertaken a number of steps which will allow for a more efficiency-signaled basis for food crop development. This includes (a) financing and participating in studies by Stanford University, the International Food Policy Research Institute, Iowa State University, the Center for World Food Studies (Amsterdam), the Center for Agro-Economic Research (Bogor) and the MOA's Directorate of Food Crop Economics on agricultural price policy (b) relaxing import restraints on soybeans, but not soybean meal (c) increasing the rice floor price (for rough rice) from 1988 to 1989 by 19% and (d) calling for a more general state of food self-sufficiency in the Fifth Plan instead of a strict call for rice self-sufficiency.

In 1987 and 1988, the efficiency of agricultural pricing policy was set back by the ban on rice imports (excluding loan-in-kind-payback trade). In 1987, nominal medium-grade Jakarta rice prices (Cisadane II) increased by 24%. This was followed by a 26% increase in 1988 prices. From 1985 to December 1988, Bulog rice stocks were drawn down by 2.2 MMT's in order to contain the price increase. The effect of the import ban was to induce Bulog to return to a quantity target basis to guide procurement operations in 1988. This in turn fueled inflationary pressures in the rice market. The use of import restrictions to stimulate high domestic prices in rice, sugar and soybeans distorted prospects for efficient resource allocation in agriculture and, through pressures on wages and food costs, reduced growth/economic diversification prospects in the manufacturing and services sector. Beginning in December 1988, government apparently relaxed the import ban and has begun rebuilding domestic rice stocks with imported rice. To the extent that this marks a shift away

from a highly restrictive import substitution policy, this can be regarded as a price policy movement in the right direction. The main obstacle to reform in agricultural pricing is that government continues to follow a highly inward-oriented philosophy of agricultural trade and development at the expense of export-based agriculture and the non-agricultural sectors.

- Milestone: Abolish Coconut Cess

In the trade area, government has not repealed the Bapengko cess on inter-insular movement of copra and international trade in CCO (crude coconut oil). However, total revenues from this tax amounted to under 3 million dollars in 1987. Government has improved the incentives environment for coconut smallholders by deregulating (shifting to general importer status) exports of CCO in 1987 and by deregulating imports of CCO and copra in November 1988. Furthermore, there is evidence that a concerted effort to implement the 1986 Presidential Decree 4, banning the issuance of special licenses for inter-insular trade, has reduced Java to Sulawesi trade margins, offsetting in part the CCO tax burden. In the area of eliminating discriminatory nuisance taxes, in 1988 the Ministry of Finance convened a special workshop on reforming Provincial and Local Government taxation authority which focused on these problems. The main obstacle to eliminating specific nuisance taxes is in identifying alternative, less distortionary, means of taxation to offset the revenues foregone.

- Milestone: Improve Inter-insular Trade

Government has made a concerted effort, over the past two years, to improve inland distribution and storage of agricultural commodities through regulatory reforms in the area of inter-insular shipment and warehousing. The November 21, 1988 trade deregulation package largely abolished Directorate General of Sea Communication administration of inter-island shipping and replaced it with a simplified two-line shipping system, easier licensing procedures, permission for shipping companies to lease foreign vessels and to establish joint ventures with foreign firms and national shipping company selection of sea-routes. The investment reforms in the November 21, 1988 package also provide foreign companies and joint ventures (PMA) authority to market their products in the domestic market through wholly owned marketing subsidiaries. This was designed to improve incentives to foreign investment and eliminate a source of policy-induced domestic marketing inefficiency. The November 21, 1988 package also included provisions for simplifying the licensing requirements for development and operation of warehousing facilities.

In order to identify areas for further deregulation, the MOA's Bureau of Planning, using ARSSP funds, has commissioned special studies on investment regulations. Two of these studies, on regulations affecting fisheries and regulations affecting livestock have already been completed. Obstacles to continued reform in this

area include: (a) difficulties in regulatory enforcement, (b) inter-Ministerial conflicts over agro-based investment regulations (c) the pervasiveness of over-land commodity taxes, and their importance to local government revenues outside of Java and (d) opposition to implementation of inter-island shipping deregulation.

- Conclusions: The Importance of Recent Agricultural Policy Reforms

In agriculture, two years of import restraints combined with poor domestic supply performance have led to a sharp appreciation of real food prices. In real terms, between 1987 and end-1988, the price of rice has increased by 24%, the price of corn by 7%, the price of cassava by 32%, and the price of soybeans by 14%(1). During this time, real wages for unskilled labor have risen roughly in line with inflation, suggesting that fixed income earners, the urban poor and the rural landless have assumed a heavy burden from the sharp changes in the relative price structure. Although government has announced removal of pesticide subsidies, the total financial subsidy burden for agriculture is rising; fertilizer subsidies have blossomed from a financing problem into an arrears issue; the rural credit sector - including new programs - is rife with subsidized lending rates, irrigation cost recovery is barely in the pilot-test phase, and government programs remain very much set in the high-capital input, single package mold.

The events of the past year suggest that the agriculture sector is beginning to develop a reform agenda. It will likely be more difficult to advance major reforms in agriculture until there is a fundamental rethinking of the role of the sector. While agriculture's primary mission remains rooted in import-substitution and employment generation, efficiency-oriented reforms will be treated as less of a priority than is maintaining the status quo. There has been little real movement away from a target driven allocation system, particularly for the foodcrops and sugar. In addition, import restrictions led Bulog to abandon it's price stabilization objectives in favor of a targeted buildup of public stocks further destabilizing an already short market. With the exception of shrimp and oil palm, there are few signs that, outside of already established players, agro-based industrial development is moving ahead. However, 1989 may bode well for agricultural

(1). These figures are drawn from BPS, Indikator Ekonomi, Bank Indonesia, "Laporan Bulanan", and Bulog, Price Monitoring Division.

(2) It is too early to comment on the impact of the specific agricultural reforms. Pesticide production continued to increase in 1988, although industry reports suggest farm level consumption declined. Fertilizer consumption continued to rise, even though farm prices rose a whopping 26%. The latter will likely encourage government to accelerate the pace of subsidy removal.

development. The loosening of rice import restraints, combined with forecasts of excellent weather, may relieve pressure in the food sector. Furthermore, government efforts to promote private agricultural investment, highlighted in the Fifth Plan, can be expected to materialize during 1989 as well(2). In agriculture, where the reform movement has less experience, and to a certain degree conflicts with the prevailing development strategy, it is very important to demonstrate--through selected policy reform efforts--that a more efficiency-g geared agro-economy will best serve GOI's agricultural interests. ARSSP's agricultural policy agenda is defined rather broadly in some areas (e.g., investment, trade and output pricing).

It is not clear that the agricultural diversification objective is well thought out, nor that it signals the sorts of changes that government could be expected to take action on in the near-term. Diversification seems to be interpreted in many different ways by different policy-makers. Some interpret it as extending import substitution policies from rice to other foodstuffs. Some interpret it as government focusing its administrative resources on selecting agribusinesses for public support. Others view it as more of a shift in policy favoring greater efficiency largely through productivity gains. Diversification itself is a 'process', or a means by which fundamental sectoral objectives (growth, equity, employment generation) may be achieved. Because of the general confusion regarding the actual content, or fundamental aims, of agricultural diversification in Indonesia, it would be more appropriate to strive for an objective, rather than a process.

3.2.2 Domestic Resource Mobilization Objective

- Findings

The second ARSSP objective is "to expand and increase the efficiency of financial markets thereby increasing capital for investment". Sub-objectives in the area of pensions and insurance are as follows: "in Banking: to expand banking services at unsubsidized cost levels (by) a) continued maintenance of market-oriented interest rates and b) draft and introduce legislation permitting financial institutions to expand and extend services in both urban and rural areas".

The most important monetary policies over the past two years have been the continued maintenance of an open capital account with positive real rates of interest and an effective pegging of the nominal exchange rate(1). This can be considered as a sign of a

(1). Nominal interest rates in Indonesia have appreciated rapidly during the past two years reflecting the advance in Libor, the swap premium and continued high intermediation costs. In the third quarter of 1987, the MOF ordered State Enterprises to withdraw funds from foreign assets to halt speculative movement against the rupiah. Aside from this incident, open market operations of Bank Indonesia have enabled swap premiums to track exchange rate expectations reasonably well.

sincere implementation of the 1983 reforms. Since 1987, real interest rates have remained positive at 8 to 12% (net-inflation). Real interest rates have continued to rise after the 1986 devaluation reflecting the inflation rate, devaluation risk cover and the fall in petroleum prices. In October 27, 1988 and December 20, 1988 two comprehensive packages of capital market policy reforms were announced. This was preceded by a set of capital market reforms included in the December 24, 1987 trade and investment policy package. The majority of the reforms announced can be expected to further achievement of the GOI milestone of maintaining market-oriented interest rates and expanding and extending coverage of financial institutions in the urban and rural areas. In the case of maintaining market interest rates, government has, with the exception of interventions in the quarter of 1987, allowed market forces to determine interest rates in the private banks. Government has also expanded non-priority lending programs in the State Commercial Banks (SCB's) in an effort to direct a greater share of banking activity towards the commercial market.

- Milestone: Improve Banking Access

The December 24, 1987 policy package simplified listing requirements for the Jakarta exchange, introduced a parallel (over-the-counter) market for smaller companies, introduced the use of bearer securities and made provision for foreign investors to purchase shares on the stock market. These measures were designed to help broaden opportunities for private resource mobilization and to encourage greater term-equity investment in the financial system.

The October 27, 1988 package of financial reforms included changes in policy designed to improve banking competitiveness, increase access to banking services and provide for fair treatment between savings and equity investment. A number of the October 27 reforms were designed to increase access to financial institutions such as (a) banks meeting approved soundness criteria are allowed to open branches, (b) sound non-bank financial institutions are allowed to branch in six main cities, (c) minimum capital requirements are set for private banks and cooperatives to establish banks and branches in urban and rural locations, (d) non-bank financial institutions are provided authority to issue certificates of deposit, (e) sound banks having a business volume over Rp. 100 billion may become foreign exchange banks, (f) rules on forming joint ventures between foreign banks and national banks, primarily for export-credit purposes, were eased and simplified and (g) foreign and joint-venture banks were permitted to branch to five cities in addition to Jakarta.

The October 27 package included various measures aimed at promoting competition in rural financial intermediation including (a) provisions enabling state owned enterprises (BUMN, BJMD) to deposit a limited portion of their funds at either private banks or non-bank financial institutions, (b) provisions to restrict concentration in a bank's portfolio to a single debtor, debtor group or board of

director's, (c) extending the swap facility from 6 months to three years, (d) extending SBI and SBPU validity from 7 days to six months with the cap on bank loan limits removed, (e) reducing the reserve requirement for Banks and NBFI from 15 to 2 percent of obligations and (f) extending the business license for money changers from one year to an indefinite period.

A recent financial sector reform which will have a major impact is the imposition of a fifteen percent withholding tax on time deposits and certificates of deposit, with certain exceptions, effective as of 15 November 1988. This was designed to mobilize revenues and provide neutral treatment of income from short-term savings and long-term equity investment. However, due to absence of a well-formed equity market, imposition of this tax has depressed demand for financial assets. In the short-term, this has placed pressure on bank liquidity and has resulted in further upward pressure on interest rates. To the extent that this encourages investors to shift to the equity market, this will contribute to GOI's efforts to develop market-oriented interest rates for long-term borrowing, although the present reform seems to be out-of-sequence with the development of the long-term capital market.

The October 27 reforms were followed by another comprehensive policy reform package on capital markets and financial institutions on the 20th of December 1988. This package was aimed at improving competitiveness in the capital market, encouraging development of non-bank financial institutions and promoting broader non-oil revenue mobilization. Included in this package were measures which (a) enabled establishment of a private stock exchange under full Indonesian ownership, (b) enabled establishment of stock exchanges outside of Jakarta and (c) eased rules for listing shares on the Jakarta exchange and in newly created exchanges.

The package also included measures to safeguard stock market investments by prohibiting insider trading and limiting the amount of shares held by a member of the board of directors of a publicly traded company. To encourage broadening of financial services, rules for national and joint-venture licensing of leasing companies, factoring companies, venture-capital companies, securities houses, credit card corporations and consumer finance houses were simplified. Licensing requirements were broadened to allow for multi-service financial companies and banks. Non-bank financial institutions were provided authority to engage in securities, credit card, factoring and consumer finance in addition to their licensing banking activities. The December 20, 1988 policy package also regularized procedures for establishing an insurance company and established soundness measures for the insurance industry based on solvency margins and technical management capacity.

- Implementation Bottlenecks

The financial reforms cited above make a significant contribution to achievement of the GOI's policy objectives stated in ARSSP. However, as the content of the recent reforms indicates, achievement of these objectives is hindered by the lack of a clear legal framework for establishment and operation of various types of financial institutions and by the shallowness of the non-banking sector. Other factors that have hindered achievement of financial sector milestones are more structural in nature - State Commercial Banks continue to occupy a prominent position in the sector and an important part of their operations remains the channeling of low cost central bank funds to targeted programs. The budget deficit has fueled speculative movement against the rupiah. This has contributed to high short-term interest rates which have discouraged investment in long-term equity instruments. Expectation driven movement against the rupiah, particularly in third-quarter 1987, also induced the GOI to rely on non-market interventions to stabilize the exchange rate.

- Conclusions: Importance of Resource Mobilization Reforms

In the finance sector, real interest rates have remained positive, and rising, through 1987 and 1988. Growth in lending has been faster in the private banks than in the state banks, which indicates that competitive forces are being allowed to influence the structure of the market. The share of total loans allocated to the various sectors has remained much the same over the past five years - this suggests that banking reform has not yet had an appreciable effect on inter-sectoral resource transfers. Reliance of the State Commercial Banks (SCB's) on Bank Indonesia financing remains as high in 1988 as it was in the early 1980's, reflecting partly a lack of competitiveness in source of funds and partly a lack - from Bank Indonesia's vantage point - of alternative instruments for monetary expansion.

