



Australia Indonesia Partnership
Kemitraan Australia Indonesia



ROADMAP FOR INTRODUCING A MEDIUM-TERM EXPENDITURE FRAMEWORK AND PERFORMANCE-BASED BUDGETING



**INDONESIA
INFRASTRUCTURE
INITIATIVE**



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June 2010

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Geoff Dixon

Jakarta, June 2010

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¹ Directorate-General of Highways, Ministry of Public Works, Indonesia, Application of Medium-Term Expenditure Framework & Performance-Based Budgeting in Directorate General of Highways Indonesia, William D. O. Paterson and Gandhi Harahap, December 2009.

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ACRONYMS 1: DEFINITIONS SPECIFIC TO MEDIUM TERM EXPENDITURE FRAMEWORK

| | |
|----------------|--|
| Baseline | When a forward estimate is used as the starting point for budget preparation it is referred to as the baseline for budget preparation. In the course of budget preparation the baseline will be adjusted for parameter changes and proposed new initiatives. Thus the FE for the first out-year (currently 2012) will, with the passage of time, become the baseline for preparing the 2012 budget. The baseline for a ministry can be reduced for efficiency reasons while at the same time increasing the ministry's allocation for new initiatives. It is a best practice MTEF principle that proposed new initiatives do not migrate to the baseline until approved by Parliament for budget funding. |
| FEs | Forward estimates are estimates of future government spending required to implement current government policy. In a properly operating MTEF the first forward estimate (sometimes called the baseline) becomes the starting point for preparing the subsequent annual budget, and the FEs are rolled out another year as part of the budget preparation process. See also "Initiative". |
| Initiative | Forward estimates (baselines) are the future cost of implementing current government policies. Bappenas/MoF have interpreted 'current government policies' to mean the work program contained in line ministries' 2010 - 2014 Renstras. This is called the 'baseline'. New initiatives are proposals to vary this work program, eg. altering the level or timing of an output on what is assumed in the Renstra. Once a new initiative is approved by the House of Representatives (DPR) for inclusion in the budget it migrates from the list of new initiatives into the MTEF forward estimates (baseline). However, current MoF pro formas for preparing the RKA-KL do not allow ministries to separate their baseline and new initiatives (but do contain a box in which ministries must explain the changes that they request in their program allocations (see text of this Roadmap)). |
| Measures table | This is a budget table which links proposed changes in spending on programs and activities (called 'measures') to the achievement of the government's strategic targets. In its simplest form the measures table has a heading for each strategic target and lists under this heading the changes in spending (other than parameter changes) that affect target achievement, along with the resulting change in target achievement. An example of a measures table is provided in Chart 3 of this Roadmap |
| MTEF | An MTEF is an approach to annual budget preparation in which annual budgets are prepared in a rolling three (or four) year expenditure framework (some countries also include a revenue framework). This is an attempt to combine the advantages of medium term programming of expenditures (as in a static five year plan) with the need for each annual budget to take account of the changing fiscal environment (as in annual budget preparation) as well as any amendment of planning priorities. |
| Out-year | An out-year is MTEF jargon for a year beyond the next budget year. For example, right now (in June 2010) the next budget year is 2011 and the out-years are 2012, 2013 and 2014. In a year's time the FEs for the (current) first out-year will become the baseline for the 2012 budget, and the out-years will then become 2013, 2014 and 2015. At time of writing there is a difference between Bappenas and MoF about whether the Indonesian MTEF should contain two or three out-years. However this should be resolved when the regulation for the 2011 RKA-KL is released. |

| | |
|-----------|---|
| Parameter | A parameter is a cost driver for a forward estimate. For example, the level of private sector wages is a parameter of the cost of routine road maintenance, and the FEs for routine maintenance in 2011 include an assumption about wage levels in that year. If previous wage projections for 2011 turn out to be too low the ministry of finance adjusts the FEs for 2011 (called a parameter adjustment). |
| PBB | Under performance based budgeting (PBB) budget allocations are decided with reference to the projected accomplishment of the work unit or ministry, rather than (as under incremental budgeting) being based on its previous levels of actual spending. Indonesia already bases the funding of each activity on the projected level of output (a form of PBB) but is less effective in linking planned changes in activity outputs (and financing) to improved achievement of strategic objectives (the highest form of PBB). |
| Renja | This is the annual work plan prepared by each Indonesian line ministry early in the budget preparation process (May), consistent with its indicative ceiling for that budget. Renjas are submitted to Bappenas using a pre-formatted computer application. In 2010, for the first time, Bappenas has required the 2011 Renjas to include estimates of activity outputs in 2012 - 2014 - a major step toward introducing an Indonesian MTEF. |
| RKA-KL | This is the annual work plan and budget prepared by each Indonesian line ministry in the middle part of the budget preparation process (June/July) and consistent with its temporary ceiling. RKA-KLs are submitted to MoF using a pre-formatted computer application. In 2010 MoF has required the 2011 RKA-KLs to include estimates of activity financing in 2012 - 2013. While two year forward estimates have also been required in the past they have not been provided by many line ministries and have contributed little to later budget preparation. It remains to be seen whether this will now change. |
| Renstra | This is DGH's static five year plan for the national road sector 2010 - 2014. The Renstra contains the key strategic objectives for developing the national road network to 2014, as well as detailed link by link proposals for each province (in supporting documents). Implementation of the Renstra will depend on the ceilings provided annually by MoF to guide annual budget preparation. The introduction of the multi-year RKA-KL allows this to be taken into account, together with revisions to planning targets. Also, given the rolling rather than static nature of the MTEF, when we arrive at the year 2012 the third out-year of the RKA-KL will be one year beyond the end year of the Renstra, imparting a continuity to planning that is not available in the legacy framework of static five year planning. |
| RKP | This is Indonesia's annual national work plan, put together by Bappenas in the early stages of preparing each annual budget as the basis for estimating ministry budget allocations. The RKP is based on the Renjas prepared by each ministry (the ministry's proposed work plan), which are in turn based on that ministry's indicative ceiling (issued in May). The RKP is the basis on which MoF determines the temporary ceilings, within which ministries prepare their proposed Work Plan and Budget (RKA-KL), ie. their detailed financial budget request. For the first time Bappenas has prepared the 2011 RKP in MTEF format, ie. has included out-years 2012 - 2014. |
| RPJM | Rencana Pembangunan Jangka Menengah (Five year Development Plan of the Government of Indonesia). This is static (ie. prepared once every five years) national plan, albeit with a mid-period update, and therefore differs from an MTEF in two key respects: 1) the spending priorities in an MTEF are updated and rolled forward every year as part of annual budget preparation, and 2) the fiscal envelope for the MTEF is also updated each year. The RPJM is the basis for each line ministry's (static) five year Renstra. |

ACRONYMS 2: GENERAL

| | |
|----------|---|
| AusAID | Australian Agency for International Development |
| Bappenas | Agency for National Development and Planning |
| DG | Director General |
| DGH | Directorate-General of Highways |
| DPR | Dewan Perwakilan Rakyat (Indonesian House of Representatives) |
| DPU | Departemen Pekerjaan Umum (Department of Public Works) |
| FEs | Forward estimates of the future cost of implementing government policies - see annotated MTEF definitions above |
| IDPL | Infrastructure Development Policy Loan (World Bank) |
| INDII | Indonesia Infrastructure Initiative (IndII), an Australian Government funded project |
| IRMS | Indonesia Road Management System |
| KL | Kementarian Lembaga (line ministry) |
| MCA | Multi-Criteria Analysis |
| MoF | Ministry of Finance |
| MTEF | Medium term expenditure framework - see annotated MTEF definitions above |
| PBB | Performance based budgeting - see annotated MTEF definitions above |
| PEFA | Public Expenditure and Financial Accountability. This is a multi-agency partnership programme sponsored by the World Bank, the International Monetary Fund, the European Commission, which has defined a checklist of good budgeting practice |
| PI | Performance indicator |
| PoP | Pipeline of Projects |
| PPP | Private Public Partnership |
| RPJM | Rencana Pembangunan Jangka Menengah (Five year Development Plan of the Government of Indonesia) - see annotated MTEF definitions above |
| RKA-KL | Rencana Kerja Anggaran Kementerian Lembaga (Work Plan of a ministry) - see annotated MTEF definitions above |
| RKP | Rencana Kerja Pemerintah (Government Work Plan) - see annotated MTEF definitions above |

EXECUTIVE SUMMARY

Bappenas and the Ministry of Finance (MoF) have recently moved to prepare the 2011 budget in a medium term expenditure framework (MTEF). Ministries must submit forward estimates of their financing requirements for 2012 and 2013 along with their detailed financing request for 2011.

