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IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board – Eighty-Fourth Session
Rome, 18-20 April 2005

PRESIDENT’S MEMORANDUM

TO THE EXECUTIVE BOARD

REPUBLIC OF INDONESIA

IFAD’S RESPONSE TO THE TSUNAMI DISASTER

**REVISED COVERAGE, SCOPE, IMPLEMENTATION ARRANGEMENTS
AND LENDING TERMS FOR THE**

P4K – PHASE III
PEMBINAAN PENINGKATAN PENDAPATAN PETANI KECIL – PHASE III
(INCOME-GENERATING PROJECT FOR MARGINAL FARMERS AND
LANDLESS – PHASE III)
(LOAN 458-ID)

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CURRENCY EQUIVALENTS

Currency unit	=	Indonesian rupiah (IDR)
USD 1.00	=	IDR 8 900
IDR 1 000	=	USD 0.112

WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 metre (m)	=	1.09 yards (yd)
1 square metre (m ²)	=	10.76 square feet (ft ²)
1 acre	=	0.405 ha
1 hectare (ha)	=	2.47 acres

ABBREVIATIONS AND ACRONYMS

AsDB	Asian Development Bank
BRI	Bank Rakyat Indonesia
IDPs	internally displaced persons
P4K – Phase III	Pembinaan Peningkatan Pendapatan Petani Kecil – Phase III (Income-Generating Project for Marginal Farmers and Landless – Phase III)

GOVERNMENT OF THE REPUBLIC OF INDONESIA**Fiscal Year**

1 January – 31 December

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I. INTRODUCTION

1. **The 26 December 2004 earthquake and tsunami disaster.** The tsunami that swept across the Indian Ocean on 26 December 2004 and caused giant waves travelling at about 500 km/hr to hit the coastlines of 15 countries¹ along the ocean generated widespread devastation. This was the worst natural disaster in recent history, causing an unprecedented loss of human lives and massive physical and economic damage. Indonesia is among the countries that bore the brunt of the devastation. The known death toll currently stands at over 300 000, with Indonesia paying the highest price in terms of lives lost and physical damage.

2. In Indonesia, the earthquake struck the province of Nanggroe Aceh Darussalam (hereinafter referred to as Aceh) and the north-western part of North Sumatra province about 35 minutes before the first of the three ten-metre-high tsunami wave masses entered and flushed away, entirely or in part, towns, villages, infrastructure and farming areas up to 6 km inland. Indirectly, it affected villages located up to 15 km from the coast. The inhabitants of these villages were not food self-sufficient and the damage to the landlines isolated them from supplies of food and other basic subsistence items and services, forcing them to look for aid in camps for internally displaced persons (IDPs). In numerous locations, coastal landscapes and habitats have been completely washed away, with only fractions of these now emerging from the sea. Thirteen of the 21 districts of Aceh, particularly those on the west coast, and the island of Nias (North Sumatra) were devastated. The waves cut deeply into the densely populated areas of Banda Aceh, the capital of the province, decimating its population. One out of every two inhabitants of the city has lost family, property or business – or, in many cases, all three. Aceh Besar and Aceh Jaya were the second and third most affected districts, respectively.

3. According to the latest government figures, 265 000 people have either died or are missing. Some 2.8 million have been affected directly or indirectly by the disaster. Of these, 700 000 are homeless, of whom approximately 450 000 are displaced and are being housed in temporary, camp-type locations. Preliminary assessments indicate that the impact on the productive sectors and physical infrastructure has been enormous. Prior to the disaster, Aceh was one of the three poorest provinces of Indonesia, with over 30% of the population living below the poverty line, against the

¹ Bangladesh, India, Indonesia, Kenya, Malaysia, Maldives, Mauritius, Myanmar, Seychelles, Somalia, Sri Lanka, Thailand, the United Republic of Tanzania, Yemen and the French overseas department of Reunion.

national average of 18.4%² – and double that of North Sumatra. Agriculture contributes more than 56% to the provincial GDP – if oil and gas revenues are excluded. Agriculture, livestock and fisheries are the worst hit.³ Farms within 6 km of the coastline on the west, and within 4 km on the east, have been badly affected. The estimates show that crops have been damaged on 34 600 hectares (ha) of paddy lands and 29 000 ha of drylands. In addition, up to 40 000 ha of estate crops, including tree crops; 50 000 heads of cattle; 50 000 buffalo; 70 000 goats, 8 500 sheep and 2.5 million poultry birds have been lost. Besides the immediate damage in the form of crop and animal loss, it is expected that the reduced productivity or permanent loss of land due to sand and mud deposits, as well as erosion and salinization, will be quite extensive. Many of the irrigation systems of the devastated 465 villages need to be reconstructed.

