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President's report

Proposed loan and grant to the Republic of Indonesia for the Rural Empowerment and Agricultural Development Scaling-up Initiative

Note to Executive Board representatives

Focal points:

Technical questions:

Ron Hartman
Country Director
Asia and the Pacific Division
Tel.: +39 06 5459 2184
e-mail: r.hartman@ifad.org

Sarah Hessel
Programme Officer
Tel.: +39 06 5459 2622
e-mail: s.hessel@ifad.org

Dispatch of documentation:

William Skinner
Chief
Governing Bodies Office
Tel.: +39 06 5459 2974
e-mail: gb_office@ifad.org

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For: Approval

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Abbreviations and acronyms

4Ps	public/private/producer partnership(s)
AAEHRD	Agency for Agricultural Extension and Human Resource Development
BAPPENAS	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
DPMO	district programme management office
M&E	monitoring and evaluation
MoA	Ministry of Agriculture
NPMO	National Programme Management Office
PPSU	provincial programme support unit
READ	Rural Empowerment and Agricultural Development Programme in Central Sulawesi
READSI	Rural Empowerment and Agricultural Development Scaling-up Initiative

Map of the programme area

Indonesia

Rural Empowerment and Agricultural Development Scaling-up Initiative

President's report



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

Map compiled by IFAD | 14-10-2016

Republic of Indonesia

Rural Empowerment and Agricultural Development Scaling-up Initiative

Financing summary

Initiating institution:	IFAD
Borrower:	Republic of Indonesia
Executing agency:	Ministry of Agriculture
Total programme cost:	US\$87.28 million
Amount of IFAD loan:	SDR ... million (equivalent to approximately US\$58.88 million)
Amount of IFAD grant:	SDR ... million (equivalent to approximately US\$1 million)
Terms of IFAD loan:	Ordinary: repayment term of 18 years, including a grace period of six years, with an annual interest rate equivalent to 100 per cent of the IFAD reference rate
Cofinancier(s):	Private-sector partners
Amount of cofinancing:	Private-sector partners: US\$6.49 million
Contribution of borrower:	US\$15.08 million
Contribution of beneficiaries:	US\$5.84 million
Appraising institution:	IFAD
Cooperating institution:	Directly supervised by IFAD

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed financing to the Republic of Indonesia for the Rural Empowerment and Agricultural Development Scaling-up Initiative, as contained in paragraph 49.

Proposed loan and grant to the Republic of Indonesia for the Rural Empowerment and Agricultural Development Scaling-up Initiative

I. Strategic context and rationale

A. Country and rural development and poverty context

1. Indonesia is a fast-growing middle-income country with the fourth largest population in the world. With 3 per cent annual urban growth, over 50 per cent of Indonesians now live in urban centres, generating a soaring demand for consumer goods, including food products. The productivity of Indonesian farmers will need to increase by more than 60 per cent within the next 15 years.
2. Steady economic growth has led to gradual poverty reduction. However, the pace of this reduction has been stagnating in recent years, particularly in rural areas. Malnutrition remains stubbornly high and the prevalence of stunting (height for age) among children under five years of age has risen slightly. Rising inequalities, with an increase in the Gini coefficient from 0.36 in 2005 to 0.41 in 2014, are threatening to roll back progress made in poverty reduction and further entrench poverty.
3. Agriculture is still the main source of income for one third of the population and for 64 per cent of poor people. Changing diets, new technologies and a favourable policy framework offer strong opportunities for rural transformation. Yet declining land sizes and insecure tenure arrangements, together with limited access to technologies, infrastructure, rural finance and markets, pose risks to agriculture – further increased by climate change vulnerability.

B. Rationale and alignment with government priorities and RB-COSOP

4. The 2015-2019 National Medium-Term Development Plan prioritized food sovereignty in key staple foods (including rice), greater production of estate crops and poverty reduction in rural areas. Accordingly, the Government of Indonesia is seeking to develop approaches that assist rural people in increasing their agricultural productivity and improving their livelihoods – linking to and supporting the implementation of key policies, such as the Village Law (6/2014) and the Farmer Empowerment and Protection Law (19/2013).
5. The 2016-2019 results-based country strategic opportunities programme (COSOP) aims to support inclusive rural transformation to enable rural people to reduce poverty and achieve sustainable livelihoods. It seeks to accomplish this through the provision of financing and technical support to develop innovative models that can be replicated and scaled up by the Government and other partners. Investments made by IFAD will contribute to three interlinked strategic objectives: (i) small-scale producers participate in remunerative agricultural markets; (ii) small-scale producers and their families are more resilient to risks; and (iii) rural institutions deliver responsive services meeting the needs of small producers.