The Directorate General of Highways (DGH) has much to gain from this development, given recent criticism that its "current annual planning and budgeting framework does not include a phasing in of project stages over the medium-term, starting with a preparation budget in year one, followed by land acquisition costs and finally construction costs. This reduces the ability of DGH to efficiently utilize resources allocated through the budget."

However, DGH will need to alter its own internal procedures for preparing its budget request if it is to benefit from introduction of an MTEF. The present Report suggests a Roadmap for the required changes.

The immediate challenge for DGH is how to prepare estimates of the funding it needs for road preservation and development in 2011 in the context of an integrated program for 2011 - 2013. To do this DGH will need to create a much stronger connection between its internal planning and budgeting procedures than in pre-MTEF years. To make this connection this Roadmap recommends

Roadmap Step 1.a) formalise the responsibilities of DGH's planning and budgeting sub-directorates in providing the multi-year information required by MoF's new multi-year RKA-KL forms.

Roadmap Step 1.b) review existing DGH internal procedures for preparing its budget requests and develop a new and more policy based multi-year focus for preparing the 2011 RKA-KL.

Roadmap Step 1.c) DGH to base requested changes in funding to 2013 on changes in target achievement, using a format such as that suggested in Chart 3 below.

Step 1 in the Roadmap will need to be accompanied by improvements in the way DGH goes about prioritising its spending on road preservation and development:

Roadmap Step 2.a) DGH to develop a pipeline of projects for programming individual road development proposals across the next three or four annual budgets, possibly using the methodology described in Annex 2.

Roadmap Step 2.b) DGH to develop a tool for prioritising proposals in its pipeline of projects, such as the Multi-Criteria Analysis tool described in Annex 3.

Roadmap Step 2.c) DGH to review and develop its capacity to estimate optimal road preservation solutions using tools that can interface with the preparation of DGH's multi-year budget request.

Steps 3 - 6 of this Roadmap relate to how DGH can develop internal planning and budgeting processes to link its MTEF to performance based budgeting (PBB) for the national road sector

Roadmap Step 3: DGH to consider preparing an MTEF report following the approval of the 2011 budget (similar to its 2009 'White Paper') which outlines financing required to achieve its road network targets for 2014.

Roadmap Step 4: DGH will include a measures table in its MTEF publication to improve the transparency of the steps it is taking to achieve its road network targets for 2014.

Roadmap Step 5: DGH to introduce a distinction between its baseline funding and funding for new initiatives in developing its request to MoF for funding to achieve its road network targets.

Roadmap Step 6: when DGH internally prepares its budget request it will use the forward estimates for the first out-year of its MTEF as the baseline for preparing its next budget request.

CHAPTER 1: INTRODUCTION TO THE ROADMAP

The processes for preparing annual budgets in a Medium Term Expenditure Framework (MTEF) are not necessarily complex. However, they do involve procedures which are substantially different from Indonesia's own highly developed and elaborately sequenced planning and budgeting processes, together with a new set of jargon (see list of MTEF Acronyms and Definitions at the start of this Roadmap). This helps to account for the limited success of Indonesia's previous attempts to implement an MTEF, as required in the 2003 Finance Law, as well as the gradualist approach now being taken by Bappenas and the Ministry of Finance (MoF) in interfacing existing planning and budgeting processes with development of an MTEF.

However, 2010 has been a year of substantial progress in creating such an interface (outlined in Annex 1) and the Directorate General of Highways (DGH) has much to gain from the success of Bappenas's initiative. This Report provides a Roadmap for participation by DGH in the new MTEF process.

1.1 MTEF DEVELOPMENTS IN 2010

DGH's portfolio objectives and responsibilities are ideally suited to preparation of its annual budget in a medium term expenditure framework. It will enable DGH to address recent criticisms that preservation and development of the national road network is currently undertaken on an ad hoc, year by year, basis (successive single year work plans rather than multi-year programs).²

The advantages of budgeting in a multi-year framework have long been recognised by Bappenas and MoF, and have been written into Indonesia's Finance Law.³ After some years of delay, Bappenas and MoF have instructed line ministries to submit their 2011 budget requests together with forward estimates of their funding requirements for 2012 and 2013. This will potentially enable DGH's annual budget request to spin off from multi-year programming of its road expenditures, rolled forward and updated by DGH each year.

Moreover the greater certainty of future budget funding for DGH provided by the forward estimates will also facilitate development of a multi-year program of road maintenance and development.⁴

This document proposes a road map for MTEF development in DGH. It identifies options to

- comply with the Bappenas/MoF requirement to prepare its annual budget as part of a multi-year spending program, by improving the quality of MTEF data prepared within DGH
- build on the Bappenas/MoF requirements by developing clearer links between forward estimates in the MTEF and achievement of strategic goals for the national road network.

² A further consideration is that, while the MTEF trigger for IDPL4 is likely to be regarded by the World Bank as having been met, there remains a possibility of a trigger for IDPL5 involving refinement of MTEF based budgeting in DGH.

³ Law 13 of 2003.

⁴ However this depends on the data entered by a line ministries for 2012 (when preparing its 2011 Renja and RKA-KL) actually being used by Bappenas/MoF as the starting point for preparing its 2012 budget (see above).

CHAPTER 2: WHERE ARE WE NOW?

2.1 THE BAPPENAS/MOF INNOVATIONS

A timeline for the 2011 budget preparation process is provided in Chart 1. For this budget round Bappenas/MoF have introduced two important changes:

- in addition to their 2011 budget request, ministries must submit estimates of their annual budget requirements for 2012 - 2013, and
- they must use revised program/activity structures for requesting funds, which now conform more closely to their existing administrative structures.

These changes are interlinked, but discussed separately below. Part B of this document contains a suggested Roadmap for DGH building on the Bappenas/MoF requirements.

Box 1: Recent MTEF history in Indonesia

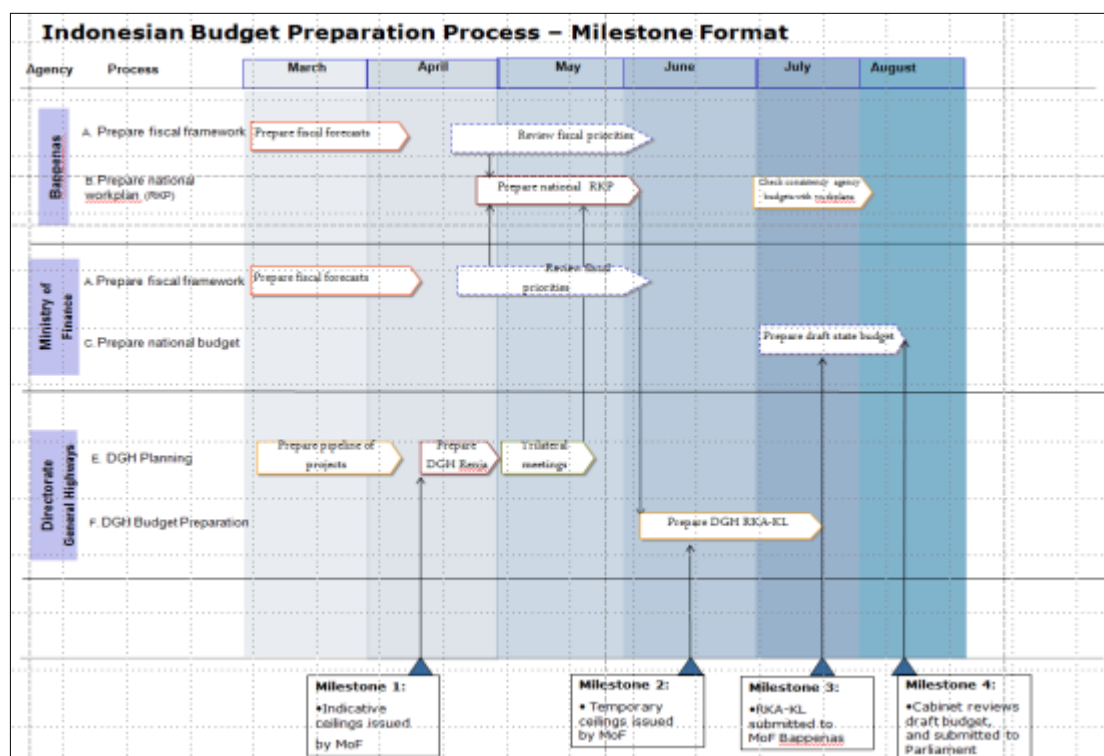
Indonesia's Financial Law 17 of 2003 requires annual budgets to be prepared in an MTEF. In recent years the Ministry of Finance has asked national agencies to include in their annual budget request (Work Plan and Budget or RKA-KL) the agency's estimate of its financing requirements for the two years beyond the next budget year (forward estimates or FEs). MoF did not require a distinction between baseline and new initiatives. However, in the past, agencies have usually failed to provide these out-year figures, and in any case their derivation has been too uncertain to be used by MoF to create a national set of forward estimates (MTEF).