4. Seventy per cent of the fishing boats and gear have also been lost, while 55% of the fishing ports have been damaged, resulting in the cessation of almost all fishing activities, which contributed to 6.5% of provincial GDP and provided jobs for over 100 000 people prior to the tsunami. Fifty-eight per cent of these were full-time fishermen, while the others alternated farming and fishing with off-farm income-generating activities, according to the labour requirements and opportunities of the cropping and fishing seasons. The brackish water culture ponds have also been severely affected, with damages amounting to USD 52 million. This accounts for approximately half of the total damage to the assets of the subsector, estimated at USD 105 million. An estimated USD 425 million will be lost in terms of revenue before Aceh's fishing industry recovers to pre-tsunami production levels by 2009.

5. The loss in terms of volume of production from the agriculture and fisheries sectors that will not be processed and marketed by the agri-business-related sector amounts to USD 270 million. The overall cost for recovery of Aceh has been estimated by the Government at USD 4.5 billion, which corresponds to 97% of the annual provincial GDP.

6. **IFAD's response.** Shortly after the disaster struck and at the request of the governments of the affected countries, IFAD began working with the affected communities and their governments, emergency assistance agencies and other official development assistance partners, to identify interventions in support of the recovery process. The Government of Indonesia appreciated IFAD's expression of condolence for the tragedy caused by the tsunami and encouraged the Fund to assist in the recovery process, particularly in the agriculture sector.

7. Given the magnitude of the disaster and the volume of assistance pledged in Indonesia, IFAD's assistance in the recovery process started early – with the Special Meeting of the Association of Southeast Asian Nations (ASEAN) Leaders on the Aftermath of the Earthquake and the Tsunami held in Jakarta on 6 January 2005. The leitmotif of IFAD's engagement in the country has been to work in partnership with other official development assistance and emergency assistance agencies and to build on the guidance and leadership provided by the Government. As a member of the team for the needs assessment, rehabilitation and reconstruction of Aceh and North Sumatra, composed of the Government and representatives of the international community, IFAD contributed to producing the damage and loss assessment report, and the recovery strategy notes. It also participated in various sectoral forums and provided inputs to formulate the assistance frameworks (blueprints and master plans) with other partners, in particular the Ministry of Agriculture and the National Development Planning Agency, in charge of coordinating the recovery phase. In addition to the World Bank and the Asian Development Bank (AsDB), IFAD has also cooperated closely with the Food and Agriculture

² This was exceeded only by Maluku with 33% of its population living below the poverty line, and Papua with 39%. Similarly to Aceh, both provinces are conflict-torn.

³ The following information is drawn from: data collected by the Team for the Needs Assessment, Rehabilitation and Reconstruction of Aceh and North Sumatra as presented to the Consultative Group Meeting for Indonesia on 19-20 January 2005; the IFAD/Ministry of Agriculture inception mission of February 2005; and the preliminary drafts of the master plan of the Ministry of Agriculture, March 2005. More up-to-date information may be available with the publication of the Government's blueprint and master plan, scheduled for April 2005.

Organization of the United Nations and the World Food Programme. Such cooperation among United Nations agencies and international financial institutions should be forcefully promoted during the transition from emergency to full recovery, to allow synergies and complementarities to emerge.

8. On 4 February 2005, the emergency phase was officially declared complete. On 5 February 2005, IFAD fielded its inception mission with representatives of the Ministry of Agriculture's Task Force for the Tsunami Disaster and the Department of Agriculture of Aceh Province. This team held consultations with affected rural communities living in IDP camps in Aceh's coastal areas, to listen to their aspirations and formulate the Aceh Recovery Programme with them. The main design features of the programme formulated during these consultations have been integrated into the sectoral and national strategies for post-tsunami recovery. The design has its roots in IFAD's most successful programme in Indonesia to date – the Post-Crisis Programme for Participatory Integrated Development in Rainfed Areas. The first phase of this programme focused on capacity-building of poor communities (particularly for the poorest sections and their enablers, such as government bodies and NGOs); savings and credit management; community management of natural resources and infrastructure works; and enhanced skills for income-generation. The second phase has a stronger thrust for the economic empowerment of poor rural communities, with considerable emphasis on sustainable livelihood development.