6. The IFAD-supported Rural Empowerment and Agricultural Development Programme in Central Sulawesi (READ), implemented from 2008 to 2014, contributed to a sustainable improvement in the livelihoods of more than 80,000 poor rural households in Central Sulawesi Province by combining community empowerment with focused agricultural support packages. The READ piloted a number of innovations, including groundbreaking public/private/producer partnerships (4Ps). Following completion of the programme, the Ministry of Agriculture (MoA) began scaling up the READ approach in two provinces (West Kalimantan and East Nusa Tenggara), with a total budget of some 20 billion Indonesian rupiah (Rp) per year (US\$1.53 million). Based on its learning from this experience, the Government has now requested IFAD to support the scaling up of READ's successful approach into a programmatic platform for agricultural investments.
7. The Rural Empowerment and Agricultural Development Scaling-up Initiative (READSI) will work towards the priorities and goals laid out in the 2005-2025 National Long-Term Development Plan and the 2015-2019 National Medium-Term Development Plan, particularly those of ensuring food security, self-sufficiency and food sovereignty through increased domestic production capacity. It is fully aligned with the 2016-2019 COSOP and IFAD's strategy to pilot innovative rural development approaches for scaling up through national programmes.

II. Programme description

A. Programme area and target group

8. **Programme area.** The proposed area will include a total of 24 districts: 20 within the six provinces of Sulawesi Island and 2 districts each in West Kalimantan and East Nusa Tenggara. READSI is expected to reach a total of about 450 villages, including 90 villages that were included under READ. Participating districts will be selected according to the following criteria: (i) high poverty levels; (ii) agricultural potential accessible to the target group; (iii) credible commitment from provincial and district leadership to delivery of the programme and close collaboration with central-level teams; and (iv) diverse and varied development challenges for testing and further developing a programmatic platform for rural development.
9. **Target group.** READSI will target: (i) poor and near-poor people who have the potential to generate economic returns from agriculture with programme support; and (ii) landless and land-poor people, including woman-headed households, who will be included in activities directed at homestead gardening, improved nutrition and financial literacy. The targeting strategy will ensure the inclusion of ethnic groups and indigenous peoples that meet programme selection criteria, as well as the adaptation of activities to the social and culturally influenced particulars of indigenous peoples. The programme is expected to benefit about 382,500 direct beneficiaries or 76,500 households. Women are expected to constitute 50 per cent of programme beneficiaries.

B. Programme development objective

10. The programme's goal is to support the growing prosperity of Indonesian smallholder farming families, and its objective is to empower rural households in the programme area with the skills, confidence and resources to sustainably improve their farm and non-farm incomes and livelihoods through a scalable programmatic approach.

C. Components/outcomes

11. **Component 1: Village agriculture and livelihoods development** aims to increase household incomes and livelihoods through the improved productivity and profitability of farm and non-farm activities and better management of household finances and nutrition. Activities are based on the proven READ approach of community mobilization closely integrated with agricultural and livelihood development, and clustered in four complementary activities:

- (i) **Community mobilization.** Establish an organizational structure for social mobilization; identify and mobilize the target group around common interests; and build the capacity of the target group to pursue its economic and livelihood interests;
 - (ii) **Agriculture and livelihoods.** Support food crops, estate crops, homestead gardening, livestock, agricultural machinery and infrastructure, and non-farm livelihoods through intensive extension support to target farmers, a starter inputs package, and agricultural equipment, machinery and small infrastructure;
 - (iii) **Savings, loans and financial literacy.** Increase access to and use of affordable seasonal and investment finance through financial literacy training, savings and loan activities within community groups, machinery investments and strengthened linkage to existing financial organizations;
 - (iv) **Nutrition.** Improve nutrition and encourage local innovation through technical awareness-raising and training, integrated homestead gardening and social marketing approaches.
12. **Component 2: Services, inputs and market linkages** aims to improve critical services and input markets in programme districts in terms of quality, relevance, availability and accessibility to serve community needs. It will cover five key services, each addressed in a subcomponent:
- **2.1 Agricultural extension service (all districts).** Support and deliver extension activities under component 1 and improve overall agricultural extension through: recruitment and training of new and existing extension staff; review and updating of all existing relevant technical packages used by that staff; and upgrading of training programmes and extension facilities.
 - **2.2 Financial services (all districts).** Support smallholder borrowers through: strengthened partnerships with banks; collaboration with Indonesia's Otoritas Jasa Keuangan (Financial Services Authority) in registering community-based financial organizations as microfinance institutions and strengthening supervision; and expanded agricultural insurance.
 - **2.3 Seed supply markets and system (all districts).** Support quality seed supply through a four-step process: (i) breeding, (ii) multiplying, (iii) distributing high-quality seed, and (iv) providing credible assurance to farmers that their seed is of a consistently high standard.
 - **2.4 Cocoa farmer support services and markets (Sulawesi only).** Enhance the profitability of cocoa farming through: upgrading the coverage of embedded services delivered within the supply chains; developing high quality, affordable private service providers; expanding the cadre of private and public extension professionals; and strengthening the role and capacity of the technical line department for district estate crops.
 - **2.5 Livestock production, health services and markets (until midterm, only in East Nusa Tenggara).** Establish an effective and efficient system of animal production and health services through upgraded technical support. Activities will be reviewed at midterm and potentially scaled up to other districts.
13. The 4Ps will be an important approach to enhancing sustainability, especially for: financial services through locally focused partnerships with banks; expansion of the successful READ partnership with MARS Cocoa and establishing new partnerships with other lead cocoa firms; and market-oriented collaborations between rice-seed multiplier farmers and the supporting technical seed producer agencies of MoA. To ensure sustainability of and equity within these partnerships, they will be facilitated following careful due diligence to ensure that they deliver clear benefits to READSI

communities. Each of the 4Ps will be assessed and designed individually, negotiated and managed.

14. **Component 3: Policy and strategy development support** aims to strengthen the policy and institutional framework for smallholder agriculture. This will include informing national policies and programmes, documenting and scaling up best practices and building public capacity to effectively deliver services in support of inclusive rural growth. Activities will be supported across the entire policy cycle, from the identification of policy issues to policy analysis, approval, implementation and monitoring. The component will focus on addressing policy issues relevant to smallholder agricultural development in Indonesia, and specifically those relevant to the policy and institutional challenges associated with scaling up: (i) rice-seed-sector and fertilizer policies and approaches that are linked to the IFAD-supported Policy Dialogue Platform on Irrigated Agriculture in the Badan Perencanaan Pembangunan Nasional (BAPPENAS – National Development Planning Agency) and aim to inform the 2020-2025 National Medium-Term Development Plan; (ii) alternative approaches to improving the effectiveness and efficiency of central investment programmes in the agriculture sector, using READSI as a practical pilot; and (iii) strategy and approaches to developing a demand-driven public extension service that responds to farmers’ needs.

III. Programme implementation

A. Approach

15. READSI is a farmer-centred programme, enabled through an integrated approach at the village level anchored in social mobilization processes. Building on the READ experience, READSI will put the villages, and especially the programme-mobilized agricultural and livelihoods groups, at the heart of implementation, with services and support organized around these groups. The mix of key activities will respond to demand on the part of READSI households in each village, with households free to choose which groups to join. READSI will also support a transition to a more genuine empowerment of farmers, for example by reducing the size and scope of subsidies, with a greater emphasis placed on supporting farmers in making their own choices on how resources should be invested.
16. READSI will also expand elements of the original READ approach, including deepening and increasing the number of private-sector partnerships – in the cocoa sector, but also in financial services. It will also see an evolving role for the National Programme Management Office (NPMO), as it transitions its systems and practices from managing a project to a programmatic platform able to operate across many more and varied districts. As READSI moves towards this programmatic platform, the framework for selection of districts for the programme and their eventual graduation out of READ will evolve. As is already being seen in the original READ districts, the intensity and nature of supported needs change as districts make progress and deliver results. READSI will thus apply a district graduation process, with different sets of support activities provided throughout the process.
17. Given the growing importance of village-led investment in Indonesia more generally, especially under the new Village Law, READSI will coordinate with the Ministry of Villages, Underdeveloped Regions and Transmigration and other key agencies to ensure links and synergies are developed between READSI and these other initiatives – both centrally and practically at village and district levels.