For the 2006 budget MoF issued instructions to pilot agencies to prepare three year FEs identifying for each year 1) a baseline (the cost of existing service level commitments), and 2) proposed new initiatives. (Directorate General of Budget and Fiscal Balance, Medium-Term Expenditure Framework (MTEF) Guide, Budget 2006, February 2005). However agencies did not respond to the MoF circular, apparently due to lack of sufficient implementation guidance.

In June 2009 MoF issued a new draft manual for preparing an MTEF compliant budget request (see reference at foot of this box). This continued to emphasise preparation of budget requests in a three year framework and the separate presentation by each pilot agency of its baseline in each of the three years and its proposed new initiatives. Consistent with this, the text of the (just released) regulation requiring line ministries to complete their 2011 budget requests identifies the baseline as the financing included in the line ministry's Renstra, and new initiatives as proposals to vary the scale or timing of Renstra outputs. Significantly, however, the distinction between baseline and proposed initiatives has been omitted from the forms to be submitted by line ministries containing their 2011 budget request (the line ministries budget request for 2011 and forward estimates for 2012 and 2013 (RKA-KL)).

See: Directorate-General of Budget, Implementation of Performance-Based Budgeting and Medium-Term Expenditure Framework, June 2009, 5 volumes. Manual 3 is: "Application of the Medium-Term Expenditure Framework (MTEF)".

Chart 1: Indonesian Budget Preparation Process – Milestone Format



2.2 MTEF DEVELOPMENTS

Earlier attempts by MoF to link budget preparation to an MTEF had been largely unsuccessful (see accompanying box).⁵ However, for the 2011 budget preparation round the initiative has swung to Bappenas, which has introduced two MTEF related changes

- DGH's annual physical work plan (Renja) is for the first time being prepared using a four year template issued by Bappenas (2011 and the out-years 2012 - 2014) rather than the previous one year template.⁶ By late May DGH had largely completed its new 'four year Renja'
- Bappenas's 2011 National Work plan (RKP), which is prepared on the basis of the ministry Renjas and is submitted to Parliament, is also being prepared in four year format for the first time.

As can be seen from Chart 1, the Renjas and RKP are preliminary steps to line ministries preparing their detailed budget requests (ie. their proposed Work plan and Budget or RKA-KL). Importantly, the new RKA-KL (to be prepared by DGH in June and July) will be DGH's MTEF. This is because it will

⁵ For some years line ministries (KL) have been instructed to in their proposed Work Plan and Budget (RKA-KL) forward estimates of their spending for the years beyond the next budget year, but this has been honoured in the breach. For the 2006 budget MoF instructed KL to separate their budget request into baseline and proposed initiatives - again largely unsuccessful. Piloting of an MTEF in six KL also achieved little. Key reasons for lack of progress have been the challenge of embedding the MTEF in existing budget processes, limited outreach by MoF to individual (pilot) KL and MoF's willingness to accept budget requests which didn't include requested MTEF information.

⁶ The Renja is prepared following the issue of indicative targets to each ministry in mid May. See the manual issued by Bappenas for the preparation of the 2011 Renja/KL: Petunjuk Penyusunan Renja K/L (Rencana Kerja Kementerian/Lembaga), Tahun 2011.

contain DGH's estimates of its funding requirements in each of the three years to 2013. These forward estimates are prepared at the activity level, are based on activity outputs, and distinguish between domestic and external financing.

However, Bappenas/MoF are wisely adopting a 'proceed carefully' strategy to the introduction of an MTEF and their changes this year stop well short of the introduction of a best practice MTEF budget process, particularly the best practice requirement that line ministries separate their requested budget baseline from their proposed new initiatives. On the downside, however, Bappenas/MoF have not as yet prepared a roadmap for the development of the Indonesian MTEF, although future directions (particularly the future introduction of a distinction between baseline funding and funding for new initiatives) are foreshadowed in recent Bappenas/MoF presentations to line ministries.⁷

2.2.1 Uncertainties...

Absence of a Bappenas/MoF 'road-map' for the introduction of a national level MTEF creates some uncertainties for DGH in developing its own roadmap to an MTEF:

- uncertainty about what forward estimates prepared for the 2011 budget will be used for: it is not clear at this stage whether, as DGH prepares its 2011 budget request, the data it enters in the RKA-KL pro forma for 2012 will actually be the starting point (a year later) for preparing its 2012 budget request
- this will depend on the quality of the estimates for 2012 provided by the line ministries in mid 2010
- however, if the first year of the forward estimates is not used as the starting point for preparing the subsequent budget the advantage of an MTEF in providing greater certainty to line ministries regarding their future funding will be compromised
- although Bappenas/MoF documentation of the current planning and budgeting reforms indicates that the concepts of a baseline and new initiatives will be used to make budget adjustments⁸ there is no provision in the current Bappenas/MoF pro-formas for Renja and RKA-KL for line ministries to distinguish between their baseline spending and proposed new initiatives
- the baseline/new initiatives distinction is generally regarded as good practice MTEF budgeting (for example by the PEFA benchmarks)⁹ since it allows the budget preparation process to allocate fiscal space (the difference between the revenue projections and the baseline) to new initiatives, while simultaneously putting pressure on the baseline

⁷ See Bappenas/MoF presentations to line ministries on 17 March 2010 and 24 May 2010. An authoritative statement of MTEF methodology is in Bappenas, Direktorat Alokasi Pendanaan Pembangunan, Kerangka Pemikiran Reformasi Perencanaan dan Penganggaran, Modul 1, Section E. This outlines the general principles of MTEF - setting a baseline and using this to define fiscal space, which (budget by budget) is allocated among new initiatives which are subsequently included in the baseline. However, there is no indication in the Bappenas document of any Roadmap for staging the introduction of these MTEF elements in Indonesia.

⁸ Bappenas, Direktorat Alokasi Pendanaan Pembangunan, Kerangka Pemikiran Reformasi Perencanaan dan Penganggaran, Modul 1, p. 21.

⁹ PEFA (Public Expenditure and Financial Accountability) is a multi-agency partnership programme sponsored by the World Bank, the International Monetary Fund, the European Commission, which has defined a checklist of good budgeting practice.

- the baseline/new initiatives distinction may be introduced for future budget preparation rounds, but according to Pak Wismana "not yet".¹⁰

Further uncertainties relate to whether Bappenas/MoF will publish an annual "national MTEF" document (as do many countries). At present it appears that there is no intention to publish a national MTEF report which is additional to the comprehensive set of existing planning and budgeting reports. However, it appears that the newly introduced three year rolling version of the existing RKP would effectively be Indonesia's 'national MTEF'. The question whether DGH should itself produce a road sector MTEF Report is discussed further below.