At present, there is some evidence of a reduction in financial intermediation costs, particularly in cases where non-priority loans account for a high and rising share of a Bank's portfolio. However, in large part, the State Commercial Banks continue to operate on average, rather than marginal cost of fund principles, with spreads ranging from 4 to 6% on term loans. Selected non-subsidized programs continue to perform well - witness the growth in lending under the small scale credit (Kuppedas) and the savings mobilized under the small scale savings (Simpedes) programs. However, the banking system is far from unified, GOI program lending remains very important to the solvency of the SCB's, while interest ceilings in general have been removed specific programs continue to impose artificial ceilings, and the stock market, while making important

gains, is still relatively shallow (1). *

On the investment side, regulatory reforms have contributed to the growth and diversification of export-based industries. This is confirmed by estimates of growth in non-oil manufactures and by a rapid rise in the number of firms taking advantage of P4BM's duty drawback facilities. Although government regulations have made a substantial contribution to investment licensing and operation, the fact remains that the investment regulatory regime continues to be ranked near the bottom of the list for ASEAN nations in terms of attractiveness to foreign investment. By comparison, businessmen consider the regulatory reform in other

ASEAN nations to be more attractive, particularly in the area of divestiture policy, tax incentives, contract law enforcement, use of expatriate staff and operating permit requirements. Indonesia's abundant natural resources, combined with low labor costs and a stable polity, act to offset these regulatory disadvantages(2). On the agricultural front, long and arduous procedures for obtaining access to agricultural land, and obtaining permits for forestry land replacement, continue to hinder agro-based investment. For selected agro-industries, licensing restrictions--designed to balance raw material supply and processing demand--serve as serious barriers to competition.

Overall, the objective of 'domestic resource mobilization' is a bit misleading. Normally domestic resource mobilization is interpreted in public finance as efforts made by government to encourage public or private savings through fiscal and monetary policy. In fact, in this area, important reforms are underway in broadening the domestic tax base, eliminating indirect (and relatively more distortionary) taxes and introducing a more transparent budget through elimination of quantitative trade restrictions. Under the heading of 'domestic resource mobilization', one would typically expect to see areas such as domestic taxation, debt management and transparency in public finance highlighted. These, in fact, are important resource mobilization issues. It could be argued, in fact, that achievement of ARSSP milestones, unto themselves, would have very little effect on domestic resource mobilization--as it is commonly understood. Once again, it appears that there is a mis-match between a process as an objective, and a set of milestones which appear to be part of an effort to contribute to 'financial deepening'.

(1). His honorable Minister Ali Wardana cites improvement in BRI rural credit operations as evidence of economic improvement post-deregulation. Minister Wardana cites statistics which indicate that, post 1983, BRI intermediation costs have fallen from 60% of credit outstanding to 14%; rural credit volume has risen by a factor of 12 and savings deposited in BRI village units has increased by a factor of 9. See Ali Wardana, "Structural Adjustment in Indonesia: Export and the High-Cost Economy", Keynote address to the 24th Conference of S.E. Asian Central Bank Governors", Bangkok, 25 January 1989.

3.2.3 Institutional Change Objective

- Findings

The third main ARSSP objective is in the area of institutional change in agriculture and finance. The primary program objective is to 'introduce institutional reforms required to improve planning and implementation of policies and programs aimed at agricultural sector diversification'. Sub-objectives were defined in the areas of agricultural research (AARD), agricultural planning and financial sector management. These sub-objectives and milestones are as follows:

"in research - (a) establish a staff planning unit in AARD to review commodity mandates and propose alternative approaches", (b) develop a management information system which will help in monitoring research performance against program priorities, (c) implement changes required in organizational structure to improve agency management and staff performance;

in Planning (a) establishment of a working group on reorganization of Ministry of Agriculture planning, management and administration functions, (b) preparation of an analysis of international markets (prices, competition prospects) for selected agricultural commodities; plans to be incorporated in Repelita V, (c) Preparation of a plan to carry out environmental impact assessments throughout the MOA

in Finance, under the program objective, introduce institutional reforms required to improve management of policy changes related to domestic resource mobilization, e.g., (a) within the Ministry of Finance, establish units responsible for development and supervision of the pension and insurance industries, and (2) develop manpower plans and training programs for Ministry of Finance officials responsible for pension and insurance administration."

- Milestone: Improve Agricultural Research Management

In the case of AARD, measures taken in support of specific institutional objectives include (a) the proposal to re-establish the Center for Agricultural Programming, led by a director with a mandate to help set priorities, plan, program and monitor research expenditures, was approved by the Minister of Agriculture in January 1989 (b) an AARD research policy statement, laying out detailed guidelines for priority setting, improved programming, better research administration, staff restructuring, financing and outreach has been approved by the Minister of Agriculture in January 1989. Formal issuance of the research policy statement is expected

(2). See Price Waterhouse, "Foreign Investment in Indonesia", 2 volumes, 1987.

in Spring 1989, (c) AARD has begun preparation of a research Master Plan together with a team of World Bank consultants, (d) AARD has prepared comprehensive commodity research programs for corn and legumes together with USAID consultants, (e) AARD has, with AID project assistance, employed two management consultants to train staff and establish building maintenance procedures in 3 institutes and 10 research stations (f) AARD has established a 10 person steering committee and employed Winrock International consultants to design a management information system (MIS), (g) AARD has used ARSSP budget support to finance MIS development and training costs in fiscal 1988/89 and (h) a MIS training program is underway with the aim of training 144 computer-trained individuals.

Progress in AARD institutional reform has been hampered by (a) the need to mesh formal agency structural reform with the timetable for Ministry reform, (b) the transition period accompanying a turnover in agency leadership, (c) a lack of AARD staff trained in research planning and financial management, (d) excessive reliance on outside agencies for planning and programming support and (e) an attempt to finance MIS training in advance of MIS development.

- Milestones: Agricultural Planning: Guide Regional Development, Incentives Policy and Improve Sustainability

In the area of agricultural planning, specific activities undertaken in support of institutional reform objectives include: (a) an ARSSP supported study has been completed by the Bureau of Planning on the future role of the Provincial Kanwil in regional agricultural planning, (b) other Bureau of Planning studies are underway on decentralization and staffing (c) the Junior Minister of Agriculture established and began staffing a Task Force on Agricultural Policy Analysis in mid-1988 with a mandate to study selected commodity markets and analyze policy options, (d) a plan for administrative reorganization of the Ministry was prepared in late 1988 under the auspices of the office of the Secretary of Agriculture (e) Bureau of Planning staff have continued MOA budget analysis work initiated in 1986, (f) the Bureau of Foreign Affairs, Commodity Analysis Division has prepared special studies on latex, rubber, coffee and tea in 1988, (g) a MOA Andal Commission has been formed to supervise implementation of environmental impact assessment (EIA) procedures in the Ministry, (h) the Bureau of Planning has employed an AID consultant to design procedures for an environmental impact assessment and (i) MOA has requested donor support for an expanded package of technical assistance to implement EIA procedures.

Factors which have hindered implementation of the institutional objectives for improved agricultural planning include (a) the lack of an official mandate to form a committee on reorganization of Ministry of Agriculture planning, management and administrative functions, (b) lack of staff capability in areas of international market analysis, (c) a lack of clear delegation of responsibilities amongst the Bureau of Planning, MOA, Planning Unit of the Director General of Estate Crops, MOA, Joint Marketing Office of the PTP's,

MOA, Bureau of Foreign Affairs, Commodity Analysis Division, MOA, and Directorate of External Agricultural Trade, MOT for international agricultural market analysis, and (d) a lack of staff and tested-experience within MOA on environmental impact assessment procedures.

- Milestones: Prepare Pension and Insurance Institutions

In support of the specific institutional objectives laid out in the Finance sub-sector, government has registered the following progress: (a) a Board for the Analysis of Regional Finance, Credits and Balance of Payments was provided responsibility for review of pension, insurance and banking legislation, (b) comparative studies to Western Europe, Canada and Australia were conducted in 1988 by MOF staff together with representatives from Bank Indonesia and private industry to review options for Pension and Insurance legislation and administration, (c) staffing plans and administrative scope for proposed Pension and Insurance oversight boards have been drafted, (d) licensing requirements for insurance firms were specified in the December 21, 1988 financial sector package and (e) implementation guidelines for implementing these licensing requirements are under preparation as of January 1989. The primary constraint to implementation of these institutional reforms has been extended delays in the passage of the proposed pension and insurance laws.

- Conclusions: The Importance of the Institutional Reforms

The institutional changes described above do make significant progress towards achievement of the ARSSP milestones. In the Finance area, delay in passage of the pension and insurance Legislation has delayed progress on establishing responsible institutions in these areas. It will likely require several years before one can evaluate whether or not these institutional changes will in fact lead to better agricultural research management, better agricultural planning and better financial sector supervision. None of these reform items could be expected to have a particularly significant effect in the short-run, and for this reason, one can question their inclusion in a policy reform agenda. There have been particularly important institutional reforms undertaken within the last two years, such as the reorientation of the Ministry of Trade from licensing to trade promotion, however, those listed in the ARSSP agenda are not of that kind. Institutional reforms which constitute a major change in the role, responsibility or authority of a public body, may be regarded as appropriate for inclusion in a policy agenda, whereby those related to a gradual improvement in resource management, would better be dealt with under project assistance.

- Recommendations

On balance, government has made significant progress towards meeting the goals and objectives stated in the 20/7/1987 list of policy objectives and milestones. Government has moved cautiously in certain areas, although in practically each item, there is evidence of a concerted movement in the direction of agreed upon reform. There is clear evidence of a cautious, reasoned movement towards reform in both agricultural diversification and resource mobilization. In milestone areas where there has been a relative lack of apparent regulatory progress, there is evidence that reform proposals have been made and that these proposals are being given a thorough political hearing. It is also clear that the ARSSP reforms are only a small sub-set of important policy reforms undertaken by government in the past two years, and that the overall reform movement is designed to address the GOI's macro-economic imbalances.

Government shows evidence of being strongly committed to policy reform--reform of the type that by allowing stronger play to market forces, is likely to encourage faster growth and development. Recent reforms have been moving in the right direction, but that it will require several years to evaluate the full effect of the reforms. There remain significant trade, finance, investment, and public expenditure/operation distortions which can only be corrected by further policy change. In the commodity producing sectors, the very development strategy itself is in a state of transition, and, therefore, policy is framed and implemented to serve a set of internally inconsistent goals and objectives.

In agriculture, for those who support a inward-oriented, sufficiency-based development strategy, many of the policy instruments in place today are appropriate. The opposite is the case for those who support a more outward-oriented growth-maximizing development strategy. In the Industrial sector, those who argue in favor of supporting infant industries tend also to support many of the self-same set of protectionist, restrictive policies which have come under attack in government's deregulation effort.

In finance and trade, there is more of a consensus regarding the need to reorient the development strategy and public policy change than there is in agriculture and industry. In both industry and agriculture, the framing of a more neutral, efficiency signaling policy regime will require a greater consensus on the need to change development strategies than that which prevails at present. This implies that enunciation of a policy reform strategy cannot outpace agreement on the overall development objectives/strategy of the sector.

Within government, very important institutional reforms are occurring, but these are not the types of institutional reforms that ARSSP highlights. In an institutional sense, government has undertaken important reforms by redefining the role of the public sector. The more important institutional reforms, at present, have

to do with changing the roles and responsibilities of public institutions (e.g. from licensing to facilitating, from commodity production to regulation), rather than improving management per se. Improved planning and better supervision - as reflected in ARSSP's institutional objectives - are important institutional goals, but are not, at the present juncture, in the mainstream of the institutional reform effort.

Policy reform has been piecemeal and very difficult to predict. Government has argued that reform should be properly sequenced (e.g. finance and trade before commodity producing sectors) and gradual (e.g. when political forces permit). This implies that there is a high degree of error and uncertainty attached to trying to predict the composition and pace of policy reform. This implies that one should not attach too much importance to framing a milestone list--much less a list of fairly specific, time-tracked reforms, but rather focus efforts on supporting and advancing the policy agenda, within the broad categories government is working to reform.

a) Update Milestones: USAID and GOI may wish to update the list of policy milestones to take into account advances registered during the first two years of ARSSP and to signal new directions for ongoing reform. It would be appropriate to eliminate the policy milestone regarding removal of pesticide subsidies because of government's December 1988 announcement abolishing pesticide subsidies. It would also be appropriate to drop the policy milestone calling for a removal of inter-insular copra taxes because of the rather inconsequential nature of this particular reform.

It is also recommended that the institutional objectives be deleted from the ARSSP milestone list because implementation experience has shown that institutional change requires a longer time-frame than can be accommodated with short-term program assistance and because of the dependence of institutional change on progress in the policy arena. Institutional objectives should be shifted from establishing new institutions to a focus on evaluating the impact of recent policy change, analyzing institutional options and providing short-term assistance in policy reform implementation.

It is also recommended that the financial sector policy milestone regarding introduction of insurance and pensions laws be deleted from the list as their passage is now tied more to political fortunes than to any possible assistance that a donor agency can provide.

Items which may be appropriate candidates for addition to the milestone list include the following:

- a) remove non-tariff trade barriers for agricultural imports and exports.
- b) lower the rates of tariff protection on agricultural imports.

c) phase-out special targeted liquidity credit programs from Bank Indonesia in favor of financial injections in the equity market and two-stage off-lending to the private banks.

d) reduce the role of government in agricultural commodity production and distribution while improving the competitiveness of state owned enterprises in the agricultural area.

Further investigation is warranted to validate the soundness and acceptability to Government of these additional/replacement reforms. If budget support is reoriented to finance innovative policy activities, then the milestones will serve as a framework against which support activities can be vetted. Since to date the milestones have served primarily as an internal USAID accounting device, rather than as a focus for government reform efforts, the number, generality and breadth of the milestone list should be adapted to resources available for supporting policy-based assistance within USAID.