B. Organizational framework

18. READSI will follow the implementation structure of the READ and will build on good practices developed by other IFAD-supported investments in Indonesia, including: operating within mainstream government systems and processes; building strong systems and processes to maximize management efficiency; and benchmarking among and within districts and of staff, enabled by independent monitoring and

evaluation (M&E), strong and transparent governance structures, and incentives for strong performance.

19. MoA will be the executing agency, with the Agency for Agricultural Extension and Human Resource Development (AAEHRD) being assigned to host the READSI NPMO, continuing from READ. The NPMO will contract additional technical specialists to work as an integrated part of READSI delivery in the areas of social mobilization and rural finance.
20. While the NPMO has overall responsibility for programme delivery, each of the components has specific implementation arrangements, drawing on district-level agencies. Provincial programme support units (PPSUs) will be set up in each province for administrative functions such as financial reporting, M&E and planning. A district programme management office (DPMO) will be set up in each district to lead implementation of district-level activities (primarily under component 1).
21. READSI will be overseen by a steering committee (SC), which will provide support for overall direction of the programme. The SC is chaired by a senior official of the Ministry of Agriculture and co-chaired by BAPPENAS, and will include representatives of central government (Ministry of Villages, Underdeveloped Regions and Transmigration, Ministry of Home Affairs), subnational government (representatives of READSI districts), private-sector partners and other key implementing partners and stakeholders, such as farmers' organizations. In the interests of effective decision-making, members will be appointed for not less than one year, and total membership of the SC should not exceed 20 people.

C. Planning, monitoring and evaluation, and learning and knowledge management

22. **Planning.** Planning processes and schedules within READSI will be harmonized with the mainstream planning process of the Government at central, district and village levels. The NPMO, in consultation with the districts, will prepare the annual workplan and budget and procurement plan and submit them to IFAD for review and no objection.
23. **Monitoring and evaluation.** The M&E and knowledge management framework of the READSI will draw on the experience of the IFAD-supported Coastal Community Development Project (CCDP). Considering the scaling-up objectives, READSI will have a strong emphasis on M&E and knowledge management, which will include: (i) a weekly/monthly dashboard that shows progress in key outputs and objectives, including gender; (ii) a sex-disaggregated database on all outcomes, outputs and indicators related to individuals or households; and (iii) household-level analysis of poverty impact to enable an understanding of how different interventions impact different causes of poverty.
24. The READSI will collect data electronically (tablet-based) directly into a centrally maintained management information system to improve the timeliness and reliability of data in order to make the M&E system more robust and valuable as a management tool.
25. **Learning and knowledge management.** The programme is expected to generate practical knowledge of what works (and what does not) and how to scale up investments into successful programmatic approaches. Effective, efficient learning, knowledge management and communication are thus central to the READSI longer-term vision. Accordingly, the programme will invest in good-quality, evidence-based knowledge management in order to contribute to policy development processes. Building on knowledge generated through the M&E system, the READSI will systematically share knowledge and exchange and link it to policy activities.
26. Activities under component 3 will support specific knowledge management efforts within the READSI and also contribute to broader policy and strategy processes in

MoA and other government stakeholders at national, provincial and district levels – such as BAPPENAS and district governments.