Other uncertainties relate to whether MoF will in the future issue multi-year indicative ceilings to line ministries (for the 2011 MTEF a single ceiling for 2011 only has been issued), the access rules for line ministry edits to their forward estimates for 2012 to 2014 once these have been entered to the MoF database, and whether the existing coverage of the forward estimates will be expanded to include payments to sub-national levels of government.

In summary, Bappenas and MoF have yet to make a number of key decisions about the future architecture of Indonesia's MTEF. In my view (given past difficulties) there is much merit in their current strategy of moving slowly, each new step taken only when the previous step is successful. This incremental strategy does, however, give DGH scope for 'moving ahead of the game' by anticipating future MTEF developments, particularly in the area of linking its forward estimates to achieving strategic outcomes for the national road network (performance based budgeting or PBB).

2.3 PBB DEVELOPMENTS

For the 2011 budget round Bappenas has also introduced a new program/activity structure for budget allocations. This is intended to make Echelon 1's more accountable for achieving sector *outcomes* and Echelon 2's more accountable for sector *outputs*. This is achieved by introducing a one-to-one correspondence between existing administrative structures and the new program/activity classification.

Thus whereas the old DGH program structure had separate programs for road preservation, road development and administration, there is now a single DGH program which combines preservation, development and administration. The Department of Public Works Director General is responsible for achieving the performance targets for this program, which are listed in its five year Renstra.

DGH's new sub-activities have a one-to-one correspondence with its sub-directorate structure. Echelon 3 managers are to be held accountable for achieving the output/sub-output targets listed in DGH's 2011 Renja.¹¹

Importantly, the Performance Indicators (PIs) for directorates and sub-directorates are stipulated at the output/sub-output level (ie. are measures of activity in each sub-directorate). This means that they cannot easily be connected with strategic targets in the DGH Renstra, such as " Preservation of national roads so that 94% of the national road network in stable condition" or " Facilitate the development and preservation of national roads to the border area in Aruk, Entikong, Nanga Badau,

¹⁰ Comment by Pak Wismana (Bappenas Director for Allocation of Development Funding) at meeting on IDPL4 on 12 May 2010.

¹¹ It remains to be seen how far DGH management will be held accountable for achieving its activity based targets.

Simanggaris, and Nunukan on the island of Borneo and Sota (Merauke) in Papua, and to facilitate the development of local roads to provide access in the hinterland areas."¹²

At the current evolutionary stage of the MTEF this is a weak link in the Bappenas's strategy for introducing MTEF-PBB, which should be addressed in the DGH MTEF.

¹² Achievement of these strategic targets involves input from multiple sub-directorates, and the mapping of sub-directorate outputs into strategic outcomes. This would be very complex and this consultant is not aware of any successful *holistic* mapping of the outputs of the individual work units in a ministry into the achievement of the ministry's sector targets.

CHAPTER 3: ROADMAP FROM HERE ONWARDS

The departure point in DGH's 'Roadmap to an MTEF' is the new Bappenas/MoF requirement to prepare the 2011 budget request (RKA-KL) in a multi-year framework, described above.¹³ As indicated above, the new RKA-KL (to be prepared by DGH in June and July) will, in a formal sense, be an MTEF since it will contain DGH's estimates of its funding requirements in each of the years to 2013 (its forward estimates). The forward estimates are to be prepared at the activity level, based on activity outputs, and distinguish between domestic and external financing.

This DGH Roadmap is in two sections. The first focuses on adoption by DGH of basic procedures for estimating its funding requirements to 2013 for inclusion in the RKA-KL. Experience suggests that Indonesian ministries have in the past had difficulty meeting MoF's request for forward estimates. For road preservation this involves the use of an effective cost minimisation model (IRMS updated or replaced) and for road development the creation of a 'pipeline of projects' database and sound prioritisation procedures for feeding projects from the database into the successive budget requests to 2013 (see the above criticism by the World Bank of DGH's existing year by year approach).

Second, while the MTEF prepared by DGH must be consistent with Bappenas/MoF requirements for the 2011 RKA-KL, the Bappenas/MoF approach is cautious. There is scope for DGH to develop MTEF and PBB information *additional* to that currently required by Bappenas/MoF. The central innovation proposed for DGH in this Roadmap is a clearer link than exists at present between DGH's multi-year spending program in its RKA-KL and the achievement of its strategic targets for the national road network.¹⁴

3.1 WHAT NEXT IN THE DGH ROADMAP TO AN MTEF?

Chart 1 indicates the 2011 budget timeline. It is clear from the timeline that once the 2011 RKP is approved by Parliament MoF will release detailed temporary ceilings to each ministry for the preparation of the ministry's detailed budget request (RKA-KL). The temporary ceilings are likely to be issued in mid June.¹⁵

3.1.1 Roadmap Step 1: DGH to provide its MTEF forward estimates to MoF in July 2010

When DGH receives its temporary ceilings in mid June 2010 (see Milestone 2 in Chart 1 above) it will submit to MoF its proposed Work plan and Budget (RKA-KL) for 2011 - 2013. This comprises a detailed budget request for 2011 together with its forward estimates of its financing requirements for 2012 to 2013 based on its strategic (Renstra) targets for 2014.

The multi-year RKA-KL submitted by DGH in July 2010 is effectively a sector MTEF for the national road network.

¹³ The requirement is in the soon to be released regulation for preparation of the 2011 RKA-KL.

¹⁴ DGH's strategic targets are listed in its Renstra. The highly significant but very general MoF requirement for line ministries to explain requested changes in funding to 2014 is in Form 1 of the RKA-KL (Section F).

¹⁵ The temporary ceiling will be issued for 2011 only.

The immediate challenge for DGH is how to prepare the MTEF data for 2011 - 2013. The data are to be entered in a MoF provided computer application used by each ministry to submit its RKA-KL, using pre-determined formats for the forward estimates.¹⁶ Forward estimates¹⁷ will be entered at the program level of the budget classification, and be formatted in the same way as the forward estimates submitted by all other line ministries when preparing their 2011 budget request.¹⁸

There are several issues for DGH in preparing its MTEF data (2011 RKA-KL). The following sections identify these challenges and provide a suggested Roadmap for DGH to meet them.

Roadmap Substep 1.a): formalise the division of responsibility between DGH's planning and budgeting sub-directorates in providing the information required by MoF's new multi-year RKA-KL.

The World Bank and the Paterson Report have both criticised the ad hoc, year by year, nature of DGH budgeting for road development.¹⁹ Evidence supporting such a disconnect between DGH planning and budgeting is provided by the failure in recent years of DGH to provide information requested by MoF about road financing requirements in the two years following the next budget year.²⁰

Step 1.a) in this Roadmap is to formalise the responsibilities of the planning and budgeting sub-directorates in providing the multi-year information required to fill out MoF's new RKA-KL formats. This would clearly define the information required from the planning sub-directorate to complete the new multi-year RKA-KL.

¹⁶ The comprises three tables set out in the MoF regulation for preparation of the 2011 RKA-KL. At the time of preparation of this Roadmap report MoF had prepared the regulation but not yet signed off. However, the information to be provided in the three forms is listed in the June 2009 Manual on the MTEF and PBB.

¹⁷ The term 'forward estimates' (FEs) refers to a line ministry's request for financing in the two years beyond the next budget year (ie, 2012 - 2013). Ministry's are instructed to request sufficient financing to implement the Government's approved policies (ie. the planning targets in the line ministry Renstra). There is currently ambiguity between Bappenas and MoF over whether there should be three years of FEs (as in the Renja) or two (as in the case of the draft RKA-KL pro forma).

¹⁸ The six agency MTEF pilot was completed late in 2009.

¹⁹ The Bank notes: "The annual planning process is connected to the ministry's five year plan; however, the planning, budgeting and oversight of multi-year programs and projects is strictly annual. There is no formal preparation of a pipeline of projects with decision points that would activate the entry of specific phases of the project into the budget process. Inadequate integration of multi-year program and project life-cycle planning with the budget process reduces the ability of DGH to manage their projects and financial resources effectively leading to delays during budget implementation." World Bank, *Indonesia, Directorate General of Highways, Ministry of Public Works, Financial Management Assessment*, draft, October 2008 (p. iv).