3.3 Future A.I.D Strategy

- Findings

Continue Policy-Based Assistance: The Government of Indonesia and USAID should continue to cooperate in the area of policy based assistance. Such assistance should build upon the positive accomplishments of the first two years of ARSSP implementation. Reasons for continuing policy-based assistance include (a). a demonstrable commitment by government to progressive reform as demonstrated by the numerous policy packages and announcements during the past two years, (b). a continued and well recognized need for further improvements in the policy framework to elicit efficient patterns of growth and development during the Fifth Plan period (c) evidence of significant contribution to the reform process by selected activities financed under ARSSP and (d) continued budgetary constraints which require short-term special assistance financing. Special assistance financing should be phased-out over the next two to three years in order to provide a positive incentive to government to raise the efficiency of public expenditures, contain expenditures within a manageable limit and improve the domestic resource mobilization effort.

In their 1987 Economic Memorandum, the World Bank draws an important distinction between three categories of donor assistance. The IBRD classification system is a useful aid in understanding the differences in the role played by project, program and special assistance lending under the IGGI.

The bulk of economic assistance provided to Indonesia is in the form of project aid. Project aid is designed to add to the nation's capital stock by financing a discrete set of development activities. The time-span of project assistance is contingent upon the length of time required to complete the particular development

task. Physical and financial measures of progress are used to monitor progress in implementation. Under most circumstances, the policy framework is treated as a factor outside the domain of project intervention.

In recent years, a larger share of multilateral bank development financing has been in the area of adjustment financing. The rationale for this type of support is that budget support is required to assist government during a period of transition in economic management. This type of support is used to facilitate change by offsetting the adjustment costs which occur during the transition to an improved policy regime.

Starting with the downturn in international petroleum prices in 1985, Indonesia began to shift its sovereign borrowing portfolio from project to program based assistance. Two broad categories of program assistance can be identified. The first is what the Bank classifies, for the Indonesian case, as special assistance. Special assistance is short-term, quick-disbursing financing provided to a government in order to finance a budget deficit during a period of economic adjustment. Special assistance lending is typically linked to an economic adjustment program in policy because of the need to reform both the incentives regime and public management in order to promote desired patterns of economic growth and development.

Special assistance programs are either linked explicitly or implicitly to a policy reform program. In the former case, loan conditionality is explicitly tied to a package of agreed-upon reforms. In the latter case, a time-slice of disbursements are phased-in according to ongoing donor review of progress registered in economic management. The scope of adjustment program assistance varies from the macro-economy to the sector and even the sub-sector, while the basic focus remains on improving the policy environment. In order to provide Government with the fiscal flexibility to implement a reform program quickly, special assistance is either used for general budgetary support or support to a broadly defined grouping of economic sectors and sub-sectors.

In recent years, a new form of lending has developed along the interface between special assistance/adjustment financing and projects. These are policy-associated loans which are typically referred to as "hybrid reform loans"(1). A hybrid reform loan combines both the reform emphasis of an adjustment package, targeted improvement sectoral or sub-sectoral public investment management with the financing of a set of clearly identified capital investments. In such a loan, a program for sectoral or sub-sectoral policy reform is linked, either implicitly or explicitly, to the financing of a time-slice of a government's public expenditure program. These loans are often used to help in the transition from heavy dependence on project-based assistance to development and effective management of investment programs. Such loans also serve as a 'bottom-up' approach to policy reform compared to the more 'top-down' nature of economy-wide special-assistance.

- Conclusions

The ARSSP program lies somewhere on the cusp between special-assistance and hybrid-type reform lending. It shares the characteristics of special assistance in that quick disbursing budget-support financing is provided subject to a semi-explicit link to a policy reform program. On the other hand, expenditures are targetted for sets of budget-investments at a sub-sectoral level, as in the case of a hybrid-loan. As in a hybrid loan, ARSSP financing is linked to institutional improvements which, together with additionality rules, constitute a partial approach at reforming public expenditure management.

- Recommendations:

a) Shift more into Hybrid Assistance

A number of factors argue in favor of shifting, over the medium-term, from special assistance and project-based lending to what has come to be termed 'hybrid-reform' assistance. USAID has had experience with this form of assistance, particularly in the Africa region, and such experience may be of use in the design of an ARSSP amendment. Factors which contribute to the need to reduce special assistance over the near-term to Indonesia include difficulties in maintaining a transparent link between special assistance and policy reform, the need to avoid institutionalizing special assistance by breaking the link between this support and a rapid correction of the budget deficit and difficulties in encouraging better use of public expenditures in a project, rather than a program lending mode.

On the other hand, there is a continued need to focus attention on reforming policy, and coordinating macro-economic policy reform with sectoral policy reform, which shall become ever more important in the years to come. A continued focus on policy, combined with an attempt to integrate the many on-going investment projects into efficient and effective investment programs, lies at the heart of 'hybrid-reform' lending. For AID, this provides a mechanism for focusing assistance efforts sectorally while maintaining an active involvement in the policy dialogue. It also provides a mechanism by which to program activities which are more directly linked to policy reform and improving government program management without fully entering in to project management responsibilities.

(1). Examples of hybrid lending operations include the IBRD's Irrigation Sub-Sector Loan, Rural Credit Sector Loan, the Urban Sector Loan and the Agricultural Research Management Project. Other examples include the Asian Development Bank's Irrigation Sub-Sector Loan and Financial Sector Loan.

b) Continue Support in Agriculture and Finance:

In the near-term, policy-based assistance should be contained within the general limits of agriculture and finance. There remains considerable scope and need for reform in both sectors and AID and GOI should continue to build upon advances registered during the first ARSSP period. With perhaps the exception of the health sector, it does not appear as if USAID has had adequate project experience, or in-house expertise, to serve as a basis for program assistance outside of agriculture or finance at the present time. Expertise in these other areas could, of course, be developed; however this will likely require several years to be at a level at which active policy advisement is possible.

c) Focus the Policy Dialogue Process on Options Analysis:

The policy dialogue process could be improved by focusing the AID Mission's efforts on a combination of (a) providing financial support for activities directly linked to policy formulation and implementation and (b) by preparing and sharing analysis of policy issues and options with responsible officials in the Government of Indonesia. It is important that the substance of the policy dialogue process center around reform issues - in terms of the options government has for making reform, likely consequences of reforms, options for improving reform implementation and impacts of previous reforms, rather than focusing too much on the procedural side of disbursements, monitoring and reimbursements. Unfortunately in policy-based aid, government officials at a senior policy-advising level, get drawn into questions of improving the particular special assistance program's flow of funds and documentation trail although this is neither their area of expertise nor interest.

In fact, AID has made a significant investment in policy analysis capabilities to support the USAID/Jakarta policy dialogue with the GOI. One way of focusing AID analysis resources, would be to prepare a series of internal Mission working papers on topics related to ARSSP milestones. For this purpose, AID could draw on both the economic expertise in the ARSSP program, analysts working elsewhere in the Mission and analysts hired for specific tasks. For AID, the success of the policy dialogue is partly conditioned by an understanding of policy and reform processes built up through years of project-related assistance. In the finance and agriculture areas, it would be worthwhile trying to maintain activities (e.g. in the FID Project and Agricultural Planning Project) that have provided substantive input into the policy dialogue process in the past.

4. ARSSP's Budget Support

As Section 2.4 discussed, the issue of linkage between the policy agenda and budget support components of ARSSP. One point of view is that, in principle, the use of ARSSP funding is not of concern to A.I.D. in a program that is strictly budget support. A.I.D. should only be concerned about whether aggregate budget levels for the selected agencies meet the criteria for ARSSP support (i.e., the additionality issue discussed in section 4.2). There should be no programming of ARSSP funds by A.I.D. below that aggregate, agency level. From this position, examining the use of ARSSP funds is inappropriate because A.I.D. is not involved in programming - this is general budget support and A.I.D.'s responsibility does not extend to programming decisions.

Alternatively, if the budget support is to assist the agencies to carry out activities that advance the policy agenda, then A.I.D. must be interested in the results of the activities, such as research, studies, and training that contribute to policy formulation and implementation. The utility of those activities for policy-related purposes, is therefore, a fair evaluation issue. Further, it was assumed that the agencies receiving budget support will manage ARSSP funds according to GOI regulations and accounting systems that apply to their development budget. The validity of those assumptions is also relevant to the evaluation.

The evaluation adopts the position stated in the PAAD in reference to the changes involved with the policy and institutional milestones ARSSP supports: that budget support "... will provide resources to help effect some of these changes" broadly speaking (PAAD, p. 17). Section 4.1 reviews the utility of ARSSP budget support; section 4.2 examines the financial management system established for ARSSP budget support.

4.1 Budget Support Activities

- Findings

The bulk of ARSSP budget support was not used for activities directly related to the achievement of policy and institutional milestones. This is consistent with the position that there is (or should be) little association between the policy agenda and the budget support components of ARSSP. That is, budget support was intended as short-term assistance to help to "bridge" or "tide over" selected GOI agencies until government revenues increased.

However, a number of activities were conducted using ARSSP budget support that contributed to progress toward the policy milestones. Though the linkage between these activities and reform actions should not be overdrawn, special studies, seminars and workshops financed under ARSSP contributed to generating policy reform ideas, laying the groundwork for future reforms, broadening

inter-Ministerial communication on reform options, refining proposed legislation and identifying possible solutions to policy implementation problems.

Ministry seminars conducted with ARSSP funding have been cited as helping to build consensus on policy formulation and implementation.

Other examples include:

a) ARSSP financed comparative study tours that exposed officials to alternative regulatory regime options. Such study tours were conducted in the areas of banking, pensions, insurance, pawn shops, plantation development and brokerage. In addition to the benefits gained from exposure to alternative regulatory systems, such study tours were cited as an important means of bringing reluctant officials 'on-board' to support the reform movement.

b) During the first year of ARSSP implementation, the MOF conducted twelve special studies on public policy and the Planning Bureau of the MOA commissioned nine special studies. Annex 2 contains a listing of these studies. In the second year of ARSSP assistance, the MOF has proposed fourteen more special studies while Agriculture continues to work on those proposed under year one financing. In addition, under Bappenas guidance, the Center for Agro-Economic Research in Bogor is conducting four studies in the policy area with ARSSP budget support.

One potentially significant activity that ARSSP budget support will fund is an Integrated Pest Management program developed by the FAO. This is a highly innovative program in that IPM methods are not widely practiced in Indonesia. Providing financial backing to IPM activities, while in the design stage, appears to have played an important role in the decision to remove pesticide subsidies. A number of officials stated that IPM was a major factor in the removal of pesticide subsidies because it would allow farmers to adjust to higher pesticide prices without a loss in production or income. (Other factors contributing to the decision include the rising fiscal burden from the subsidy, the build-up of subsidy arrears, difficulty in monitoring the use of the subsidy and a recognition of environmental hazards created as a result of pesticide over-use.) If IPM activities proceed as anticipated under Bappenas' supervision, this will serve as an important mechanism for aiding the GOI to reach Fifth Plan objectives while offsetting the costs associated with the removal of pesticide subsidies. At this time, however, the IPM program has not yet started.

AARD has financed research activities using ARSSP budget support that are closely linked to policy reforms. For example, research on TSP applications on irrigated rice in Java showed that TSP application rates on rice are well in excess of optimal or even yield maximizing levels in various allocations. The fact that TSP accounted for the largest share of total fertilizer combined with research station evidence of TSP over-use, contributed to the

decision to reintroduce differential product pricing for fertilizers. This has been interpreted by numerous officials as a signal that the government intends to continue to use differential product pricing as a means of correcting adverse price distortions. However, the quality and utility of the special studies have varied. Ministry of Finance studies and seminars tended to focus on devising options for already identified policy problems or areas thought to be in need of near-term regulatory reform. Ministry of Agriculture studies, by comparison, focused more on basic research to identify areas for future reform. A greater stress on quality control, together with a relatively more narrow set of objectives, appears to have enhanced the utility of policy research. In respect to the comparative study tours, it is impossible to determine how useful or persuasive these tours were in advancing reforms.

Certain ARSSP activities that were designed to advance the policy agenda, through institutional reform or policy discussion, appear to have had little if any effect on the achievement of policy milestones, such as support to the agriculture research stations.

Other ARSSP financed activities appear to be counter-productive to achieving proposed policy milestones. The direction of GOI policy reforms has been towards a more market-driven, efficiency signaled economy, with a move away from a target-driven, policy sheltered system of allocation and production. In the agriculture sector, ARSSP resources has been used to finance development and mapping of fifth plan production targets for rice, secondary food crops and estate crops. ARSSP financed maps designating commodity-specific production targets have been distributed to the appropriate Provincial authorities for implementation during Fifth Plan. This runs counter to the implicit objective of the Fifth Plan that tries to move away from target-driven allocation of resources.

Likewise, the pattern of institutional reforms supported by ARSSP has been designed to increase efficiency and make more effective use of limited public resources. In some cases, it appears that the selected agencies have not had sufficient time to plan and program ARSSP budget assistance effectively. For example, AARD distributed budget support widely and relatively evenly over all research institutes. According to program managers, funds were allocated in proportion to the number of staff at each institute, concentrating funds on those institutes with more trained staff or who had submitted a greater number of research proposals. It does not appear that AARD has been able to utilize program assistance to meet agricultural research priorities, due to a lack of planning and programming support.

Apparently, it was assumed that the bulk of ARSSP budget support would be directed to on-going work of the participating agencies whereas many of the activities funded by ARSSP constitute new activities (as noted above, most of which are unrelated to policy reform). In certain instances in both the MOA and the MOF, the desire to raise development budget levels quickly has run counter to

attempts to reduce waste and introduce a more efficient, prioritized system of public expenditures. There is evidence that the release of ARSSP funds also resulted in GOI staff setting aside their on-going work to find activities for which ARSSP funds could be used. It is understood that senior GOI officials are aware of this absorbtive capacity issue and have taken action to improve the use of budget support funds.