D. Financial management, procurement and governance

27. **Financial management.** The programme's arrangements will be aligned with government systems as regards accounting systems and standards, treasury systems, procurement, asset management and audit. The NPMO will be responsible for financial management and will be staffed adequately. Its role will include: (i) preparing the annual workplan and budget; (ii) treasury forecasting and annual disbursement projections; (iii) collecting and consolidating expenditure reports from PPSUs and DPMOs; (iv) timely preparation and submission of withdrawal applications to IFAD; (v) interim financial reporting; (vi) preparation of annual financial statements; (vii) coordination with audit processes; and (viii) procurement.
28. A financial management assessment of the programme was prepared in accordance with IFAD's guidelines. It found an overall medium financial management risk. The risk will be mitigated by a range of measures that include: hiring of external financial management expertise at the NPMO level; development of manuals; interim financial reporting; strengthened internal audit arrangements; and regular training, in addition to intensive support and training at start-up.
29. **Flow of funds.** IFAD funds will flow through Indonesia's Treasury Single Account (TSA) to two designated accounts for the IFAD loan and grant respectively – denominated in United States dollars and held by the Ministry of Finance at Bank Indonesia. Disbursements for programme expenditures will be made via the Treasury system through local Treasury offices (Kantor Pelayanan Perbendaharaan Negara [KPPN]) and reported from that level through the Government's financial management information system for public finances (Sistem Perbendaharaan dan Anggaran Negara [SPAN]).
30. **Procurement** will be undertaken in accordance with national procurement rules and regulations to the extent that these are consistent with the IFAD Project Procurement Guidelines.
31. **Audit.** The supreme audit institution (Badan Pemeriksa Keuangan [BPK]) will audit programme accounts annually, in line with IFAD guidelines. The resolution of audit observations will be monitored by the NPMO, BPK and IFAD through its supervisory processes. In addition, the READSI programme will be included in the workplan of MoA's Internal Audit Unit, with reporting made available to IFAD supervision missions.
32. **Governance.** Anticorruption measures will include: (i) creating and sustaining a corruption-free environment for programme activities; (ii) complying with internal procedures and controls, following international best practice standards; (iii) complying with requirements of IFAD's Policy on Preventing Fraud and Corruption in its Activities and Operations (2005, as amended to date); (iv) ensuring that a good governance framework is implemented promptly; and (v) establishing a complaint mechanism for programme beneficiaries and other stakeholders.

E. Supervision

33. Supervision will be undertaken by IFAD through biannual supervision missions. In addition, the Fund will adopt a continuous supervision and implementation support approach through the newly opened country office.

IV. Programme costs, financing and benefits

A. Programme costs

34. Total programme costs, including physical and price contingencies, are estimated at US\$87.28 million over a five-year implementation period.

Table 1

Programme costs by component and financier

(Thousands of United States dollars)

Component	IFAD loan		IFAD grant		Private sector		Beneficiaries		Borrower/ counterpart		Total
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount
1. Village agriculture and livelihoods development	35 096	72.1	-	-	3 195	6.6	5 838	12.0	4 562	9.4	48 690
2. Services, inputs and market linkages	8 265	50.4	-	-	3 298	20.1	-	-	4 828	29.5	16 391
3. Policy and strategy development support	-	-	1 000	90.9	-	-	-	-	100	9.1	1 100
4. Programme management	10 516	65.3	-	-	-	-	-	-	5 587	34.7	16 102
5. Unallocated	5 000	100	-	-	-	-	-	-	-	-	5 000
Total	58 877	67.5	1 000	1.1	6 493	7.4	5 838	12.0	15 076	17.3	87 284

B. Programme financing

35. Total programme costs of US\$87.28 million will be financed by an IFAD loan equivalent to US\$58.88 million (67.5 per cent of total costs), an IFAD grant equivalent to US\$1 million (1.1 per cent of total costs), a contribution from private-sector partners estimated at US\$6.49 million (7.4 per cent of total costs) and the Government for an estimated total amount of US\$15.08 million (17.3 per cent of total costs). In addition to taxes and duties, the Government will cover salaries of all NPMO, provincial, district and subdistrict programme staff. Beneficiary contributions are estimated at US\$5.84 million (6.7 per cent of total costs), mostly to cofinance the purchase of basic and advanced mechanization of agriculture under subcomponent 1.2. The IFAD grant will finance policy activities under component 3. The contribution from the private sector – together with the IFAD loan – will cofinance cocoa-related activities under activity 1.2 and subcomponent 2.4.

Table 2

Programme costs by expenditure category and financier

(Thousands of United States dollars)