The Paterson Report notes that "The need for a more systematic and long-term approach to investing in capacity expansion is considered to be urgent and the top priority for the sector at present. It requires strategic planning, stronger prioritization, and increased mobilization of financial resources. See Paterson, W. D. O. and Gandhi Harahap, *Application of Medium Term Expenditure Framework and Performance Based Budgeting in Directorate General of Highways Indonesia*, Indonesia Infrastructure Initiative, March 2010, p. (vi)."

²⁰ In previous years MoF has unsuccessfully attempted to meet its obligation to prepare annual budgets in an MTEF (contained in the 2003 Finance Law) by asking line ministries to include in their RKA-KL forward estimates of the financing they require in the two years beyond the next budget year. This was largely honoured by line ministries in the breach, including by DGH, despite the potential for greater certainty it offered of future budget funding for the national road network.

This applies particularly to Form 1, Section F, of the new RKA-KL format which requires (for the period to 2014) " Explanation of changes to program allocations between the ongoing allocations and the proposed allocations". Chart 2 below contains the relevant extract from the RKA-KL form.

While the budget sub-directorate is responsible for estimating parameter changes associated with price and wage variations, the planning sub-directorate would normally be responsible for suggesting the new policy initiative component (particularly variations to the scale or timing of output changes already included in the Renstra).

Recommended Roadmap Step 1.a) formalise the responsibilities of the Sub-Directorate of Planning and the Sub-Directorate of Programming and Budgeting in providing the multi-year information required by MoF's new multi-year RKA-KL forms.

Roadmap Substep 1.b): creation of a formal Department of Public Works (DPU) procedure for preparing its annual budget request in the multi-year RKA-KL framework

Indonesia's new multi-year framework for Renjas and RKA-KLs will require changes in the way each line ministry prepares its annual budget, to give greater emphasis to the planning aspect. With the new four year framework, budget preparation will need to broaden beyond a narrow focus on annual financing to one which identifies and prioritises policy options for the next three years.

Best practice involves establishing an internal Budget Committee in each line ministry, which is responsible for preparing that ministry's budget request. The Committee usually has representatives from the key directorates as well as the ministry's planning and budgeting offices.

Early in each budget preparation cycle the Budget Committee will call for budget proposals from the various directorates in the ministry, ie. the funding each directorate feels that it needs to implement its responsibilities and achieve its targets over the next three or four years. Under MTEF based budgeting this 'call for proposals' is often limited to proposals for changes in the existing FEs for the next budget year and subsequent out-years, ie. proposals to vary the financing already contained in the ministry's forward estimates. If the Budget Committee process is working well these 'new initiatives' from ministry directorates will be clearly linked to resulting improvements in target achievement.

The Budget Committee ensures that all new initiatives are well defined and appropriately costed. It also screens for 'policy vacuums', ie. ministry objectives where new initiatives are needed to meet government priorities but fail to be identified within the ministry due to weak policy development processes in the relevant directorates.

The ministry's Budget Committee then prioritises proposals from the directorates to fit within the ceilings provided to that ministry by the ministry of finance. It submits the short list of proposed initiatives to the ministry's budget office to elaborate the costing and to compile into the ministry's integrated budget request to the ministry of finance.

The preceding paragraphs describe 'best practice' steps for preparing a policy based budget request within a line ministry. Now that Indonesia's is moving to multi-year budget requests the legacy, accounting based, approach to annual budget preparation will need to be replaced by a policy based approach to multi-year budget programming such as the one described. This is an essential part of 'getting value out of an MTEF'.

The Director General of the Directorate-General of Highways has expressed strong interest in introducing a greater MTEF focus within the Directorate (see Annex 1).

Recommended Roadmap Step 1.b): review existing DGH internal procedures for preparing its budget requests and develop a new and more policy based multi-year focus for preparing the 2011 RKA-KL.

Roadmap Substep 1.c): improved processes for identifying road initiatives to include in the MTEF

MoF has recognised that earlier RKA-KL budget preparation rounds failed to achieve a strong connection between a ministry's request for budget finance and improved achievement of its strategic objectives. To remedy this, Form 1 in the new RKA-KL pro forma asks line ministries to provide the information indicated in Chart 2 below:

Chart 2: EXTRACT FROM RKA-KL FORM 1 SECTION F

| |
|--|
| <p>F. STRATEGIC OBJECTIVE ACHIEVEMENT STRATEGY:</p> <p>Fill in a description of steps taken to achieve strategic objectives, starting from:</p> <ol style="list-style-type: none"> (1) Strategy and policy related to strategic objectives (from the K/L's Strategic Plan); (2) Description of each program; and (3) Organizational Units Responsible for the Program (4) Explanation of changes to program allocations between the ongoing allocations and the proposed allocations. |
|--|

Requirement (4) is particularly important. Explanation of changes in the level of financing in terms of changes in target achievement (requested in (4)) is at the heart of performance based budgeting and modern MTEFs. The 'ongoing allocations' referred to in (4) are generally called the baseline and the 'proposed allocations' are the sum of the baseline and proposed new initiatives.²¹

However MoF has not asked for budget requests in the RKA-KL to be split into the baseline and proposed new initiatives, or proposed a format to assist ministry's provide the 'explanation' requested in (4).²² When the regulation for RKA-KL preparation is released there may be more guidance. However, I suspect (but hopefully will be proven wrong) that Indonesian ministries will fail to complete (4) in a way which can link variations in their funding request to changes in their target achievement.

²¹ Proposed allocations also reflect parameter changes due to eg. price changes for delivering existing service levels or changes in public sector salary levels.

²² In countries with well developed MTEFs, such as South Africa, the justification by line ministries of the changes they request in their baseline allocations is at the heart of budget preparation procedures. At the current stage of the Indonesian MTEF it is a minor part of the budget submission required from line ministries, but is likely to grow in importance in future budget preparation rounds.

Roadmap Step 1.b) is therefore for DGH to develop its own approach to implementing (4), ie. explaining changes in requested funding in terms of changes in target achievement. This could be based on the template of the type illustrated in Chart 3 below, which suggests a tabular format for linking changes in future budget allocations to changes in the achievement of DGH strategic targets.

Recommended Roadmap Step 1.c) DGH to base requested changes in funding to 2013 on changes in target achievement, using a format such as that suggested in Chart 3 below.

3.1.2 Roadmap Step 2: improved processes for identifying road initiatives to include in the MTEF

In the Roadmap of further MTEF development there are two high priority steps for the remainder of 2010.

First, DGH lacks a sound internal processes for identifying and fleshing out new road initiatives for inclusion in the annual budget and MTEF. The main sources of possible initiatives are the Renstra, discussions with Balai and use of simulation data from the Indonesia Road Management System (IRMS). However, there is no structured process for ensuring that all potential initiatives for achieving a particular DGH strategic objective are identified and (importantly) prioritised for inclusion in successive annual budgets.

Reflecting this, as indicated earlier, the World Bank and the Paterson report have criticised DGH for ad hoc management of budgets for national road development, and the Echelon 3 in charge of the budgeting sub-directorate has indicated on a number of occasions that the most urgently needed improvement to DGH budgeting is to introduce procedures for prioritising potential road development initiatives for inclusion in the budget.

Step 2 in the Roadmap is therefore to establish a formal procedure in DGH for identifying and prioritising initiatives relating to each of its strategic objectives.

This requires several sub-steps:

Roadmap Substep 2.a). Develop Pipeline of Projects

While the DGH Renstra (five year plan) contains clear medium term road development objectives and a five year program for achieving them, there is currently no mechanism for programming individual road development activities across the next three or four annual budgets, taking account of the indicative ceiling provided by the Ministry of Finance. Instead, an ad hoc, year-by-year, approach is taken, with funding for each development activity being reconsidered in each annual budget preparation round. The World Bank assessment of this is summarised in the accompanying box.

In order to determine the financing needed by DGH for achieving its road targets in each year of the MTEF, DGH should consider introducing a Pipeline of Projects (PoP). This will help channel initiatives from the Renstra into the MTEF, reformulating Renstra plans into specific initiatives across the three or four years of the MTEF. This will take account of successive RKP produced by Bappenas, as well as internal DGH discussions between the DGH's central office and the Balai.