9. The executing agency of the Post-Crisis Programme for Participatory Integrated Development in Rainfed Areas encouraged the rest of the administration to develop this programme into a national programme for poverty reduction. The Ministry of Agriculture found the programme characteristics particularly suitable for supporting people-centred recovery in the aftermath of the tsunami, and valid in terms of long-term development.

10. The Aceh Recovery Programme is meant to help the tsunami survivors fulfil their three basic aspirations: (i) to return to and rebuild their villages, (ii) to rebuild their houses and (iii) to resume their previous occupations. Its implementation arrangements have been chosen on the basis of feedback provided by the communities and local government regarding the feasibility of various implementation options offered. The overarching concern was for affected communities to have a say in shaping the recovery of Aceh and for them to be placed in the driver's seat in terms of the management of funds. All those consulted expressed great anxiety regarding the process of assistance delivery; they stressed the need to ensure that assistance flow to where it is needed and that affected groups decide how and where the funds are used. As a result, the programme specifically focuses on the institutional underpinning of the development process, the resumption of which it aims to support. It has identified a good targeting mechanism, and a channelling system that aims to maximize aid impact and effectiveness: this could easily embrace any additional sectoral interventions that other donors may be interested in financing. Moreover, management of funds is in the hands of the beneficiaries and the institutions over which they have control.

11. Beyond providing immediate livelihood rehabilitation support, the programme aims to create more resilient livelihood systems and to seize opportunities for economic development and for fostering a people-centred growth process. In addition to having a direct impact on the productive life of the communities, it aims to reinforce the currently fragile social capital, which has been dismantled by nearly 30 years of conflict. Thus, it supports the Government's expressed commitment to reconciliation and long-term development. If appropriate financing is mobilized promptly, disbursements could commence in May 2005, meaning that communities would be helped move quickly from their very difficult living conditions in the IDP camps, and start rebuilding their lives in the way they wish.

12. IFAD has offered the Government of Indonesia the following assistance package:⁴

- (i) The inclusion of Aceh Province in the areas covered by the AsDB-cofinanced P4K – Phase III – Pembinaan Peningkatan Pendapatan Petani Kecil – Phase III (Income-Generating Project for Marginal Farmers and Landless – Phase III) (loan 458-ID) and the reallocation of USD 3.18 million to the recovery of Aceh, from the funds available in the existing loan.⁵
- (ii) The provision of a grant amounting to USD 1.5 million from Italian supplementary funds, to cover the cost of immediate livelihood rehabilitation work with the communities through local NGOs, while government services are being helped to resume their normal activities under P4K – Phase III.
- (iii) The expansion of the area covered by the Post-Crisis Programme for Participatory Integrated Development in Rainfed Areas to be financed by an additional USD 30.0 million in grant funds, with adjustments to its phase II design as defined in the Aceh Recovery Programme.

13. Initially, IFAD offered USD 30.0 million in the form of a loan. Subsequently, the Government expressed the wish to finance the recovery activities through grants, also in consideration of the availability of other agencies to offer support in this form. As a result, IFAD committed to help mobilize financing of the Aceh Recovery Programme through grants by inviting other donors to support the programme and/or include it in their own assistance packages. The IFAD assistance package would include the design work undertaken and an amount of USD 34.68 million comprising USD 1.5 million from Italian supplementary funds⁶, USD 3.18 million as reallocation from the loan financing of P4K – Phase III and an additional USD 30.0 million in grants requested from external financiers. In addition, the Fund is proposing to change the terms and conditions of the loan financing P4K – Phase III from intermediate to highly concessional.

II. RATIONALE FOR THE EXTENSION OF P4K – PHASE III TO THE TSUNAMI-AFFECTED AREAS

14. **Rationale.** The expansion of the area coverage of P4K – Phase III will be financed through approximately USD 6 million from both IFAD and AsDB loans. The USD 3.18 million reallocation from the IFAD loan will help finance (i) capacity-building of approximately 500 self-help groups to manage group resources, including savings, profits from internal lending and grants; and (ii) the resumption of agricultural extension services in support of immediate livelihood rehabilitation. The reallocation from the AsDB loan amounts to USD 2.9 million. This will be used to provide grants to the self-help groups to capitalize them for internal lending as well as to help them rebuild their microenterprises and/or resume off- and on-farm income-generating activities. The limited capacities of local government to respond to the disaster will require strong support from a well-established administrative structure that can help restore and develop service provision and guide implementation. P4K – Phase III avails of a very good management unit at the central level. This unit is highly experienced and motivated, and can provide the required support.