- Conclusions

The fact that the bulk of ARSSP expenditures have not been used for activities directly related to the ARSSP policy agenda is consistent with the position that budget support was intended only to "tide over" selected GOI agencies and that only a limited portion of this assistance would contribute to achievement of policy milestones.

In respect to the effectiveness with which budget support funds have been used, there is a clear difference between the utility of activities that were well designed, managed and more directly linked to the policy agenda and the bulk of general budget support. ARSSP budget support was used effectively in several instances with minimal involvement by A.I.D. staff to advance the GOI's policy reform efforts in ways consistent with the overall structural adjustment process and the government's attempts to increase the efficiency of public expenditures.

This suggests that by strengthening the linkage between budget support and policy and institutional reform measures, the effectiveness of ARSSP's support could be improved, as well as clarifying just what it is that ARSSP "supports" and how it does so.

- Recommendations

a) The GOI's programming of ARSSP budget support should increasingly focus on activities that more directly pertain to the objectives of the program. Activities only partially or completely unassociated with the ARSSP policy agenda and institutional reform should receive much lower priority in the allocation of ARSSP budget support funds by the GOI.

b) A.I.D. needs to take a more active role in the identification and proposal of GOI programming options to advance policy and institutional reforms in the agriculture and financial markets sectors. In line with the concept of program/sector assistance, A.I.D. should not become involved with implementation of GOI activities. Rather, A.I.D. should focus on the outcome, results and utilization of those activities.

c) Though general budget support for agricultural research has not resulted in optimal use of ARSSP funds, agriculture research remains a high priority and is deserving of continued support, targeted to policy-related work.

4.2 ARSSP Implementation and Financial Monitoring

- Findings

4.2.1 Program Start-up

ARSSP budget support is part of the special assistance donors are currently providing to the GOI. Substantial lending is being provided by the Japanese, World Bank and the Asian Development Bank in support of Indonesia's structural adjustment efforts. Special assistance totaled \$1.1 billion in IFY 87/88, and \$2.3 billion in IFY 88/89. With a budget of \$65.8 million, ARSSP is clearly a very small part of this special assistance.

As a mode of program assistance, A.I.D.'s involvement in the programming of ARSSP funds and its financial management responsibilities were to be limited to the overall or aggregate level of participating agencies receiving ARSSP funding. The Financial Plan in the PAAD states:

"It is not required that the assistance under this program finance any specific activities. USAID will accordingly only monitor that funds go to target departmental budgets and that additionality in these key budgets is obtained."
(PAAD, p.37)

This means that A.I.D. does not become involved in the actual programming of ARSSP funds below the aggregate agency level, i.e., directing funds to specific projects or activities. If that is the case, then A.I.D.'s responsibility for the use of funds and application of U.S. government regulations does not extend below the aggregate agency level.

That may be well and good in principle; however, soon after signing the program agreement, the mission confronted the issue of how to implement ARSSP. The PAAD provides little useful guidance in this respect.

The first hurdle was meeting the conditions precedent to the program agreement so that the first disbursement could be made for IFY 87/88. This took until November 25, 1987. Because this was well into the third quarter of IFY 87/88, the first disbursement on December 21, 1987 covered both the third and fourth quarters of IFY 87/88. It is apparent from interviews and files that getting this far took considerable effort on the part of GOI and A.I.D. staff to develop the financial reporting system needed for ARSSP budget support.

4.2.2 The Financial Monitoring System

During the months following the signing of the program agreement, A.I.D. staff developed the financial reporting forms for ARSSP. The set of annual and quarterly reports were based on the GOI's regular procedures for development budget planning, financial accounting and management of donor funding. Consequently, the submission of financial reports follows the IFY cycle - beginning in April 1 and ending March 31 and the GOI budgeting cycle - from July through March.

Prior to submission of proposed development budgets (DUPs) in November, the program steering committee (chaired by Bappenas and composed of representatives of agencies receiving ARSSP funds) is to determine the activities and funding levels for ARSSP assistance. After review by Bappenas, and agreement by the MOF, A.I.D. and the participating agencies, the proposed development budgets, including ARSSP support, is forwarded for consideration in the national budget.

Budget allocations are established for each ministry and its sub-components and submitted in January to Parliament for review and approval. Proposed project budgets are adjusted and reviewed again by Bappenas and the MOF prior to final approval by the House, usually in March. The result is project/activity line item budgets (DIPs), routine budgets and transfer programs. It should be noted that the DIPs constitute highly rigid allocations; funds (including ARSSP funds) are earmarked for specific activities and funds normally cannot be moved from one DIP line item to another during the course of the year without an amendment, a time-consuming process. This means that ARSSP funds are, for all intents and purposes, "locked into" a discrete set of activities for the year.

Without going into all of the details of the financial reporting system, what should be recognized is that ARSSP's budget planning and expenditure tracking is based on estimated budget requirements and expenditures of individual projects. ARSSP and PL-480 funding are not commingled with the GOI's development budget, but rather, kept separate. In other words, the GOI's budget system establishes a record of ARSCP allocations to and expenditures for individual projects/activities within the participating agencies - i.e., below the aggregate agency level. Despite the original intention of monitoring only at the aggregate, agency level, financial data disaggregated by project/activity are routinely reported to A.I.D.

4.2.3 Additionality, Carry-overs and PL-480 Contributions

The above financial reporting data are used for ARSSP's disbursement mechanism. Disbursements are made according to a ninety day maximum advance procedure, i.e., disbursements are made to maintain a maximum of ninety day cash requirements for ARSSP supported activities. Funding requests and expenditure reporting were to have been on monthly basis; this proved too cumbersome, so a quarterly system is used instead.

A.I.D. approval for disbursements has largely focused on whether the GOI's development budget complies with the concept of additionality. This means that ARSSP funds will be additional to the GOI's "normal support" for the participating agencies by augmenting the "base" budgets allocated to the participating agencies, and by providing the resources needed to maintain important activities. Additionality responds to the concern that ARSSP funding might result in reductions in the GOI's budgeting for participating agencies, i.e., GOI funding would be directed elsewhere once those agencies received ARSSP support. This would defeat the intention of raising the development budgets of "key agencies". Therefore, ARSSP funding became "loosely" contingent on meeting the additionality criteria in an effort to deal with the fungibility issue.

Although the PAAD refers to additionality, it does not define how it will be measured. The first disbursement for the last two quarters of IFY87/88 were not problematic because baseline levels for the MOA and MOF for IFY 87/88 were easily met. However, with the beginning of a new fiscal year, defining additionality became a thorny issue. It was not until August 2, 1988 in Program Implementation Letter no. 7 that the first official attempt was made to clarify to the GOI what A.I.D. meant by additionality.

According to PIL 7, additionality refers to increases or decreases from one year to the next in the development budgets of participating agencies proportional to changes in the national development budget. If the GOI's overall development budget increased by 10% over the previous year, the budgets of participating agencies would have to increase by at least 10%. If the national development budget decreased by 10%, then the budgets of these agencies should not be reduced by more than 10%. The PIL goes further to note that balances of unspent funds at the end of the year should be carried over to the following year. The principle is that GOI's budget is spent first; when that is fully expended, ARSSP funds are then used. Funds unspent at the end of year are by definition unexpended ARSSP funds. Finally, the PIL establishes a ceiling for the budgets of participating agencies - ARSSP and GOI funds combined should not exceed the IFY 85/86 level.

Based on these rules, an analysis of the IFY 88/89 budgets for ARSSP assisted agencies indicated that three agencies were not in compliance with additionality and that three others exceeded the 85/86 ceiling. Disbursement for the first and second quarters was held up until midway through the second quarter (August 1988) when A.I.D. made a case for exempting these agencies from the very rules it had just established in the PIL. Among the arguments made was that although AARD's budget was above the 85/86 ceiling level, this was acceptable because of the importance of agricultural research in justifying the use of agriculture account funds for ARSSP. The Directorate General of the MOF was similarly exempt from the ceiling because it was incurring extraordinary expenses in preparing banking, pensions and insurance legislation.

The definition of additionality was further refined in PIL 8 which added the criterion that changes in the development budget of agencies also had to be minimally proportional to changes in their ministry's budget. For example, if the MOA's budget increased by 10%, then AARD's should increase by at least 10%. A decrease of 10% in the MOA's budget should result in no more than a 10% decrease in AARD's budget. Within the mission, the carry-over issue was also further refined, resulting in a formula to apportion unexpended funds between ARSSP and GOI accounts if there were good reasons for the shortfall in expenditures; but this refinement was never applied.

The mission confronted a problem in what to do if additionality was not met. At one point, it was proposed that ARSSP funds would be adjusted downward in proportion to the deviation from the proportionality requirement. For example, if the overall development budget increased 15%, and the agency's budget increased only by 10%, then ARSSP funding requested for that agency would be reduced by 5%. Alternatively, the mission could withhold disbursement.

A final consideration in analyzing the GOI's budget concerns the attribution of PL-480 local currency contributions to participating agencies. It was agreed that PL-480 funds would not have to meet additionality criteria. However, PL-480 funds were to be provided in proportion to the ratio of total PL-480 funds to total ARSSP grant funds - i.e., 34.7% of ARSSP support to an agency should come from PL-480 funds, the remainder from ARSSP funds. For IFY 88/89 the GOI had already been combined PL-480 funds with their own budget and had allocated these funds to participating agencies. Alternative ways of attributing PL-480 contributions by the GOI were proposed. In practice, the PL-480 allocation and proportionality issues have not been used in monitoring PL480 contributions.

4.2.4 Use of the Above Rules

After months of A.I.D. staff time, the mission now has the basis for tracking and determining additionality, carry-over and PL-480 proportionality. In practice, carry-over has occurred only once and PL-480 proportionality seems to be ignored. Annex 3 contains the mission's latest effort based on the initial budget (Anggaran Murni) and 87/88 expenditure data to assess additionality. Accepting the data at face value and recognizing that there are legitimate reasons why two agencies appear not to meet the additionality rule, it could be concluded that the present budget levels comply with additionality criteria and the fourth quarter disbursement for IFY 88/89 could be made.

However, the GOI operates officially on a balanced budget, and expenditures are adjusted upwards or downwards as actual revenues deviate from projections. An important adjustment occurs in the Fall with the ABT, a supplemental budget for the DIPs. The initial budget (Anggaran Murni) that takes effect on April 1 may represent

as little as one-third of total commitments in some years. Hence, the initial budget can deviate, sometimes substantially, from actual expenditures. Interviews with GOI officials supported this - with only two months left in the current fiscal year, some were still not sure what their budget would be. Consequently, total expenditures for the year are the most reliable basis for assessing additionality (realizing that the expenditures reported shortly after the end of the year are estimates; actual realizations are not available until some two years or more after the end of the year).

Nonetheless, the initial budget (Anggaran Murni) must be used to assess additionality for committing ARSSP funds for the coming year because ARSSP funds are committed for the coming IFY six or more months in advance of having expenditure data for the current IFY. This problem was recognized in A.I.D.'s analysis supporting PIL 7. The best that could be suggested was to assess additionality on the basis of the initial budget, the revised budget in September and actual expenditures for the preceding IFY when those data become available. If expenditure data (end of year estimates) indicate additionality criteria have not been met, the question then is what to do about it several months after the fact when ARSSP is already well into the next IFY.

4.2.5 Disbursements

ARSSP disbursements under this system have been irregular. The first disbursement for the third and fourth quarters of IFY 87/88 occurred in late December 1987. Disbursement for the first and second quarters of IFY 88/89 occurred in August 1988. The third quarter disbursement was the most timely to date - October 1988 (the start of that quarter). A request for the fourth quarter disbursement made on 21/12/88 has not been met because of apparent non-compliance with additionality by two participating agencies. Two months after the request, A.I.D. learned that noncompliance was due to the end of construction activities for these agencies; meaning budget reductions were justifiable. Disbursement was also delayed by the lack of a report from the GOI concerning progress toward the policy agenda items.

The irregular flow of ARSSP funds runs contrary to helping the participating agencies to maintain effective operations. AARD's agricultural research program exemplifies this most clearly. Delay of first and second quarter disbursements for IFY 88/89 meant that funds needed by agricultural research stations arrived months too late. That is, funding for the supplies and planting required for field trials in February arrived in late August, months out of step with the agricultural cycle. The effects of this irregular flow of ARSSP funds were compounded by this year's unusually late allocation of GOI budget (usually in June/July, this year, in October). Research stations had no development budget funds from April to September. By October, with the allocation of ARSSP and GOI budget, they were comparatively awash with funds

4.2.6 A.I.D. Involvement in the Programming of ARSSP Funds

There is evidence that A.I.D.'s role in programming and monitoring ARSSP budget support has exceeded the initial intention of focusing at the participating agency level. From the very outset, with the design of the financial reporting system, the level of detail dropped below the aggregate, agency level. Further, some correspondence between A.I.D. and the GOI identifies activities that ARSSP could support and sets limits to commodity procurement, suggesting, for all intents and purposes, A.I.D. involvement in the more detailed programming of ARSSP funding. This currently continues with A.I.D. project officers occasionally recommending that their counterparts use ARSSP funding for specific activities. A.I.D. has waived on defining to the GOI what A.I.D.'s position is on programming and monitoring ARSSP funded activities. Despite telling the GOI that A.I.D. will not be involved with programming; the mission has questioned the GOI about uses of ARSSP funds that may be inappropriate by A.I.D. regulations.

- Conclusions

The complexity and lack of congruence with the reality of the GOI budgeting process undermines the utility of additionality. That is in no way a criticism of the efforts of A.I.D. and GOI staff who tried (heroically) to identify how the concept of additionality could be made operational. but in retrospect, this has been a concerted effort at making an impractical idea work. Additionality runs contrary to the new relationship between A.I.D. and GOI ARSSP tries to advance. With the development of Indonesia as a middle income country and its growing management capabilities, program assistance, as opposed to direct management of project investments, is increasingly appropriate. Additionality is largely inconsistent with this. It tries to assure, and even force through withholding disbursements, that the GOI adheres to ARSSP's budget support priorities.