The nature of a PoP is described in Annex 2.

The pipeline would have separate categories for activities which have not yet passed appraisal and those which have and are ready to implement once funding has been scheduled in the MTEF.

This step in the Roadmap to a full MTEF could be taken in 2011. However it should be coordinated with any upgrade of, or replacement for, IRMS.

Recommended Roadmap Step 2.a) DGH to develop a pipeline of projects for programming individual road development proposals across the next three or four annual budgets, using the methodology described in Annex 2.

Box 2: Drawbacks of a Lack of Multi-year Focus in DGH

The World Bank notes:

"The strictly annual nature of the government-wide budget process is reflected in the planning and budgeting of DGH. Multi-year new construction projects are identified in the five-year master plan of the DGH. This five-year planning period coincides with the government wide five year development plans. New construction projects are fragmented into the five stages for DGH planning and budgeting purposes with limited focus on the life-cycle, progress and performance of the project. Expenditures for feasibility study, land acquisition and actual construction (and upon completion maintenance) related to the one project are budgeted for separately. Budgeting decisions which should be interdependent across the project life cycle are revisited (and renegotiated) in out-years. There is no formalized preparation of a pipeline of projects with decision points that would activate their entry into the budget process that would define future allocation of resources to subsequent steps. This overall flow related to projects is not reflected as a seamless and interdependent stream of decision in the current budgeting practices.

"The lack of a pipeline of projects and insufficient project life-cycle and program monitoring reduces the ability of DGH to flexibly manage resource flows. The current annual planning and budgeting framework does not include a phasing in of project stages over the medium-term, starting with a preparation budget in year one, followed by land acquisition costs and finally construction costs. This reduces the ability of DGH to efficiently utilize resources allocated through the budget. A rapid increase in resource allocation, as seen in the past two years, is likely to aggravate absorption problems as DGH is not ready with an implementation-ready pipeline of projects to allocate resources to. This was seen recently. After a 16 percent increase in the allocation to DGH from 2006 to 2007 the absorption rate fell from 95.3 percent in 2006 to 78.2 percent in 2007. Having a multiyear program and project life-cycle framework in place would enable a phased approach to spending increases, or decreases, making it easier for DGH to absorb increases or to adjust to decreases."

Source: World Bank, Indonesia, Directorate General of Highways, Ministry of Public Works Financial Management Assessment, draft, October 2008, p. 21.

3.1.3 Roadmap Substep 2.b). Develop prioritising tool for road development options

A prioritising tool for road preservation options already exists in the form of the Indonesia Road Management System (IRMS) application (see next section). However, there is no single prioritising tool for road development options. Large project options such as toll roads are subject to economic (cost benefit) and financial appraisals and can be ranked by their economic or financial rate of return. For other development options it has been suggested that political considerations play a major part in forming short lists for migration into the budget. The World Bank and the Paterson report suggest that the approach is ad hoc, year by year, with no system for migrating development options into multi-year programs aimed at achieving DGH's strategic targets. This may have been understandable following the 1998 Asian Crisis, since for a number of years following the allocated budget for DGH was less than the amount needed for just network preservation works and virtually no budget was available for new initiatives. It was during that period when DGH and GOI embarked on a strong push to develop Private Public Partnership (PPP) projects in the road sector as a way of providing

3.1.4 Roadmap Step 3: DGH to prepare an MTEF report

In the past DGH has publicly released multi-year planning documents such as its five yearly Renstra and its 2009 'White Paper' on road development. The latter included a section on the MTEF. With the evolution of the MTEF which is currently occurring there is scope for DGH to prepare an updated 'MTEF' document for the national road sector

- the Renstra is not updated annually to take account of indicative ceilings issued by MoF²³
- the 'White Paper' presented alternative scenarios for future funding of national roads.²⁴ However it did not clearly link these alternative funding assumptions to the achievement of strategic road targets.

Step 3 of this Roadmap is for DGH to produce a National Road System MTEF White Paper, possibly on an annual rolling basis. This would include, for each of DGH's strategic targets

1. current level of target achievement and 'remaining target' for the next four years²⁵
2. a four year schedule for achieving the 'remaining target' over each year of the MTEF
3. the financing required in each year of the MTEF to implement the remaining target schedule, distinguishing budget and external financing.

For 2010 this document could be published after the budget has been finalised. Subsequently this 'DGH MTEF' would become the ongoing basis for DGH preparation of its annual budget requests.

Recommended Roadmap Step 3: DGH to consider preparing an MTEF report following the approval of the 2011 budget (similar to its 2009 'White Paper') which outlines financing required to achieve its road network targets for 2014.

3.1.5 Roadmap Step 4: DGH to include a 'measures table' in its MTEF report

An approach used by some countries to link MTEF with PBB involves preparation of a 'measures table' for each budget round. This is a table with a separate section for each sector, a separate heading for each strategic target in the sector and under each heading a list of the measures approved in the budget to improve target achievement.

For example, under DGH's strategic target of raising the proportion of national roads in stable condition to 94% (from the current 85%) the measures table might contain spending measures such as

- contracting maintenance out in nominated provinces (rather than the current use of force accounts)
- increased spending on maintenance in other provinces
- purchase of new planning software (replacing IRMS) which enables the adoption of improved maintenance strategies.²⁶

²³ However there is a mid period update of the RPJM.

²⁴ Buku Putih Pembangunan Prasarana Jalan TA- 2009. Chapter 8 includes a "Medium Term Expenditure Framework 2009 - 2011 based on alternative funding scenarios for this period.

²⁵ Targets would be drawn from the DGH Renstra and the four year rolling RKP which will now be finalised by Bappenas each May.

Best practice MTEF budgeting requires line ministries to identify each of their proposed measures (proposed initiatives) in their budget submission.²⁷ Cabinet then chooses which proposed initiatives it wants to include in the budget (hopefully those addressing its highest priorities in the most cost effective way).

For the 2011 budget Indonesia has taken a significant step in this direction. As described in Chart 2 above, MoF's new format for RKA-KL Form 1 requires ministries to provide an "Explanation of changes to program allocations between the ongoing allocations and the proposed allocations". However this does not explicitly require a connection between changes in sector allocations and achievement of sector targets. It is proposed as Step 3 in this Roadmap that DGH seizes the initiative and prepares its own measures table for the 2011 budget. Chart 3 provides a possible format for the DGH measures table which is more detailed than the MoF required format in Chart 2.

Most measures will already be identified in general terms in the DGH Renstra or Bappenas RKP. The measures table builds on this by spelling out the link between proposed changes in funding for sub-directorates and expected change in target achievement (outcomes and impacts). This makes it clear what initiatives are being taken by DGH to improve target achievement and what they cost. DGH can also be held accountable for delivering the improved achievement.

Recommended Roadmap Step 4: DGH will include a measures table in its MTEF publication to improve the transparency of the steps it is taking to achieve its road network targets for 2014.

3.1.6 Roadmap Step 5: DGH to introduce an baseline/new initiatives distinction to its MTEF?

In an earlier MoF attempt to introduce an MTEF line ministries were asked to distinguish between their baseline spending and their proposed new initiatives. This distinction is not part of the Bappenas/MoF pro formas which line ministries fill out when making their 2011 budget request. However, Bappenas/MoF documents foreshadow the introduction of the distinction between baseline and new initiatives in future years. The key question is how the baseline will be defined.

Step 5 of the DGH Roadmap would be for DGH to adopt a baseline/new initiatives format for internally preparing its budget request to MoF. If and when MoF alters the format for the RKA-KL submission to separate the baseline and new initiatives DGH will be well placed to respond.

²⁶ A measures table will include the existing spending related to a target and the existing level of target achievement. However there is an important distinction for preparing the budget between aggregate funding for a program/activity and a request to vary that funding. Rather than being a snap shot of the funding status quo a measures table is essentially forward looking - the proposed *change* in financing the achievement of a target and the resulting *improvement* in target achievement. It is this information which is required for budget planning and formulation of the MTEF.