Expenditure category	IFAD loan		IFAD grant		Private sector		Beneficiaries		Borrower/ counterpart		Total
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount
<i>Investment costs</i>											
1. Consultancies	14 163	91.3	-	-	19	0.1	-	-	1 333	8.6	15 514
2. Equipment and materials	2 191	83.2	-	-	203	7.7	-	-	239	9.1	2 633
3. Goods and services	16 928	59.5	-	-	3 101	10.9	5 838	20.5	2 587	9.1	28 455
4. Vehicles	1 881	90.9	-	-	-	-	-	-	188	9.1	2 069
5. Workshops and training	9 267	63.1	1 000	6.8	3 169	21.6	-	-	1 244	8.5	14 680
6. Works	2 769	90.9	-	-	-	-	-	-	277	9.1	3 046
7. Unallocated	5 000	100	-	-	-	-	-	-	-	-	5 000
<i>Recurrent costs</i>											
1. Salaries and allowances	-	-	-	-	-	-	-	-	8 541	100	8 541
2. Operating cost	6 677	42.0	-	-	-	-	-	-	668	9.1	7 345
Total	58 877	67.5	1 000	1.1	6 493	7.4	5 838	6.7	15 076	17.3	87 284

C. Summary benefit and economic analysis

36. **Benefits.** Benefits will derive from: (i) community mobilization; (ii) village agriculture and livelihoods development; (iii) improved services, inputs and market linkages, including enhanced financial services; and (iv) improved nutrition.
37. **Economic analysis.** The overall economic internal rate of return (EIRR) of the programme is estimated at 19 per cent for the base case. Net present value (NPV) of the net benefit stream, discounted at 10 per cent, is US\$50.7 million. Sensitivity analysis shows the economic impact that a decrease in programme benefits – up to -50 per cent – will have on programme viability. Similarly, it shows the effects of an increase of up to 40 per cent in programme costs or of a one-to-three-year delay in programme implementation on the economic viability of the programme. The analysis confirms that the economic viability remains attractive, as a positive NPV and ERR above 10 per cent are preserved in each case.

D. Sustainability

38. Sustainability of the economic benefits to the original READ households was high under READ, achieved through improved farm production practices based on knowledge and skills gained from the programme. READSI has additional elements intended to raise sustainability even further, including: (i) increasing household capacity to cope with shock and recover afterwards, through financial literacy and savings; (ii) linking community groups to private-sector providers; (iii) increasing ownership of machinery investment; (iv) improving technical services; and (v) strengthening the policy framework for smallholder agriculture.
39. New technologies, access to services and rural finance are expected to increase resilience and to support small farmers in mitigating risk, particularly related to climate change. Promoting integrated homestead gardening systems, which incorporate ponds, will provide some mitigation against short-term, climate-driven food security issues. READSI will further explore safeguards such as use of geographic information system (GIS) information in the identification of climate hazard zones and the introduction of appropriate mitigation and adaptation measures, particularly for priority crops, to reduce the vulnerability to climate risks of economic improvements and to secure higher and less-volatile farm incomes.

E. Risk identification and mitigation

40. The main risks of the programme relate to the selection of priority crops, partnerships, elite capture, and programme management capacity and continuity between READ and READSI. Mitigation measures include basing programme activities on good practices and experiences from similar investments – READSI will particularly benefit from READ capacities and processes, inclusive assessments and programme implementation, and a focus on capacity-building.

Risk	Mitigation
Priority crops do not offer sufficient market opportunities for smallholders	Supported priority crops (in addition to rice, cacao and vegetables) will be selected in close consultation with all relevant stakeholders and based on participatory market assessment.
Partnerships with private sector not beneficial to smallholder farmers	Based on IFAD's experience in Indonesia and other countries, partnerships will be facilitated following careful due diligence to ensure they deliver clear benefits to beneficiaries.
Elite capture of programme benefits	This will be addressed by: (i) providing adequate training in good leadership to designated leaders, and possible installation of a complaint mechanism; (ii) sensitizing implementing agencies and partners; (iii) selecting crops/activities targeted at women and small farmers; (iv) making information on subproject selection and financing widely available; (v) requesting MoA to provide an anticorruption plan for the programme, to be approved by the anticorruption agency; and (vi) creating a mechanism for resolution of grievances at the community level.
Limited implementation capacity	Significant additional support will be planned to support AAEHRD in coping with its workload. Regular and close monitoring over the first two years of implementation will identify emerging problems early and put in place corrective measures. District capacity is variable. READSI will implement an institutional capacity assessment with all new districts and implement a targeted strengthening plan with clear milestones. District benchmarking, coupled with the district graduation process, will offer incentives for self-improvement.
Extension staff lack capacity to respond to farmer needs and deliver relevant support	Activities will focus on strengthening demand-driven support of the extension system, combined with an upgrading of extension staff capacities and training facilities.
Delayed contracting of specialist service providers for social mobilization	A process for ensuring continuity with the READ partner NGO will be approved by IFAD and the Government prior to effectiveness.
Weaknesses in financial management impede smooth flow of funds and hamper execution of programme activities	Adequate provision of finance staffing to be foreseen at NPMO, PPSU and DPMO levels; manuals, interim financial reporting and enhanced internal audit to be put in place.