If indeed the GOI gives priority to the same areas that ARSSP supports, the effect of additionality may be completely the reverse of what is intended. Without ARSSP, the GOI might have cut budgets in other areas to fund agricultural research or the design and implementation of financial markets and customs reforms. If that were the case, additionality might actually be protecting the budgets of those other areas where cuts might have occurred. In short, the effects of additionality cannot be determined because there is no counter-factual case for comparison.

If ARSSP funding priorities are not shared by the GOI, then future development budget allocations will reflect the GOI's actual priorities when ARSSP budget support ends. The result will be a short-term infusion of funds that supports activities temporarily which become unsustainable after the program. The utility of additionality becomes yet more dubious when the disruptive effects of sudden increases of funds on routine operations are considered.

The application of additionality appears to have produced no positive benefits in respect to budget support objectives and, if the mission's recent analysis of GOI budgets is accurate, nor does it appear to have been necessary. Delays in disbursement caused by additionality have been disruptive and contrary to assisting agencies to maintain effective operations. Moreover, assuring that additionality criteria are met unnecessarily embroils A.I.D. in the GOI budgeting process (i.e., DUPs and DIPs). The additionality issue has also deflected management attention away from more important policy discussions and engaged senior GOI officials in budgetary matters that should not ordinarily be their concern.

As a management tool, what is A.I.D. to do if it finds in July or August of the present IFY that expenditures for the previous year do not meet criteria for additionality? Does it disallow past expenditures? Reduce future budget support levels in the offending agencies? Does it withhold disbursements? None of these punitive actions are viable because each would only defeat the intent of providing budget support.

Regarding ARSSP budget support in general, earmarking funding to specific agencies runs contrary to sound financial management principles. It introduces yet more rigidities into an already overly-rigid budgeting process. It precludes re-directing funding to areas that support emerging policy and institutional reform priorities of the GOI. Moreover, initial decisions about which agencies are to receive ARSSP funding has resulted in an anticipation of and dependency on continuing that support over the course of the program. This runs contrary to the idea that ARSSP would provide a flexible funding mechanism.

The assumption that ARSSP funds would be managed in accordance with GOI budget regulations was inaccurate. In some instances, ARSSP funds have been viewed as an "extraordinary" resource that could be used for activities for which the regular development budget (i.e., funding from local resources and foreign aid) cannot be used (without special exception being granted for such activities). A.I.D. contributed to the current confusion about appropriate use of ARSSP funds by not making its position clear from the outset.

The present financial reporting systems embroils A.I.D. in a level of detail that was not originally envisioned. Despite the best of intentions of those involved with implementing ARSSP, the reporting of budget and expenditure data at the project/activity level crosses the line between program and project assistance.

A.I.D.'s role in ARSSP programming is ambiguous and needs to be clarified. Complete non-involvement in programming was probably a bad idea from the beginning. The mission should recognize that it can work cooperatively with the GOI on identifying programming options directly related to ARSSP's policy agenda without violating the intent of program assistance.

In short, mid-course corrections are needed to make ARSSP a flexible funding mechanism for activities that directly advance ARSSP's policy agenda. These changes will need to be fully understood by the GOI, emphasizing that these modifications are an effort to improve the utility of ARSSP.

- Recommendations

- a) Eliminate additionality as a criterion for ARSSP disbursements.
- b) Continue to use the quarterly request and expenditure system; however, use an attribution method for liquidating ASRRP funds (e.g., total agency expenditures over the past quarter are equal to or exceed previous ARSSP disbursements)
- c) GOI financial reporting to A.I.D. should be limited to the participating agency level, using the existing quarterly reporting forms.
- d) ARSSP funds should be subject to the same rules that govern the GOI's development budget; exceptions should be made only with prior mutual agreement between the GOI and A.I.D.
- e) Develop a negative list of uses of ARSSP funds to clarify A.I.D.'s position on appropriate categoric uses of ARSSP funds.
- f) To the fullest extent possible, ARSSP funding should support work on policy analysis, formulation and implementation of reforms.
- g) A.I.D. should work collaboratively with the GOI to identify ARSSP funded activities, with the GOI having responsibility for the implementation of these activities, and A.I.D. providing assistance directly or through short- and long-term technical advisors to improve the quality of the final product or activity.
- h) A.I.D.'s monitoring of these activities should focus on the utility of these activities in respect to policy issues (e.g., the use of study findings, next steps in policy implementation).
- i) Explore alternative funding mechanisms to support policy analysis, formulation and implementation. On a pilot basis, develop a special fund to support innovative policy activities. The fund would be outside of the normal budget/DIP process and constitute supplemental budget support for policy related activities. Section 6 on the recommended amendment to ARSSP provides more detail (1).

4.3 Technical Assistance

- Findings

\$1.5 million were budgeted in ARSSP for short- and long-term technical assistance. \$541,000 of these funds have been expended or obligated for the following: a) planning the IPM program, b) assistance for preparing the GOI for the GATT meetings, c) developing ARSSP's management information system, d) funding the long-term JCC/ARSSP program manager and e) costs of the interim evaluation.

The remainder is earmarked for the CARD Iowa State Project, a technical advisor to the Ministry of Trade and short-term advisors for the Trade and Technology project, analysis of financial de-regulation, and funding for Agriculture Trade and Development Mission (ATDM) activities. In short, no additional funds remain in the account.

The technical assistance account of ARSSP has been directed to activities that generally fit the policy agenda. The most important use to date has been the funding for the JCC position, the IPM and MIS planning have also been useful, whereas the GATT preparation has received a mixed appraisal. The earmarked activities have good potential for contributing to the policy component of ARSSP.

- Conclusions

The technical assistance account has been a useful source of funding that gives additional flexibility to ARSSP, allowing it to respond to GOI policy initiatives. The recommendations that the mission needs to become more actively engaged in policy analysis will require short- and possibly long-term technical assistance funding.

- Recommendation

Add additional funding to the technical assistance account with the amendment to ARSSP and target such funds on policy analysis activities.

-
1. The mission has already begun working on recommendations a), c), e) and i) during the course of the evaluation based on initial findings.

5. ARSSP Management Requirements

5.1 Introduction

This section assesses USAID's effectiveness in meeting the management requirements of ARSSP. It establishes the relationship between USAID's role in the policy reform process and the level of effort that role implies both for USAID and for the GOI. It assesses the organization, staffing, and management of ARSSP within the Mission, and by the GOI, and Mission coordination with other donors. It discusses the provisions for tracking progress through the statement of a policy agenda and through the establishment of a management information system. It examines ARSSP's contribution to liquidating the Mission's pipeline vis-a-vis the developmental benefits derived from the GOI's use of the funds. It compares the relative merits of ARSSP as a mode of development assistance with other forms of development assistance in the Mission's portfolio.

5.2 The Management Requirements of ARSSP in Comparison with Other Modes of Development Assistance

- Findings

ARSSP represents an initial effort by USAID/Jakarta to find ways of reducing the management demands that its development assistance imposes on the Mission. This section examines the management demands of ARSSP's program assistance. The actual management of ARSSP, and the ways in which this management can be improved are discussed in section 5.3.

5.2.1 Demands on the Mission

The mix of skills required to manage policy-based budget support differs from that in traditional project assistance. This is because, unlike traditional project assistance, policy-based budget support: 1) makes improving the policy environment (in specified areas) its only explicit output -- as a means of achieving its development purposes and goals; and 2) does not specify or control how financial resources transferred to the GOI are to be used to achieve this output. For USAID this means that policy-based budget support places greater emphasis on specialized analytical capacity in particular policy areas rather than on a generalist's technical knowledge. In principle it should also make fewer administrative demands associated with USAID regulations and with supervision of activity implementation.

More specifically the management of ARSSP's policy-based budget support involves tasks in the following four broad areas:

- policy analysis
- quality control of policy-related activities
- program administration
- maintenance of a management information system

The execution of these tasks requires: 1) an understanding of national development issues to identify an appropriate policy agenda; 2) an analytical capacity to determine policy constraints and options to overcome them; 3) a technical background to determine if policy-oriented activities are well-formulated and make an appropriate contribution to achieving policy objectives; 4) good coordination of the analytical/technical staff within the Mission; 5) good coordination and communication with the GOI; 6) the collection and management of the information needed to assess progress of policy and quality of policy-related activities; and, 7) financial information of the level of detail necessary to satisfy US government requirements.

The number of staff necessary to administer any particular policy-based budget support program depends on: 1) the nature of the contribution which the Mission wishes to make to policy reform in Indonesia; 2) the narrowness, or breadth, of the focus of the policy agenda; 3) the amount of effort USAID must make to maintain a desirable pace of progress on the GOI's ARSSP-related activities; 4) USAID's involvement in the management of the use of ARSSP funds.

1) More in-house analytical capacity is required the more the Mission wishes to be informed and actively involved in the analysis of policy changes being contemplated or adopted by the GOI. The Mission's interest in adopting a more active role in the policy reform process implies a greater commitment to establishing in-house analytical capacity.

2) The demands for analytical capacity and coordination increase as the focus broadens. The Mission has shown a preference for increasing rather than reducing the scope of its policy agenda and this implies the need for more specialists.

3) More Mission staff time is required if USAID considers it necessary to provide technical advice, assist with the hiring of technical assistance and/or to undertake some of the administrative tasks associated with implementing policy-related activities. Section 4.2 has recommended that USAID take a more active role in assisting the GOI with its policy-related activities. Experience with managing existing USAID projects in Indonesia suggests that the maintenance of a desirable pace of progress on the ARSSP-related activities will mean that a number of tasks, such as help with recruitment of technical assistance, preparation of implementation-related correspondence, and ensuring movement on the process of fund disbursement, will continue to make administrative demands on USAID program management.

4) More Mission staff time is required for the administration of disbursement and the supervision of accounts and expenditures if the Mission is concerned about how the funds have been used. Section 4.2 has recommended ways for the Mission to limit its involvement in monitoring the use of ARSSP funds.

5.2.2 Demands on the GOI

ARSSP budget support is based on an assumption that a simple transfer of money to the GOI coffers will do developmental good, and that the GOI has the managerial and budget programming capacity to effectively utilize the funds and to further the objectives of the program. The Mission has distanced itself from the management of funds and transferred virtually all of the responsibility for sound use of budget support monies to the GOI. This has reduced USAID financial accounting and reporting requirements, and has reduced the number of PILs and requests for advances and reimbursements which make administrative demands on the GOI.

Consequently, the principal management demands ARSSP places on the GOI are related to demonstrating to the Mission that its assumption is well founded; that is, that the GOI demonstrates sound management of ARSSP budget resources and continues its policy reform efforts. This means demonstrating its capacity and willingness to program and use funds judiciously yet flexibly. This means allowing USAID access to the information needed to monitor policy reform progress and to engage in policy dialogue with USAID.

The requirements described above are desirable in any form of development assistance but the greater devolution of responsibilities to the GOI in policy-based assistance may require a greater commitment of time and effort from more senior level government officials than other forms of assistance.

- Conclusions

The management of policy-based programs such as ARSSP requires the following:

- A specialized capacity to analyze and discuss progress on each of the focal areas covered by the policy agenda, credibly and discretely.
- The technical knowledge and time to assist with the identification and to use the results of policy-related activities undertaken in association with the program.
- The resources needed to help the GOI implement its policy-related activities, and to a lesser degree, for USAID's administration to expedite the disbursement of funds.
- The maintenance of management information on funds allocation (to the Directorate General level), policy progress, and policy-related activities to provide the basis for tracking and assessing progress toward the achievement of program objectives.

ARSSP will not necessarily be less management intensive than other forms of development assistance. There is a trade-off between the level of management effort the Mission wishes to make and the level

of information and involvement which it can have in the process of policy reform and the use of its funds. Given the Mission's active engagement in support of the GOI's policy initiatives and its limited involvement in the monitoring of the use of ARSSP funds, the Mission needs to: a) limit the focus of its policy agenda to the analytical capacity it has, and b) reduce the number, and increase the value, of the activities it wishes to supervise directly.

Section 4.1 indicates that there is room for improvement in the planning and implementation of the GOI's policy-related activities. Technical assistance for the maintenance of quality control needs to be combined with a flexible and quick disbursement mechanism to fund a range of activities in support of policy and program development. One approach to providing such technical assistance has recently been proposed in a management plan developed by the Canadian International Development Agency (CIDA) for a C\$14.9 million Water Sector Technical Cooperation Fund. The plan provides for a Canadian Executing Agency to be contracted to assist the GOI in the management of the use of the funds. USAID should examine this approach.

The disbursement of budget support has involved fewer PILs and related paperwork for the GOI. However, ARSSP requires GOI commitment to the sound use of the funds and to the achievement of the policy objectives, cooperation in making available monitoring information to USAID, and a willingness on the part of high level GOI officials to engage in policy dialogue.

- Recommendations

a) Given that policy-based program development is not necessarily less management intensive than other forms of assistance, adequate provision should be made to cover each of the following types of tasks:

- policy analysis
- technical assistance for the design and quality control of policy-related activities
- program administration
- maintenance of a management information system

b) The Mission should review the approach proposed by CIDA for reducing the management demands on the Agency associated with fund disbursement and supervision by combining umbrella funding with technical assistance.

c) In future policy-based development assistance it should be made clear to the GOI that USAID will need data and other information to determine whether policy reform is moving in the desired direction, as well as minimal accounting data.

5.3 The Organization, Staffing, and Management of ARSSP-related Efforts within the Mission, by the GOI, and Coordination with Other Donors

- Findings

5.3.1 The Organization, Staffing, and Management of ARSSP-related Efforts within USAID/Jakarta

The PAAD provides poor guidance regarding how ARSSP should be managed. It indicates that the ARSSP would be coordinated by the Project and Program Support Office, but that the technical offices would have "primary responsibility for the implementation of their respective reform agendas" (PAAD, p.34). The assignment of responsibilities, the lines of authority, the provision of long term technical assistance, and the method of achieving inter-office coordination are unclear.