²⁷ See Public Expenditure and Financial Accountability (PEFA) Secretariat, World Bank, Public Financial management Performance Measurement Framework, June 2005, Indicator PI-12 "Multi-year perspective in fiscal planning, expenditure policy and budgeting" which states: " Expenditure policy decisions or options should be described in sector strategy documents, which are fully costed in terms of estimates of forward expenditures (including expenditures both of a recurring nature as well as those involving investment commitments and their recurrent cost implications) to determine whether current and new policies are affordable within aggregate fiscal targets. On this basis, policy choices should be made and indicative, medium-term sector allocations be established. The extent to which forward estimates include explicit costing of the implication of new policy initiatives, involve clear, strategy-linked selection criteria for investments and are integrated into the annual budget formulation process will then complete the policy-budget link." p. 26.

Initially the baseline would comprise the activities included in the DGH Renstra. New initiatives would be proposals to vary the Renstra detail (in regard to timing or content).²⁸ Subsequently a definition of the baseline more consistent with PEFA benchmarks could be introduced. An earlier MoF document defined the baseline as follows: "In an annual budget framework, the scope of the baseline budget can be limited to the present level of expenditure, whereas over a multi-year period, the cost estimates must also take into account the **additional expenditure necessary to provide the same services.**"²⁹

Even if MoF does not take this final step, an internal DGH distinction between baseline and new initiatives will help move internal budget preparation from an accounting focus to a policy focus.

Recommended Roadmap Step 5: DGH to introduce a distinction between its baseline funding and funding for new initiatives in developing its request to MoF for funding to achieve its road network targets.

3.1.7 Roadmap Step 6: DGH to use the first out-year of its MTEF as the baseline for preparing its next budget request

This last step in the Roadmap to DGH's fully functional MTEF involves using the first out-year in the FEs as the baseline for annual budget preparation. The main change here is that line ministries no longer submit a budget request covering their whole budget but only for variations in the baseline which is already contained in the forward estimates held by MoF.

This focus, when preparing the budget, on variations to the baseline rather than annual re-creation of the entire baseline enables the budget preparation process to be much more policy focused. Each proposed variation can be assessed on the basis of its impact on target achievement and the change in total program cost. This approach has been adopted by a number of countries using MTEF based budgeting, including South Africa (a possible benchmark for Indonesian MTEF reforms). However, this step should only be taken when the quality of the forward estimates making up the MTEF is good enough to become the baseline for preparing each future budget.

Recommended Roadmap Step 6: when DGH internally prepares its budget request it will use the forward estimates for the first out-year of its MTEF as the baseline for preparing its next budget request.

²⁸ Use of Renstra allocations to define the baseline would simplify greatly the preparation of DGH's MTEF based budget request. Renstra allocations will need to be indexed and there will be a need to ensure that the costings underlying the Renstra allocations are plausible (this can draw on IRMS inputs).

²⁹ The costs of existing policies include in particular the:

- a) Costs of maintaining the current level of service, taking into account expected changes in the number of users or beneficiaries; (continued following page footnotes)
- b) Recurrent costs of investment projects that will be completed over the planning period;
- c) Forward costs of ongoing investment programs; and
- d) Future costs of entitlement programmes based on decisions already taken and the influence of exogenous factors, such as demographic trends.

See Ministry of Finance of the Republic of Indonesia, Directorate General of Budget and Fiscal Balance, Medium-Term Expenditure Framework (MTEF) Guide, Budget 2006, February 2005, p. 7.

Box 3: The advantage for DGH of having a baseline and new initiatives in its budget request

The distinction between baseline/new initiatives in a ministries budget request, when introduced by Bappenas/MoF, will give DGH the benefit of knowing the baseline funding 'provisionally guaranteed' for each of the next three years (updated and rolled forward in each budget round). New initiatives are then proposals to vary the baseline.

Adoption of such a framework offers major benefits to DGH, due to greater certainty of future funding for existing policies and associated commitments contained in its Renstra. This enables forward planning and contracting by DGH for road maintenance and development activities which span more than one budget year.

The separation of baseline and proposed initiatives also has a big advantage for Bappenas and MoF. It reduces the extent to which future increases in DGH budgets can 'leak' into less efficient provision of *existing* road service levels rather than being spent on the network development measures for which they were intended.

Thus, if financing for the baseline and new initiatives is separated, DGH can be held accountable for successfully implementing its approved new initiatives. This will not be easily achieved under the 2011 MTEF, in which Ministries do not separate their budget request into funding for baseline and proposed new initiatives.

However, for the use of a baseline to be effective, clear rules are required about what is funded in the baseline and what is a new initiative (a proposal to vary the baseline). In Indonesia's case Bappenas and MoF favour a baseline for each Ministry comprising its Renstra allocations, since this is regarded as "existing policy".

However, with the introduction of a multi-year RKP and RKA-KL, sometime in the future, it may be possible to define a baseline in terms of what is included in the multi-year RKP and RKA-KLs rather than what is in the Renstra and RPJM.

3.2 CONCLUDING COMMENT

Generally the introduction of FE based budgeting seems to be more successful if it is evolutionary rather than revolutionary, progressively refining existing systems toward an MTEF rather than suddenly replacing them with an unfamiliar set of processes. The attempt by MoF in 2005 to introduce a baseline budgeting system using a set of FEs for the 2006 budget encountered difficulties partly due to the complexity of the baseline concept and the imposition of demands on Indonesian budget agencies for which they were not yet ready.

This emphasises the importance of developing an MTEF architecture based on a series of changes to existing systems rather than their sudden replacement by a new system. Successive changes should build on each other, with progress in achieving each milestone being the trigger for embarking on the next. The biggest challenge is to identify the immediate next step, and this Roadmap provides some options for DGH, as well as an overall view of how its MTEF might develop.

ANNEXES

ANNEXE 1: DIRECTORATE GENERAL OF HIGHWAYS MTEF: PROGRESS WITH THE MTEF

There were three areas of significant progress towards a DGH MTEF during May 2010.

First, Bappenas and the Ministry of Finance (MoF) took a giant step toward introduction of a national level MTEF

- Bappenas's annual work plan (RKP) has for the first time been prepared in a four year format (to 2014), and
- MoF has issued a regulation for preparation of line ministry work plans and budgets (RKA-KLs) for the 2011 budget year, *plus forward (MTEF) years*.

The new RKA-KL format is supported by the release of a MoF computer-based application in which line ministries will simultaneously enter their 2011 budget request *together with* their inaugural forward estimates (FEs). Symbolically, a line ministry will not be able to send its 2011 budget request to MoF unless it also completes the FE fields.³⁰

This means that the FEs will be prepared as part of the preparation of the annual budget request, rather than being prepared as a separate and poorly related exercise after the budget has been finalised (as has occurred in a number of countries introducing an MTEF for the first time).

Importantly, DGHs new format Work plan and Budget (RKA-KL) for 2011 - 2014 will constitute its 'raw' MTEF.³¹

Second, the Director General of Highways, Pak Djoko Muryanto, has given strong support to MTEF development in the Ministry, indicating that he will take a personal interest in this and that development of MTEF capacity should be a Ministry wide focus. Reflecting this strong support he foreshadowed the INDII advisor team moving to office space adjacent to his own office.

Third, the Echelon 3 in charge of the Planning Sub-Directorate, Pak Max Antameng, who attended the meeting with the DG, has expressed interest in preparing a DGH MTEF document for public release late in 2010. This would contain summary tables from the FEs drawn from the new RKA-KL, and a link table to the strategic objectives for the national road network in 2014 (the objectives contained in the DGH five year plan (Renstra)).

In addition the Echelon 3 in charge of the Budgeting Sub-Directorate, Pak Soebagiono, reiterated his earlier request for assistance from the INDII advisers in prioritising road development options. The ability to prioritise effectively will be a key step in creating a quality set of FEs for DGH - it is undesirable that the FEs be re-created from scratch in each year (which would largely defeat the purpose of an MTEF) so it is essential the process for screening options for inclusion in the inaugural FEs should be soundly based.

³⁰ However, this does not guarantee that the FEs that are entered provide a sound basis for preparing future budgets.