15. **Original scope.** The original objectives of P4K – Phase III are to develop sustainable and participatory systems to help the poor improve their livelihoods and the well-being of their families in the long term, so that they can achieve self-reliance and live above the poverty line. The project provides for assistance in skills development, training and microfinance support services for about

⁴ It is worth noting that while the first and the second of the below-mentioned investments would meet short-term objectives, they would also lay the groundwork for the third investment.

⁵ The figure of USD 3.18 million refers to the IFAD loan. The AsDB has also agreed to provide funds for this purpose and is making similar provisions under its loan.

⁶ To be confirmed.

760 000 poor families in 12 provinces. This is being achieved by mobilizing savings and accessing a credit window through Bank Rakyat Indonesia (BRI), and by developing microenterprises and other income-generating activities through the extension service centres of the local departments of agriculture. The project is part of the Government's strategy on poverty reduction and aims to achieve its objectives through the following three components: (i) self-help group development; (ii) microfinance services; and (iii) building and institutionalizing management capacity.

16. **Status of the project.** The loans financing the project were signed with AsDB on 18 December 1997 and with IFAD on 21 January 1998 and became effective on 9 July 1998 and 18 June 1998, respectively. Both loans are scheduled to close on 30 September 2005. The AsDB loan amounts to USD 52.80 million (after three partial loan cancellations in 1998, 2000 and 2004), while the IFAD loan amounts to SDR 18.25 million (currently equivalent to USD 26.18 million). AsDB is the cooperating institution, in charge of the administration and supervision of both loans.

17. The project's physical progress and performance are satisfactory, with an overall accomplishment of approximately 98% against an elapsed loan period of 95%. The physical progress is estimated at 90% for the self-help group development component, 100% for the microfinance services component, and 95% for the building and institutionalizing management capacity component. On the AsDB loan, USD 20.1 million or 98% of the allocation for credit activities and USD 22.8 million or 70% of the allocation for non-credit, have been utilized. Overall utilization of the AsDB loan amounts to USD 42.9 million or 81% of the loan amount. On the IFAD loan, USD 14.4 million or 95% of the allocation for credit activities and USD 4.8 million or 51% of the allocation for non-credit have been utilized. Overall utilization of the IFAD loan amounts to USD 19.2 million, or 78% of the loan amount.

18. The review mission of December 2004 and the executing agency had jointly assessed loan requirements for the remaining project period and had identified a potential loan cancellation amounting to approximately USD 6.0 million. As a result, the Government of Indonesia had initially indicated to cofinanciers its intention to cancel such loan funds and requested an extension of the project completion date to 31 December 2005, with the loan closing dates moving to 30 June 2006, in order for the project to formulate and implement its exit strategy.

19. **Process of project selection.** The amendments proposed herewith result from intensive consultations among cofinanciers, all three of them being committed to providing prompt support to communities recovering from the disaster, while coordinating initiatives and identifying the most effective aid instruments. The selection of P4K – Phase III as one of the appropriate vehicles to channel assistance and the consequent adjustments were decided upon after: (i) the joint assessment of damage and needs in the agriculture sector; (ii) evaluation of the rationale for expanding the project activities to the tsunami-affected areas; and (iii) review of the executing agency's proposal for assistance to the tsunami-affected areas. It should be added that Aceh Province had already developed a strategy for replication of P4K – Phase III through NGOs several years ago, with support from the United Nations Development Programme, but implementation remained at the pilot phase. This preparatory work will facilitate the fast disbursement of grants, rather than loans, for the rehabilitation of livelihoods.

20. **Adjustment of project scope.** During consultations, the BRI, the executing agency in charge of the microfinance component, described the severe impact of the disaster on its service provision capacity: the tsunami killed its staff and destroyed its records and offices in many districts and villages. The BRI also indicated its commitment to supporting the tsunami-affected communities, but in the form of grants derived from its profit margin. As a result, for the first year, resuming service provision, while reconstructing branches, client profiles and files, will be the main activity, accompanied by grant disbursement in the less affected areas. Consequently, cofinanciers agreed that the possibility of collaborating with NGOs along with local non-banking financial institutions would

be a good way to channel assistance to the worst-affected areas, where the banking network no longer exists. This does not exclude the possibility of future collaboration with BRI when it becomes confident of its capacity for service provision once again.

21. Cofinanciers agreed that resumption of productive activities requires appropriate support services, particularly in the areas of agriculture-related extension, vocational training and skills development. However, the tsunami took a heavy toll on the capacity of local government to provide such services, decimating its staff in addition to destroying its facilities and equipment. Consequently, cofinanciers agreed to use the services of NGOs to help the district governments in grass-roots institution building, development of responsive extension and skill-building services, community empowerment, participatory approaches to development, in addition to the disbursal of the grant funds for the whole implementation period, to be phased out as soon as the government's capacity and service provision have been re-established.