The Agricultural and Rural Development Office (ARD) had initial responsibility for ARSSP implementation. In August 1988 the management of ARSSP was transferred to a newly created Economic Policy Support Office (EPSO). While the overall supervision of ARSSP program management was to be in the hands of the Chief of EPSO, the day-to-day management was to be the responsibility of a JCC agricultural economist.

The new chief of EPSO overlapped with the previous ARD Program Manager for ARSSP for approximately two months in mid-1988. The JCC agricultural economist arrived in early late November 1988. The mismanagement of recruiting the JCC on the part of the Mission and AID Washington has meant that the program was under-staffed during the first fifteen months of its operation.

During its initial period of implementation the program seems to have operated in an uneasy relationship with the rest of the Mission. Despite the fact that ARSSP's policy agenda and budget support have a bearing on the activities and objectives of other projects in the Mission, there has been continuing uncertainty among technical officers about how ARSSP relates to the rest of the Mission's portfolio. A number of management problems have arisen because of inadequate definition of responsibilities and poor inter-office communication.

Communication and coordination problems have centered around uncertainties regarding the division of responsibility between EPSO, ARD, and PSD for the implementation of various tasks associated with ARSSP management. The absence of a clear statement of the responsibilities of each office has meant that, for example, project officers have been unsure of what they are responsible for knowing and of the content of the reports they should submit regarding appropriate use of ARSSP funds, or the progress on specific items in the ARSSP policy agenda. Project officers have been asked to

enquire about the use of ARSSP funds for research stations, studies, the IPM program, on an ad hoc basis without a clear understanding of their office's rôle and responsibility in the operation of ARSSP.

Also weak communication and coordination among offices have meant that activities funded under ARSSP have sometimes failed to complement, or have even undermined, activities under other USAID-funded projects. For example, the work on an environmental assessment plan for the Ministry of Agriculture was not considered appropriate by the natural resources management staff of the Mission nor by EPSO, and ARSSP support to AARD sometimes unhelpfully diverted GOI staff from activities planned under the Agricultural Research Management Project. Contractors working on the Management Information System for AARD under USAID's Applied Agricultural Research Project were unclear about the relationship of their work to ARSSP funding and objectives. However, the ARSSP management are now working with the Mission's natural resource management staff on the design of a new project which will contribute to the achievement of the environmental milestone in the ARSSP agenda, and it is expected that the AARD Management Information System will be overhauled completely.

The EPSO Office Chief has discussed the allocation of responsibilities and his approach to ARSSP management with the ARD and PSD Office Chiefs. Also, the responsibilities of the EPSO office with regard to ARSSP management are presented in the office's functional statement which was reviewed and agreed by the Mission's senior staff. But there still remains a sense of uncertainty among some technical officers about their relationship to ARSSP. As the Mission becomes more actively involved in identifying and monitoring policy-related activities for discussion with the GOI more work demands will be imposed on the technical offices, making it important that this uncertainty is addressed and minimized.

Within EPSO there is the possibility that the ARSSP Program Manager will be overburdened with tasks related to financial control, program administration, and basic data management for the monitoring and evaluation system. This would leave insufficient time for policy analysis and technical advisory tasks the Mission needs for policy dialogue. The role of the newly arrived banking and trade technical advisor in the management of ARSSP needs to be defined better.

5.3.2 GOI Management of ARSSP

Until recently, the additional management requirements which ARSSP has created for the GOI have been limited to the programming of the additional funds and financial reporting. Reporting has fit easily into normal governmental budgeting and reporting procedures. While there have been delays in disbursement, this has been attributed to initial misunderstandings regarding the procedures for making funding requests and problems over the additionality issue (see section 4.2). The smaller number of PILs associated with fund

disbursement was considered a definite advantage by GOI representatives responsible for the budgeting and administration of ARSSP funds.

However, some have observed that the GOI approach to the management of foreign grants, such as ARSSP, is less rigorous than it is for loans. It was pointed out in section 4.1 that the use of ARSSP funds has not always been well programmed. Although some GOI officers have expressed their satisfaction with the way these funds have been administered, more senior GOI officials have not always shared this opinion. They have observed that the ARSSP funding mechanism has made it difficult to channel funds to activities in support of specific policy objectives. This has led some of these officials to the view that funding should be more directly linked to policy design and implementation.

5.3.3 Coordination with Other Donors

USAID has coordinated its program efforts with other donors through its co-financing with FAO of the implementation of the Integrated Pest Management Program, discussed earlier in this report, and through the informal exchange of information on priorities for policy reform, particularly with the World Bank and the Asian Development Bank. Also USAID's willingness to provide special assistance in the form of ARSSP budget support had some influence on the actions of other donors, such as the Asian Development Bank and the Japanese.

Respondents from the two banks felt that a continued informal collaboration and information exchange would be useful. However, other forms of cooperation, such as co-financing, were considered to introduce undesirable program management complications.

For the next few years the ADB and the Japanese will be the major donors in the agricultural and financial sectors, but other donors are also supporting activities which have a bearing on the ARSSP policy agenda. For example, the Canadians have a major program in environmental management and they are increasingly turning their attention to policy concerns. The British are providing technical assistance to Bulog, the GOI Bureau of Logistics. The Germans are assisting regional rural development projects which include the development of rural credit institutions. The UNDP/ILO is undertaking studies on rural industries and employment. With the exception of contacts with the Canadians, ARSSP coordination with the activities of these other bilateral and multilateral donors has been minimal.

- Conclusions

ARSSP has been managed with a limited input so far. This is not to say that ARSSP is a low management intensive activity, but that, more by default than by design, the program has been under-managed. This has resulted from the inadequacy of the management plan

contained in the PAAD, the delay in getting the JCC agricultural economist/ARSSP Program Manager in place, USAID and GOI staff turn-over, the adjustments which had to be made in the transition of the management of ARSSP to EPSO, and a continuing haziness in the definition of the responsibilities of the Program Manager and between EPSO, ARD and PSD.

Section 4.1 has illustrated that the programming and use of ARSSP funds by the GOI needs to be improved. A more careful targeting of the use of ARSSP funds for policy-related activities and technical assistance to ensure quality control is necessary to achieve this improvement.

An aspect of GOI management of ARSSP which has not been stressed until now, but which will come to the fore as the Mission shifts its attention from the financial aspects to the policy content of the program, is sharing of information and discussion of policy reform with USAID. This will require cooperation by GOI in assisting USAID to obtain the data it needs and a willingness on the part of policy makers to engage in a dialogue on the progress and content of the policy agenda.

USAID may be able to complement the activities of multilateral and bilateral donors as it develops its in-country analytical capability and provides more policy-related technical assistance.

- Recommendations

- a) The Mission Director should clarify with the Office Chiefs and staff of ARD, PSD, and EPSO the division of responsibilities for each of the tasks associated with ARSSP management, i.e.:
 - 1) policy analysis
 - 2) identification and support for appropriate technical assistance-type activities (including the provision of advice to the GOI and coordination on the use of ARSSP funds)
 - 3) program administration
 - 4) maintenance of a management information system
- b) Staff of all offices should be made to feel that they are part of a team effort in the implementation of ARSSP.
- c) EPSO, ARD and PSD should review the content of the policy agenda in relation to their policy analysis, monitoring, and technical advisory capacities to ensure that USAID can maintain a credible dialogue in the areas which it wishes to support. This review should take into account anticipated turnover in staff in ARD and PSD and provision should be made for an effective transfer of information as well as responsibilities.
- d) EPSO should review its responsibilities for the management of ARSSP and establish a realistic allocation of tasks to the ARSSP Program Manager and the macro and trade technical advisor.

e) EPSO should provide the Program Manager with an administrative assistant with an accounting and information systems background to provide back-up on budgetary matters, to maintain a tracking system for ARSSP-supported activities, and to assist with administrative tasks related to contract management.

f) EPSO should explore alternative ways of assisting the GOI to improve the programming of its use of ARSSP funds.

g) The GOI should be willing to make available to USAID the information relevant to the policy agenda, which it may reasonably request, and to engage in a dialogue on the progress and content of the agenda.

h) USAID should maintain and improve its communication with other donors who are supporting activities that have a bearing on the ARSSP policy agenda and activities.

5.4 Usefulness of the Policy Agenda for Monitoring and Evaluation

- Findings

Section 5.2 referred to the role of a management information system in monitoring and evaluating the effectiveness of ARSSP. This section assesses the usefulness of the policy agenda contained in the program design for monitoring and evaluating ARSSP. Section 5.5 will describe how this agenda has been used in the design and implementation of a monitoring system for the program.

The policy agenda will be assessed according to two criteria:

- 1) Were the objectives of the policy agenda, and the indicators of progress toward those objectives clear?
- 2) Was monitoring of the policy agenda manageable?

5.4.1 Clarity of the Objectives of the Policy Agenda, and of the Indicators of Progress toward those Objectives

The policy agenda provides a set of hierarchically ordered program objectives, sub-objectives and milestones which is essential for monitoring the progress of the program and for assessing its impact. As was discussed earlier, the statements themselves are fuzzy and confuse processes with development objectives. Nevertheless, without the policy agenda it would have been more difficult to judge whether or not the program was meeting its policy objectives. The agenda contrasts with the discussion of the agenda in the PAAD which lacks the specificity needed for such monitoring.

A timetable and intermediate steps for achieving each of the milestones were left out of the agenda in order to facilitate agreement with the GOI. For similar reasons, the policy agenda is

not specific about the indicators of achievement of the milestones, sub-objectives or objectives.

5.4.2 Manageability of the Policy Agenda

The breadth of coverage of the policy agenda has meant that adequate monitoring and assessment of progress toward policy objectives has required USAID not only to marshal analytical skills covering two sectors but also to coordinate the collection of information from five different USAID officers who are managing projects which have a bearing on the milestones. It has also meant coordination with almost two dozen government offices involved in the achievement of the milestones.

As was discussed in section 5.3, the proposed management structure in the PAAD and the resources which have been available to USAID to manage the monitoring and assessment of progress on the policy agenda have been inadequate.

- Conclusions

The tracking of progress on program objectives would have been extremely difficult without the policy agenda, but its vagueness and logical inconsistency mean that it only provides a point of departure. The lack of a statement of specific intermediate steps and a timetable was appropriate since the approach to achieving the milestones must remain flexible -- it requires the ability to make adjustments in the plan based on an understanding of the political and economic context in which the milestones are being advanced and of evolving GOI policy initiatives.

The subsequent monitoring by the Mission of policy progress and the periodic assessment of impact needs to be based on a clearer statement of objectives, an identification of appropriate benchmarks and indicators, and a systematic monitoring of those indicators. The progress on such monitoring is discussed in section 5.5.

The lack of focus of the agenda has made it difficult for the Mission to manage and monitor, particularly given the staff turnover and the delays in JCC recruitment.

- Recommendations

a) The Mission should continue to use a policy agenda based on development objectives, sub-objectives and milestones as a tool for the monitoring of its policy-based development assistance. The objectives, sub-objectives and milestones should be clearly stated.

b) The Mission should review and improve its management of the existing policy agenda before it considers expanding into other sectors.

5.5 Development and Implementation of a Management Information System for ARSSP

- Findings

The financial monitoring system for ARSSP is discussed in section 4 of this report. This section discusses the system developed for monitoring the process of implementation, and assessing the impact, of the reforms in the policy agenda.

5.5.1 Monitoring by USAID

The PAAD contains the outline of an approach to the monitoring of program progress which provides a useful basis for establishing an information system for the project. However, the operational details related to the mechanism for tracking progress, the allocation of responsibilities for information collection, and the specification of reporting intervals and report content were only worked out eleven months after the Grant Agreement was signed. The JCC Program Manager who will be primarily responsible for maintaining the system arrived four months later.

A management plan containing a reference to the need to monitor ARSSP was prepared with the assistance of the first ARSSP Manager and submitted by the GOI to USAID in November 1987. The plan indicated that a steering committee, with members from the various GOI agencies participating in the ARSSP, would be responsible for devising monitoring and reporting procedures for the program. However, the plan did not detail the system for policy monitoring and reporting.

For the next six or seven months monitoring progress on the policy agenda was informal and documentation was limited. A GOI steering committee met on a number of occasions with the ARSSP Program Manager to discuss ARSSP funding procedures, possible uses for ARSSP funds, and the financial reporting format devised by the ARSSP Program Manager, but policy monitoring was not addressed.

Nine months after the Grant Agreement was signed a short-term consultant arrived to develop a monitoring and evaluation system. The consultancy dealt with the monitoring of milestones and not with budgetary monitoring or with assessing the impact of the policy changes on the sub-objectives and objectives supported under ARSSP. A major task in developing the monitoring system involved documenting USAID staff knowledge of the background and progress of each of the milestones included in the ARSSP policy agenda. This established the databases and benchmarks for the program.

Benchmark forms ("Benchmark Fact Sheets") were prepared for each milestone as a baseline for monitoring progress. The forms contain information on the selection and initial status of the milestone, the indicators of the achievement of the milestone, intermediate

steps that might be taken to achieve the milestone, and reference documents cited in the previous discussion.

A simple filing system was established for monitoring the milestones. It involved maintaining, for each milestone, a chronologically ordered collection of information related to progress on the milestone, such as memos to the file, study reports, newspaper reports, administrative documents for technical assistance being managed by USAID, and official correspondence. For day-to-day use this "program file" should contain the most up-to-date information related to each milestone.

Every quarter the material in the "program file" should be synthesized and analyzed. This involves making a critical evaluation of progress in the previous quarter, problems, likely future developments, and appropriate future actions, if any, to promote the policy change. This regular and systematic review is intended to help Program Management to track the progress on policy change against the benchmarks and to ensure that no policy milestone is inadvertently overlooked. It is also intended to serve as a reference for the evaluation of the program.

In the absence of an ARSSP Program Manager to maintain and use it, the system has yet to be put to the test. Also, the lack of secretarial support for the EPSO office until December 1988 resulted in a backlog of filing for the "program files", making them less useful than they should be for day-to-day reference.