V. Corporate considerations

A. Compliance with IFAD policies

41. READSI is fully aligned with the goals and objectives of the IFAD Strategic Framework 2016-2025, the 2016-2019 COSOP and relevant policies, including those on the environment and natural resource management, gender equality and women's empowerment, and indigenous peoples, as well as with the strategies on rural finance, private-sector partnerships and climate change. In addition, READSI will focus on mainstreaming nutrition and scaling up – two areas of strategic importance to IFAD.

B. Alignment and harmonization

42. The programme is set within a number of key government policies and programmes, including the 2005-2025 National Long-Term Development Plan and the 2015-2019 National Medium-Term Development Plan. It will link to ongoing public-sector initiatives in the agriculture sector, including the Food Self-Sufficiency Support Programme – Upaya Khusus Swasembaba Pangan (UPSUS) – and the Government/Asian Development Bank/IFAD-supported Integrated and Participatory Development and Management of Irrigation Project, approved in December 2015, as well as to smaller and more localized initiatives.
43. READSI will link to and support implementation of the Law on Farmers' Protection and Empowerment (19/2013), which aims to increase farmer welfare. This will be achieved by improving farmers' access to land, finance and markets, building their

resilience to weather events and strengthening their organizations. It will link to implementation of the Village Law (6/2014), which provides villages with funds equal to 10 per cent of the state budget earmarked for regional administration – to be spent according to community-prepared village development plans.

C. Innovations and scaling up

44. Innovation and scaling up is central to the READSI approach. The programme will adopt an innovation agenda, developing and piloting approaches around smallholder agriculture, particularly in the areas of nutrition, market linkages and rural finance, thus providing incentives to local, community-driven innovation. The M&E system will provide continued evaluation of potential approaches to policy dialogue and scaling up through national financing. The READSI scaling-up strategy follows IFAD's Operational framework for scaling up results (2015) and combines testing and refining of the approach in different settings with strong knowledge management, evidence-based policy dialogue and institutional capacity-building.

D. Policy engagement

45. Under READ, IFAD provided limited support to enable MoA to conduct basic policy analysis itself, which it did and which strongly benefited the scaling-up process. Building on this experience, IFAD has allocated a US\$1 million grant to support policy and knowledge management activities, and the associated capacity-building work on which they depend. These activities will work towards: establishing a supportive policy and institutional framework for smallholder agriculture; supporting the scaling up of successful approaches; and ensuring the sustainability of programme impacts. The grant will be housed within MoA to ensure direct linkages among policy analysis, recommendations and operations, and to build in-house capacity (and demand) for analysis. Depending on the specific policy issue, collaboration with relevant agencies and knowledge partners, including universities, will be established.

VI. Legal instruments and authority

46. A programme financing agreement between the Republic of Indonesia and IFAD will constitute the legal instrument for extending the proposed financing to the borrower/recipient. A copy of the negotiated financing agreement will be tabled at the session.
47. The Republic of Indonesia is empowered under its laws to receive financing from IFAD.
48. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD Financing.

VII. Recommendation

49. I recommend that the Executive Board approve the proposed financing in terms of the following resolutions:

RESOLVED: that the Fund shall provide a loan on ordinary terms to the Republic of Indonesia in an amount equivalent to ... special drawing rights (SDR ...), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

RESOLVED FURTHER: that the Fund shall provide a grant to the Republic of Indonesia in an amount equivalent to ... special drawing rights (SDR ...) and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President

Negotiated financing agreement

To be tabled at the session.