22. The adjustments in project scope and implementation arrangements described above are required to adapt assistance to a post-disaster situation; however, the project will remain substantially in line with its original objectives. The implementation of the new activities will follow the same approach as that of the existing project – especially where NGOs are involved in implementation. Clearly, further details will be developed as a result of field assessments and interaction with the communities, and these will be included in the project administration manual. The resources mobilized through P4K – Phase III will be focused on a few districts, to maximize the impact of assistance. The Government will ensure coordination with other programmes and prevent overlapping or conflicting approaches and instruments from being applied in a given area. At this stage, cofinanciers agree that the reallocation of funds for the tsunami-affected areas will provide for:

- (i) capacity-building for district level extension staff and NGO staff;
- (ii) equipping the district extension services to resume provision of their services and undertake project activities;
- (iii) developing fiduciary mechanisms to ensure proper use of funds;
- (iv) developing 400-500 self-help groups in the worst-affected areas for resource management activities;
- (v) delivering grants to the self-help groups, to support rehabilitation of livelihoods and to capitalize groups for internal lending and savings accumulation activities;
- (vi) intensive capacity-building and training at the individual and group level, to strengthen capacities and improve skills for improved livelihood systems and diversified sources of incomes; and
- (vii) continued support and facilitation for self-help groups to access BRI and other financial institutions, to obtain credit in the longer term.

23. **Implementation period.** The implementation of P4K – Phase III (without the expansion to Aceh Province) is anticipated to be completed by 31 December 2005, requiring an extension of the loan closing date of September 2005 to December 2005. Given the long-term nature of its approach and the need for continued support by the affected communities throughout the rehabilitation phase, the assistance for the tsunami-affected areas would require a longer implementation period. It has been therefore agreed to extend such a period and let it coincide with the closing of both loans on 31 December 2006. Completion of activities and loan closing dates are required to coincide mainly for loan administration purposes.

24. **Procurement procedures.** In view of the disaster situation and the urgent need for assistance, the Government of Indonesia has requested AsDB and IFAD to adopt simplified procurement procedures. This would enable immediate mobilization of NGOs and the procurement of vehicles and other equipment that may be required.

25. Under the loan agreement of P4K – Phase III, the procurement procedures of the cooperating institution (in this case AsDB) are to be applied. Following AsDB's policy, simplified procurement arrangements and procedures may include:

- (i) procurement of domestic goods and services to revitalize the damaged local economies;
- (ii) local competitive bidding for civil works (to repair the extension service centres, for instance) with the bidding period reduced from the standard four weeks to two weeks;
- (iii) international shopping for goods and services with the bidding period reduced to one to two weeks; and
- (iv) flexibility in recruiting essential operational staff and provision for direct recruitment of consultants.

III. TENTATIVE COST ESTIMATES AND FINANCING PLAN

26. The cost of the proposed assistance to the tsunami-affected areas is estimated at USD 6.0 million. The required funds would be reallocated from the loan cancellation identified by the review mission in December 2004. The Government has requested AsDB and IFAD to finance 100% of the costs, net of non-incremental wages, levies, taxes and duties for the proposed assistance. It is anticipated that the increased financing will not have any major impact on the loan/counterpart cost-sharing ratio and that the ceiling for the local cost financing under the project will not be exceeded.

IV. CHANGE IN FINANCING TERMS

27. The Republic of Indonesia is currently eligible for financing at highly concessional terms. P4K – Phase III was negotiated in 1997, when the country was still receiving finance under intermediate terms. In the context of IFAD's response to the tsunami disaster, the Fund is recommending that the country be allowed to repay the outstanding loan financing P4K – Phase III at highly concessional terms.

V. RECOMMENDATION

28. In light of the above, I recommend that the Executive Board approve:

- (a) the revised scope of works, geographical coverage and implementation arrangements;
- (b) the revised financing conditions from intermediate to highly concessional terms, according to the following resolution:

RESOLVED: that the Fund will amend the terms and conditions governing the outstanding loan No. 458-ID in an amount equivalent to fifteen million two hundred and eight thousand and three hundred and thirty special drawing rights (SDR 15 208 330) to the Republic of Indonesia financing P4K – Phase III in various currencies to mature on or prior to 15 November 2037 and, as of the date of the Executive Board's approval, a service charge of three fourths of one per cent (0.75%) per annum shall be payable, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this President's Memorandum.

Lennart Båge
President