In the past two months the progress status reports have been partially updated to be presented to the GOI for their review. The JCC ARSSP Program Manager has not had time to assess progress on the milestones, as has been done in this evaluation. However, the EPSO Office Chief has made periodic assessments of program progress in USAID communications.

5.5.2 Reporting by the GOI

During the first year and a half of the program's implementation, USAID's involvement with the steering committee and informal working groups has primarily been in meetings concerning budget support issues. There has been no formal review of the content of the policy agenda with the GOI, nor any formal joint assessment of progress on the benchmarks.

Mission management feels that it is important for the GOI to report formally on progress on the policy agenda. A format was developed for this purpose which includes a list of minimal questions to be addressed, i.e., current status of the milestone, external factors affecting program implementation, comments on anticipated future developments, and actions to be taken in the coming reporting period by USAID and/or GOI.

Representatives of the GOI responsible for ARSSP management have been provided with sample monitoring reports prepared by the monitoring consultant for their review and use in submitting such a report. The GOI has not yet responded to the Mission's request. This is probably an indication of their discomfort with formal reporting on policy progress to a foreign donor agency.

- Conclusions

An area of monitoring which has not been developed by EPSO is the identification of indicators of the impact of milestones on the policy agenda sub-objectives and objectives. Also, it has not reviewed the validity of the indicators of achievement of the policy agenda milestones included in the "benchmark fact sheets".

The GOI has yet to submit a formal report on the status of progress on the ARSSP policy agenda. From the point of view of progress on policy this does not really matter. Reports from the GOI will not themselves contribute to progress on the policy agenda. However, they do appear to be necessary to meet the Mission's need for accountability to Washington.

The maintenance of USAID's policy dialogue with the GOI will depend primarily on the credibility of the USAID program management and technical advisors, and their ability to stay well-informed and establish informal working relationships with GOI counterparts. ARSSP's internal program monitoring should assist the Mission to sustain this process with the GOI.

- Recommendations

a) The ARSSP Program Manager should prepare an analytical quarterly review of progress on each of the ARSSP policy agenda agricultural milestones, for inclusion in the ARSSP monitoring files. He should also be responsible for maintaining the ARSSP policy agenda agricultural "program files".

b) The technical advisor for macro and trade should be given responsibility for preparing an analytical quarterly review of ARSSP policy agenda financial resource mobilization milestones and for maintaining the corresponding "program files".

c) The EPSO Office Chief should ensure that the ARSSP Program Manager and the technical advisor for macro and trade have the support, time and encouragement to maintain the monitoring system.

d) The ARSSP Program Manager and the technical advisor for macro and trade should re-examine the pertinence of policy agenda milestones, sub-objectives and objectives with the GOI. They should review and adjust the indicators for monitoring progress on the policy agenda milestones and develop indicators for assessing achievement of the sub-objectives and objectives.

- e) the GOI should cooperate with USAID in making access to information USAID needs to maintain a monitoring database.
- f) The GOI should be willing to discuss the results of USAID analyses both informally and, when appropriate, through the mechanism of the steering committee.
- g) For USAID reporting purposes, a semi-annual review and GOI concurrence on a status report ought to be sufficient.

5.6 ARSSP's Effect on the Pipeline

- Findings

ARSSP has provided a way of disbursing a relatively large sum of money more quickly and with less administrative effort than any other project in the Mission's portfolio. ARSSP has been fully obligated and in the first sixteen months after the signature of the Grant Agreement \$24 million, or about 56% of the \$43 million obligated, have been expended.

- Conclusions

ARSSP has assisted in the rapid liquidation of the Mission's pipeline. However, this is not a good measure of developmental effectiveness. Other sections of this report have indicated that the speed of disbursement has not necessarily corresponded to the capacity of the GOI to absorb the funds and to implement developmentally sound activities.

- Recommendation

The size of the pipeline, and the capacity to reduce it, should not be given undue importance in the evaluation of a particular program.

5.7 The Relative Merits of ARSSP as a Mode of Development Assistance

- Findings

It is not appropriate to make a general statement about whether the program is more or less developmentally effective than other means of USAID assistance. Rather, it is a case of choosing a mode of assistance which is appropriate to the nature of the development problems which need to be addressed in a particular country at a particular time.

In Indonesia, at this time, the ARSSP represents an advance over other means of USAID assistance in two important ways: 1) it deals directly with policy issues, and 2) it provides scope for a flexible provision of technical and financial resources. It thus addresses the policy obstacles which have impeded projects from achieving

their development objectives. It also provides an appropriate form of assistance at a time when the decline in GOI revenues has resulted in a cut-back in national budgets for the agriculture and financial sectors. Unlike project assistance which imposes additional recurrent costs on the GOI, ARSSP program assistance provides supplementary funds for the government to complete or maintain past investments and implement activities needed to advance policy reform.

- Conclusions

ARSSP's focus on policy and its use of a fast disbursing funding mechanism have brought a new combination of development advantages and management challenges which are not amenable to a simple comparison with other means of USAID assistance. The problems faced by ARSSP between August 1987 and December 1988, described in section 5, are probably no worse than those in the start-up of any other new USAID project. They have been the result of having to work out modes of operation and to discover how much staff effort is required and where it should be applied. The composition of the agenda and the management of the program can improve while the program retains its two distinctive and important elements -- a policy orientation and an openness to experiment with different approaches to providing flexible yet targeted development funding.

- Recommendation

USAID's development assistance program in Indonesia should continue to incorporate a policy orientation and should experiment with different ways of combining technical assistance with program funding.

6. ARSSP Amendment

An amendment to ARSSP is recommended to make the mid-course changes to the program discussed in the evaluation. The program authorization completion date should be extended to March 31, 1992 with sufficient additional funding to maintain ARSSP activities during that period.

The amendment should make clear USAID/Jakarta's role in supporting GOI policy initiatives. The mission should recognize that it is not able to consult effectively on all policy issues in all sectors. Rather, A.I.D.'s role should be one of a specialist, rather than a generalist in assisting the GOI with policy reform. ARSSP has served as an entre for the mission to discuss policy formulation and, in particular, implementation of reforms with the GOI in the agriculture and financial markets sectors. As the evaluation notes, much remains to be done in these two broad areas. Expanding ARSSP beyond these areas should only be done with considerable forethought about the analytical and management requirements this would entail.

The program assistance mode should be continued, and budget support should be the principle use of ARSSP funding for IFY 89/90, completing the expenditure of the \$43 million in grant funds initially approved for the program. In line with the evaluation recommendations, greater emphasis needs to be placed on the policy component and its associated objectives in the future. A first step in this is to re-examine the current objectives and policy agenda with the GOI and make necessary changes to sharpen and refine the program. This review should work toward a more focused agenda that is manageable within the staffing limits of the GOI and A.I.D. The achievement of items on the agenda should constitute meaningful policy reform progress.

The process of developing ARSSP's agenda needs to be driven by identifying constructive, important objectives the program can support. Based on these objectives, the agenda items then can be determined, assuring better congruence among agenda items and between the objectives and the agenda.

Section Three recommended a number of possible agenda modifications that could serve as an initial basis for discussions. ARSSP's future agenda should avoid trying to pick "sure winners" - i.e., agenda items that are almost certain to be achieved in the next twelve to eighteen months. The first set of reforms the GOI has implemented have produced cost reductions. As the GOI moves to reforms pertaining to allocative efficiency, the interests of specific enterprises and business groups will be more directly affected. Such reforms are likely to be more difficult and slower to achieve, as illustrated by the delays in enacting industrial and agricultural reform packages.

The amendment should recognize that sound, well reasoned analysis and advice based on that analysis will increase A.I.D.'s contribution to policy reform and implementation in Indonesia more than its money. ARSSP should build on the GOI acceptance and interest in having U.S. technical assistance for such work. Budget support might be used to fund technical advisors assisting the GOI with policy analysis. A.I.D. needs to be actively engaged in this analytical work. In the coming months, A.I.D. and the GOI need to develop a research agenda in conjunction with the refinement of the ARSSP policy agenda. This should include assessing the costs and benefits of changing public policies. Analytical working papers should serve as a basis for future development of ARSSP's policy agenda. Analysis leading to periodic agenda modifications adds flexibility to the program and helps keep ARSSP aligned with emerging GOI priorities. To support this work, the amendment should increase funding for the technical assistance component of ARSSP.

Greater emphasis on the policy objectives of ARSSP should also influence the budget support process. IFY 89/90 should be a transition year during which A.I.D. plays a more active role with the GOI in the identification of GOI programming options (i.e., activities) that relate more directly to ARSSP's policy agenda. The mission should keep informed of the progress of these activities largely on the basis of their end products and the use of those products for policy reform and implementation. In effect, the mission's role should move somewhat closer to a project modality without going so far as becoming directly involved with implementation (e.g., development of proposals, contracting, supervision of implementation progress) of the policy related activities. The Program and Project Support Office in USAID/Jakarta has begun work on developing the mechanism within A.I.D. regulations for program assistance that would effect this shift in A.I.D.'s role while increasing the focus of attention on ARSSP's policy objectives.

The amendment should consider alternative approaches to supporting policy related activities that are not tied to the GOI standard budget process. A portion of the funding to be added to ARSSP should be used for a pilot effort to establish a special fund outside of the development budget/DIP process. The fund would provide assistance for activities that augment an agency's established DIP level. Criteria should be developed that limit the fund's assistance to policy related work, such as special studies, technical assistance or training. Agencies would apply for funding through the submission of proposals to be reviewed by a governing committee. Chaired by the Junior Minister of Bappenas, the committee should include the Junior Ministers of the MOF and MOA, Bappenas staff for agriculture and finance and USAID representatives. IFY 89/90 would serve as test period for the special fund, and if successful, more ARSSP funding could be directed to the fund in IFY 90/91 and thereafter.

The evaluation recommends a number of activities that have definite staff and management requirements. This includes an ARSSP research agenda, more active participation in identifying options for GOI programming of ARSSP funds, use of the results of these activities for further policy dialogue and/or policy implementation, and minimum but adequate monitoring of progress toward agenda items. The amendment should recognize that ARSSP program assistance is not less staff intensive when adequately managed than project assistance. The evaluation's recommendations may appear to increase staff intensity, but this is only because ARSSP has been under-staffed until recently. The amendment should correct this situation.

ANNEX I - ARSSP POLICY AGENDA

II. The Agenda

The policy agenda for the Program is summarized below. Clarification or modifications of the items, relative priorities, and steps for carrying them out will be documented as necessary in Program Implementation Letters.

A. Objectives and Milestones for Agricultural Diversification

1. Program objective: Promote agricultural diversification, related agro processing and more optimal use of resources through increased efficiency and stronger participation by the private sector.

(a) Pricing sub-objective: Establish input and output prices at levels that encourage both efficient and expanded production of secondary crops.

(1) Extend and monitor trade and licensing reforms of 6 May and 25 October, 1986 to include agricultural inputs (i.e., livestock feeds, shrimp larva feeds and product packaging items) needed in the production and processing of agriculture-based export items with a view to lowering production costs and increasing trade.

(2) Reduce pesticide subsidies.

(3) Review fertilizer subsidy levels and user rates with a view to developing and implementing a strategy to adjust downward fertilizer subsidies in a way that minimizes disruptions in fertilizer demand and crop production.

(4) Assess incentive and disincentive effects of current pricing strategy for rice and non-rice crops and establish pricing levels that maintain appropriate rice production levels and encourage secondary crops production.

(b) Trade sub-objective: Reduce transportation and licensing costs associated with food and export crops processing and trade, thereby stimulating demand for and production of processed agricultural products.

(1) Reduce input costs to processing by eliminating the provincial tax on copra, a major small holder crop.

(2) Review and eliminate unnecessary licenses and other policies that increase the cost of transporting agricultural products between districts and islands.

(3) Review local and national licenses limiting investment in agro-business, eliminate restrictive licenses and introduce simplified licensing procedures.

B. Objectives and Milestones for Domestic Resource Mobilization

1. Program objective: Expand and increase the efficiency of financial markets thereby increasing capital for investment.

(a) Banking sub-objective: Expand banking services at unsubsidized cost levels.

(1) Continue maintenance of market-oriented interest rates.

(2) Draft and introduce legislation permitting financial institutions to expand and extend services in both urban and rural areas.

(b) Pensions and insurance sub-objective: Promote schemes that will help mobilize funds for capital markets, thereby providing additional resources for investment.

(1) Draft and introduce legislation providing a legal framework and establish effective pension and insurance administration.

C. Objectives and Milestones for Institutional Changes in Agriculture and Finance

1. Program agricultural objective: Introduce institutional reforms required to improve planning and implementation of policies and programs aimed at agriculture diversification.

(a) Research

(1) Establish a staff planning unit in AARD to review commodity mandates and propose alternative approaches.

(2) Develop a management information system that will help in monitoring research performance against Program priorities.

(3) Implement changes required in organizational structure to improve agency management and staff performance.

(b) Planning

(1) Establish a working group on reorganization of Ministry of Agriculture planning, management and administrative functions.

(2) Prepare an analysis of international markets (prices, competition prospects) for selected agriculture commodities; plans to be incorporated in Repelita V.

(3) Prepare a plan to carry out environmental impact assessments throughout the Ministry.

2. Program financial objective: Introduce institutional reforms required to improve management of policy changes related to domestic resource mobilization.

(a) Management

(1) Within the Ministry of Finance, establish units responsible for development and supervision of the pension and insurance industries.

(2) Develop manpower plans and training programs for Ministry of Finance officials responsible for pension and insurance administration.

III. Program Administration, Management and Monitoring.

A. Administration

The Program will require an administrative mechanism to:

1. assemble the necessary budget information to justify disbursement levels, monitor accounts, facilitate disbursement and prepare monthly expenditure reports.

2. allow adequate joint review by the GOI and USAID of progress under the Program, to permit modifications in the Program and draw upon outside technical assistance as required.

3. permit senior representatives to determine the Program's success and to decide whether subsequent program assistance is appropriate.