Logical framework¹

Results Hierarchy	Indicators ²	Assumptions
Goal: Growing prosperity of Indonesian smallholder farming families	>76,500 smallholders households directly benefiting increase household assets by 25% more than comparable non-participating smallholder households	Assumes continued social, political and economic stability
	Chronic malnutrition reduced by 10% in children under 5yrs of age.	Indicators 2 and 3 are particularly relevant to more remote communities covered by READ SI where subsistence agriculture still has a greater importance.
	Percentage of households experiencing a hungry season is reduced by 50%	
Development Objective: Rural households in Sulawesi, West Kalimantan and Nusa Tenggara Timur (East Nusa Tenggara) are empowered individually and collectively with the skills, confidence and resources to sustainably improve their farm and non-farm incomes and livelihoods through a scalable programmatic approach.	80% of participating poor and near poor ³ households direct beneficiaries increase real net farming or non-farm income by >30% more than comparable non-participating households	Local and international demand for key crops does not suffered prolonged collapse in prices or demand volumes.
	Commodity and livelihood groups are active and functioning effectively in 90% programme villages; (Disaggregated by type of group, including women's groups]	Farmers do not suffer from prolonged or repeated draughts or other adverse climate conditions or natural disasters.
	Return on investment (ROI) exceeds 20%	
Outcome 1: Improved household incomes and livelihoods are enabled through improved productivity and profitability of farm and non-farm activities and better management of household finances and nutrition.	50% real increase in labour productivity (as net farm income per day's labour) for >45,000 smallholders (60% of participating households)	Sufficient numbers of smallholder are interested in improving their production rather than leaving farming or switching to other production systems entirely. Good quality genetics and other critical are available in sufficient quantities to allow widespread adoption.
	Average yield increase for flagship and other crops for households supported on the specific crop by: <ul style="list-style-type: none"> a. cocoa: >150% b. rice: >30% c. other crops: >30% for other crops/livestock selected by farmers for support 	
	80% of participating households have affordable access to and use of sufficient seasonal & investment finance – whether from CBFOs, FSP ⁴ loans or own savings	Presence and interest of major banks and other FSP in programme districts in expanding services to rural households

¹ Logical framework has been shortened for this report.

² All indicators relating to households and individuals to have data disaggregated by gender, poverty status and ethnicity

³ "near poor" defined as living on <USD3.10 (2011 PPP) per capita per day [this poverty line to be rechecked]

⁴ CBFO - community based financial organization, FSP = financial service providers e.g. banks, microfinance institutions

	50% women participating in the programme adopt improved mother and child nutrition behaviours, set-up integrated homestead and provide ongoing mutual support	Sufficient numbers of mothers and families are interested in improving the nutrition of their families. Any possible negative cultural beliefs related nutrition can be mitigated.
	80% of all machinery and infrastructure supported have easy and equitable access for all intended beneficiaries and are well maintained at the end of the programme	Elite capture of investments is avoided.
Outcome 2: Critical services and input markets In programme districts are sustainably improved in terms of quality, relevance, availability and accessibility to serve the needs to programme communities	80% of households are satisfied with the: a) relevance, b) quality, and c) accessibility of agricultural extension and advisory services provided by the public and private sector (disaggregated by provider)	
	Rice Seed – affordable, quality, certified "READ" seed (or equivalent) readily commercially available for all farmers as needed in the local market in 80% of rice producing programme villages	Enabling seed policies and practices for rice and other crops are in place or are put in place.
	PPPs set-up and functioning well with at least 3 national scale partners to improve service delivery and input supply in cocoa or rice value chains in programme locations, including at least 2 with major cocoa businesses.	Continued interest from MARS and other major cocoa business to partner with government for sector development. Willingness of key parts of MoA to have genuine PPP with private firms.
	Good quality, active local private service providers offering services and being regularly used by programme supported farmers in 80% of programme village	Private entrepreneurs and businesses are interested to run service businesses in programme districts
Outcome 3: Supportive policy and institutional framework for smallholder agriculture	At least 2 sector-wide policy work (review/analysis) undertaken and discussed at national (and district if applicable) level.	Continued GoI commitment to high levels of investment in agriculture and pressure for investment efficiencies
	Roadmap agreed upon and resources committed for GOI to scale up READ SI approach to priority locations	
Outputs	No. of farmers trained in improved production/post harvest technology (target: 65,250)	175 HH per new village plus 25 HH per old village (homestead gardening only)
	No. of mechanization service MSMEs operating (target: 450)	1 per village
	No. of women trained and receiving starter kits for integrated homestead gardening (target: 11,250)	25 per village
	No. of individuals complete financial literacy training (target: 61,200)	80% of total programme participants