ANNEX II: Special Studies Financed Under ARSSP (*)

Ministry of Finance Studies

1. Deposit Insurance Institutions Study
2. Foreign Bank Regulations Study
3. Insurance Awareness Study
4. Deposit Insurance Study
5. Discount Market Study
6. Village Legal System Study
7. Role of BUMN in Finance Study
8. Small Farmer Livestock Credit Study
9. Cooperative Electricity Study
10. Development Pension Funds for the Rural Sector Study
11. Rural Economy Financial Institutions Study
12. Comparative Study of Credit Institutions in Economic Growth
13. Research and Institutions in the PIR and UPP Projects Study
14. Credit Recovery Study for the Tree Crops Sector
15. Field Study for Regional Development and Lending Study
16. Special Seminar on Regional Finance Options

Ministry of Agriculture

A. Bureau of Planning:

1. Review of Ministry of Agriculture Organization
2. Review of the Role of the Provincial Kanwil Office
3. Investment Requirements for the Fifth Plan period
4. Review of the Irrigation Sector
5. Long-term Land Requirements for Agriculture
6. Resource Potential of Dryland, Coastal Lands and Swamp Lands
7. Conversion Problems in the PIR Program Study
8. Industrial Policy for Rice and Secondary Food Crops Study
9. Data Development for Food, Horticulture and Smallholder Tree Crops
10. Irrigation Management Study
11. Irrigation and Diversification Study
12. Environmental Impact Assessment Implementation Study
13. Irrigation Service Sector Fee Review
14. Review of Regulations for Livestock, Fisheries and Estate Crops

B. Centre for Agro-Economic Research, AARD

1. Agribusiness Systems Study
2. Price Policy Study
3. Agricultural Mechanization Study
4. Agricultural Employment Study

* note: the majority of these studies are still on-going at the time of the evaluation. MOF officials provided three studies for review by the team. MOA officials provided five studies for review by the evaluation team.

Additionality test for 87/88 to 88/89

	87/88 Ang Murni Budget *4 (1)	88/89 Ang Murni Budget *5 (2)	88/89 as % of 87/88 *1 (3)	87/88 to 88/89 growth (3a)	87/88 Development Budget *2*5 (4)	88/89 Development Budget *2*5 (5)	88/89 as % of 87/88 *3 (6)	87/88 to 88/89 growth (6a)
MOA								
Sect Gen **	325.00	850.00	2.62	1.62	1002.6	922.9	0.92	-0.08
BIMAS	10211.00	13059.60	1.28	0.28	13453.9	13059.6	0.97	-0.03
AAETE ***	2740.00	6090.00	2.22	1.22	5260	8076	1.53	0.53
AARD **	2100.00	9585.40	4.56	3.56	6285.3	10435.5	1.66	0.66
Insp Gen	315.00	400.00	1.27	0.27	315	400	1.27	0.27
DG food crops	9250.00	13026.50	1.41	0.41	25061	27859.1	1.11	0.11
DG livestock	2750.00	5120.70	1.86	0.86	5954	7270.5	1.22	0.22
DG fisheries	3155.00	5748.80	1.82	0.82	5460	6876.4	1.26	0.26
DG est crops	4305.00	6385.70	1.48	0.48	6161.7	8357.7	1.36	0.36
MOA total	34881.00	60266.70	1.73	0.73	68953.5	83243.7	1.21	0.21
MOF								
Sect Gen **	2099.00	4278.70	2.04	1.04	24336.3	14092.7	0.57	-0.43
Insp Gen	88.00	98.20	1.12	0.12	87.8	98.2	1.12	0.12
DG budget	1345.00	1851.70	1.38	0.38	4183.6	2103.9	0.50	-0.50
DG taxation	1513.00	2382.50	1.57	0.57	4992	6027.7	1.21	0.21
DG customs	1496.00	2100.00	1.40	0.40	11413.9	2528.9	0.22	-0.78
DG monetary **	118.00	148.10	1.26	0.26	652.9	148.1	0.23	-0.77
NF,C,BOF **	30.00	635.00	21.17	20.17	0	635		
Fin Training **	515.00	701.00	1.36	0.36	1311.4	701	0.53	-0.47
Center Agency	0.00	0.00			0	0		0.00
Ofc Karwil	0.00	0.00			0	0		0.00
MOF total	7204.00	12195.20	1.69	0.69	47277.9	26335.5	0.56	-0.44
Bappenas								
Dep for Admin	561.00	819.30	1.46	0.46	819.3	819.3	1.00	0.00
Bap total	561.00	819.30	1.46	0.46	819.3	819.3	1.00	0.00
Development Budget	42646.00	73281.20	1.72	0.72	117050.7	110398.5	0.94	-0.06

ANNEX III - ADDITIONALITY ANALYSIS

*1 -- (3) = (2) / (1)
 *2 -- combination of the Anggaran Murni and the ABT budgets
 *3 -- (6) = (5) / (4)
 *4 -- source: FIL#7 "Analysis of the IFY 1988/89 Budget Request"
 Agricultural and Rural Sector Support Program
 *5 -- source: GOI 4th quarter IFY 88/89 budget support requirements,
 21 December 1988
 ** -- received ARSSP support 87/88 and 88/89
 *** -- received ARSSP support only in 87/88

GOI spending 87/88, ARSSP and development budget

	87/88 Developmnt Budget *1 (1)	87/88 GOI Budget Expenditrs*2 (2)	87/88 ARSSP Disprsmnts (3)	87/88 GOI expndtrs ARSSP funds (4)	87/88 GOI expnd/ budget *3 (5)	87/88 ARSSP expnd/ disprsed *4 (6)
IOA						
Sect Genl *	1002.6	999.4	2041.8	672.6	1.00	0.33
BIMAS	13453.9	0			0.00	
AAETE *	5260	5033.1	1640	1636	0.96	1.00
AARD *	6285.3	6076.9	9279.3	9492	0.97	1.02
Insp Genl	315	614.9			1.95	
DG food crops	25061	38333.6			1.53	
DG livestock	5954	5509.4			0.93	
DG fisheries	5460	5043.7			0.92	
DG est crops	6161.7	4953			0.80	
NOA total	68953.5	66564	12961.1	11800.6	0.97	0.91
MOF						
Sect Genl *	24636.3	23927.1	494.6	436.9	0.97	0.68
Insp Genl	87.8	87.8			1.00	
DG budget	4183.6	3914.8			0.94	
DG taxation	4992	4145.1			0.83	
DG customs	11413.9	10598.8			0.93	
DG monetary *	652.9	579.3	811.5	811.5	0.89	1.00
NF,C,BOP *	0	0	784.7	706		0.90
Fin Training *	1311.4	1205.4	451.6	426.6	0.92	0.94
Center Agency	0	0				
Ofc Kanwil	0	0				
MOF total	47277.9	44458.3	2542.4	2381	0.94	0.94
Bappenas						
Dep for Admn *	0	0	0	0		
Bap total	0	0	0	0		
Developmt Budget	116231.4	111022.3	15503.5	14181.6	0.96	0.91

- * receives ARSSP support
- *1 Anggaran Murni + AET
- *2 annual report, 6 July 88
- *3 (5) = (2) / (1)
- *4 (6) = (4) / (3)

References

Ahmad, Sadiq, "Indonesia: External Shocks, Policy Response and Adjustment Performance", (mimeo) 1988.

Ahmad, Sadiq and Basant Kapur, "A short-run Econometric Analysis of the Indonesian Monetary System", (mimeo), January 1989

A.I.D. August 28, 1987. Indonesia: Budget Support and Related Technical Assistance (497-0357), Program Assistance Approval Document. Washington, D.C.

Bappenas. November 14, 1987. "Agriculture and Rural Sector Support Project: Management Structure", submitted with Project Implementation Letter no. 4261/K/XI/1987.

BPS, Indikator Ekonomi, Bank Indonesia, "Laporan Bulanan", and Bulog, Price Monitoring Division.

Business Advisory Indonesia, "Trade Deregulation Impacts on Companies in Six Sectors and Aspects of the Corporate Financial Environment", 1987.

Drazen, A. and E. Helpman, "Stabilization with Exchange Rate Management.", Quarterly Journal of Economics, 1987.

Harris, John R., "Financial Intermediation in Indonesia: Impacts of Deregulation", (mimeo), December 1988,

Kiguel, N. and N. Livatan, "Inflationary Rigidities and Orthodox Stabilization Policies: Lessons from Latin America", World Bank Economic Review, Vol. 2, 1988.

Ministry of Finance, "Budget Tables for 1988/89 Nota Keuangan", from Bank Indonesia export value estimates

Nott, Gladys A. September 2, 1988. "Policy Monitoring and Evaluation System: Consultancy Report". Prepared for USAID, Jakarta, Indonesia for the Agricultural and Rural Sector Support Program.

Price Waterhouse, "Foreign Investment in Indonesia", 2 volumes, 1987.

Wardana, A. "Structural Adjustment in Indonesia: Export and the High-Cost Economy", Keynote address to the 24th Conference of S.E. Asian Central Bank Governors", Bangkok, 25 January 1989.

SCOPE OF WORK FOR ARSSP EVALUATION

1. Program: Agriculture and Rural Sector Support Program, 497-0357

2. Purpose and objectives of the evaluation:

To assess program progress and effectiveness as a basis for determining whether additional sector assistance is warranted. This determination will be based on:

- a. whether program performance has been satisfactory,
- b. whether continued program assistance for policy reform is needed to advance key reform activities further.
- c. whether a rapid disbursement mode of assistance offered by this sector program support continues to be appropriate in the GOI's current and prospective economic situation.

3. Background:

The Agriculture and Rural Sector Support Program is designed to assist the Government of Indonesia to increase rural employment and income opportunities through agricultural diversification and domestic resources mobilization. This cooperative program supports a policy agenda that encourages the expansion and diversification of the agricultural sector, including reassessing pricing and subsidy policies, improving the environment for agricultural processing and trade, and designing and implementing steps to expand and improve the efficiency of domestic financial markets. In addition to technical assistance, the project provides operating budget support to selected agencies in the Ministry of Agriculture, the Ministry of Finance and the National Planning Agency.

4. Evaluation Structure:

The evaluation team will proceed by focusing on the following areas:

a. ASSESSMENT OF THE POLICY AGENDA

Review the status of ARSSP implementation in terms of the progress toward the benchmarks established for the policy agenda items.

Based on this assessment, estimate which policy agenda items are likely to be fully achieved by the PACD.

Discuss the importance of the reforms enacted on the policy agenda items vis a vis the objectives of financial market development, agricultural diversification and ultimately, the income and employment goals of USAID's country development strategy.

To the extent possible, evaluate the preliminary and longer term effects of the reform measures.

b. FINANCIAL

Review and recommend improvements, if warranted, in the system of GOI budgetary submissions to AID.

Determine whether ARSSP funds have been allocated to and received by the targeted departmental budgets and that additionality in these key budgets has been determined using the project's formula.

Determine the general utility of the activities supported, and how much they have contributed to reform policy formulation and implementation.

c. CONTRIBUTION OF ARSSP TO GOI POLICY REFORM EFFORTS

Assess how the non-project mode of assistance was chosen, how the budgetary requirements for AID budget support were established and how the distribution of that support among users was determined.

Assess the process through which the agenda of reforms was developed and agreed to by the government and A.I.D.

Assess the extent to which A.I.D.'s assistance contributed to developing the policy agenda.

Review all studies and analyses conducted through the program, including those using budget support funds, to judge their utility in forwarding the reform agenda.

Assess the utility of the project funded technical assistance provided.

Assess the extent to which ARSSP resources have strengthened the position of GOI policy makers who have supported the reform agenda and the significance of this for future policy reform activities

Determine how GOI officials involved at various levels in the ARSSP program view its purpose and determine if it is accomplishing that purpose as these officials interpret it.

d. MANAGEMENT ISSUES:

Assess whether the policy agenda was sufficiently focused and specific enough for adequate monitoring of implementation and assessment of the effects of policy changes made.

Assess whether there was a functional information system included in the program design to provide for adequate data for monitoring and evaluation.

Discuss the management requirements imposed on the Mission and the Government of Indonesia as a result of this program. Discuss how the management system could be improved. Assess whether the program is any more or less management intensive than other means of A.I.D. assistance.

Review the relative effectiveness of ARSSP in addressing AID's concern that the pipeline be rapidly liquidated in Indonesia.

Discuss whether the program is any more or less developmentally effective than other means of A.I.D. assistance. This analysis should include a discussion of the relative speed with which benefits are achieved as well as relative impact of this sector assistance vs. alternatives. These effectiveness indicators should be compared with the relative costs in terms of management workload and dollar amounts.

Assess the extent to which the program was or should be coordinated with other donor efforts in similar areas.

Based on the assessments in "c" and "d" above, recommend measures to improve development, implementation and accomplishment of the ARSSP policy agenda and more effective budgetary support.

e. AMENDMENT

Determine whether the program assistance concept should be continued by A.I.D. in Indonesia.

If so, determine what form an ARSSP amendment should take.

If so, recommend areas for further policy support.

If so, recommend methods of providing the analytical capacity needed within the GOI and AID to design and implement such a program.

If so, discuss USAID staffing and management implications. Recommend changes in management of the program and other measures to improve implementation.

5. Evaluation Team:

A three person team will be required: one agricultural economist familiar with the policy environment in Indonesia, one evaluation specialist familiar with evaluation and monitoring techniques and, one program analyst working out the policy dialogue process with experience with other policy program cases.

6. Schedule:

The evaluation will begin in mid-January 1989 and continue for a period of six weeks.

1 week	Interviewing designers of the program in AID/W. Meet with IBRD officials. Review of the literature on policy program for structural adjustment
3 weeks	Data gathering in country
1 week	Drafting the report and presenting it to the Mission and the GOI.
1 week	Preparation of the final report.

Total Time: 36 days

7. Reports:

A final evaluation report will be required before the team departs.

8. Funding:

The evaluation will be funded with ARSSP program funds.