³¹ 'Raw' in the sense that the RKA-KL is prepared at the very detailed activity level and need to be summarised and linked to strategic objectives in order to provide policy relevant FEs.

Risks

While the above developments reflect substantial progress toward institutionalising an MTEF in DGH, it will be a challenge to ensure that quality FEs are contained in this inaugural MTEF

- a shortcoming in MoF's formats for the RKA-KL is the absence of a strong link between the funding which will be proposed by line ministries for 2011 to 2013 and the achievement of the strategic objectives laid out in their five year plan (Renstra). This is because the FEs are entered at the activity level, and linked to proposed physical outputs of the individual sub-directorates rather than achievement of strategic objectives which usually involve multiple sub-directorates and even ministries
- a related risk arises from the need to strengthen coordination within DGH, particularly between the sub-directorates of Planning and Budgeting. The Planning Sub-Directorate has a key role in providing support prioritisation of road development options for inclusion in the new multi-year framework, reflected in requests for INDII assistance in prioritising road development options for inclusion in the FEs.

Management of this risk requires INDII advisors to work *jointly* with the Echelon 3's in the Planning and Budgeting Sub-Directorates to ensure preparation and prioritisation of a pipeline of development projects, and that the needs of the latter are met within the tight timeframe of the budget preparation deadlines. The prospect of publishing a DGH MTEF document later in 2010 will give the planning sub-directorate a greater stake in the development of a pipeline of road development options.

ANNEXE 2: CREATION OF A PIPELINE OF NATIONAL ROAD DEVELOPMENT ACTIVITIES

The World Bank, as well as a previous INDII Report³², have expressed concern about the tendency for the Directorate General Highways (DGH) to adopt an ad hoc, year by year, approach to funding Indonesia's national road development objectives.³³

While the DGH Renstra (sector five year plan) contains clear medium term road development objectives and a five year program, there is currently no mechanism for programming individual road development activities across the next three or four annual budgets, taking account of the indicative ceiling provided by the Ministry of Finance (MoF). Instead an ad hoc, year-by-year, approach is taken, with funding for each development activity being reconsidered in each annual budget preparation round.

A double window of opportunity now exists for addressing the lack of a 'pipeline' in DGH. First introduction of an MTEF in DGH (when fully achieved) will require a PoP to identify and prioritise new initiatives over the MTEF period (the next budget year plus three out-years).³⁴

Second, for the 2011 budget preparation Bappenas is for the first time preparing its Annual National Work plan (RKP) on a three year rolling basis.³⁵ This is a key step in Bappenas throwing its support behind introduction of a national MTEF, overcoming a key reason for earlier MTEF false starts by the Ministry of Finance.

Bappenas's new RKP will provide DGH with an updated (rolling) three year national planning framework for the first time, to guide prioritising of a multi-year pipeline of potential road development activities.

The Echelon 3 in charge of the Sub-Directorate of Budgeting and Programming has indicated that his most urgent priority for the successful introduction of an MTEF is the development of a PoP and an associated prioritising mechanism.

³² Paterson, W.D.O. and Gandhi Harahap, *Application of Medium-Term Expenditure Framework & Performance-Based Budgeting in Directorate General of Highways Indonesia*, March 2010. See p. (vi): "The need for a more systematic and long-term approach to investing in capacity expansion is considered to be urgent and the top priority for the sector at present. It requires strategic planning, stronger prioritization, and increased mobilization of financial resources."

³³ The World Bank Report, *Indonesia, Directorate General of Highways, Ministry of Public Works, Financial Management Assessment*, draft, October 2008. The Report notes (p. iv) that "The annual planning process is connected to the Ministry's five year plan; however, the planning, budgeting and oversight of multi-year programs is strictly annual. There is no formal preparation of a pipeline of projects with decision points that would activate the entry of specific phases of the project into the budget process. Inadequate integration of multi-year program and project life-cycle planning with the budget process reduces the ability of DGH to manage their projects and financial resources effectively leading to delays during budget implementation."

³⁴ Development of a 'pipeline' of possible initiatives will be a key part of introducing an MTEF, supporting the distinction between DGH baseline spending for the four year period and its proposed new initiatives for meeting targets in its Renstra and Bappenas's annual national work plan (RKP).

Under the MTEF, once a new initiative is approved for budget funding it becomes an ongoing expenditure and migrates to the baseline forward estimates.

³⁵ The RKP is prepared early in each budget preparation cycle and guides ministries in the preparation of their draft annual work plans.

Coverage of the Pipeline of Projects (PoP)

DGH's three main spending areas are road preservation, road development and administration. Road development can be further divided into 1) currently funded/ongoing road development activities and 2) potential future activities which are as yet not receiving funding from the budget or donors.

While 1) and 2) together comprise DGH's road development program, the PoP will contain only 2).³⁶ Only when a proposed development activity in the PoP is accepted for budget funding does it move out of the PoP and into the category of currently funded development activities.

For each potential road development activity in the PoP the following data would be entered:

- a unique identifier for the proposed development activity
- a comprehensive text based description of the proposed activity, including its location and outputs
- a statement of the relevant DGH objective(s) (drawn from the Renstra and latest RKP)
- a costing of the proposal in each MTEF year
- an indication of the source of funds (domestic and external, identifying counterpart contributions)
- an estimate of the resulting improvement in performance indicators for the relevant objective(s).

The concept of a pipeline of projects

The PoP will adopt a four-year time frame (coming budget year and subsequent three out-years). This will keep it in line with Bappenas's new rolling RKP, and the PoP will implement the priorities in the new RKP

At the start of each DGH budget preparation cycle the 'portfolio' of prospective development initiatives will be updated and rolled forward by a year following the circulation of the new RKP by Bappenas.

Since it is a pipeline concept, the PoP will have an inflow and an outflow...

What goes into the pipeline?

The PoP will include all potential national road development activities identified by DGH, or requested for inclusion by Parliament or other sources. It will be divided into two categories

- Category 1) prospective development activities which have been identified but for which appraisal procedures have not yet been completed (appraisal procedures include cost-benefit analysis or Multi-Criteria Analysis)

³⁶ The PoP therefore comprises possible development activities to be considered for inclusion in the next budget request (Renja and RKA-KL) and/or subsequent years of the MTEF.

- Category 2) prospective development activities for which appraisal procedures have been completed and the project accepted as worth financing subject to MoF ceilings and competing initiatives.

What comes out of the pipeline?

Exit of a proposed development activity from the PoP would be through

- failure of a Category 1 activity to complete appraisal or to pass appraisal and enter Category 2
- approval of a Category 2 activity for budget financing
- deletion of a Category 2 activity for other reasons.

Migration from the PoP to the budget can only be from Category 2, and is through inclusion of the proposed activity in the approved DGH Renja and subsequently its RKA-KL.

System requirements

The PoP should be managed on a database platform, and ideally would be integrated with the update of the IRMS platform. Generic commercial off the shelf systems are available for project portfolio management, and these would need to be reviewed at an early stage. A possible interim solution would be to develop the PoP in a spreadsheet.

ANNEXE 3: DEVELOPMENT BY DGH OF A TOOL FOR PRIORITISING OPTIONS IN ITS PIPELINE OF PROJECTS

Ideally economic (cost benefit) analysis should be used for appraising all road development proposals. However, where some road development objectives are political or strategic in nature problems may arise in quantifying the full benefit stream, and therefore in prioritising competing proposals. Multi-Criteria Analysis is a possible supplementary tool in this circumstance. It is used by Bappenas to prioritise projects for inclusion in the 'Blue Book'.³⁷

| SCORING TABLE FOR CHOOSING BETWEEN ALTERNATIVE ROAD INITIATIVES | | | | | | |
|--|--|-----------------|---------------------------|--------------|---|---|
| Based on Multi-Criteria Analysis | | | | | | |
| Criteria | Renstra objective | | Score for each Initiative | | | |
| | Objective | Priority weight | Initiative 1 | Initiative 2 | 3 | 4 |
| A. Relevance to each Renstra objective (separate row for each Renstra objective) | 1. Preservation of national roads either cross or non-traffic, so that 94% of the national road network in stable condition. | | | | | |
| | 2. Increased capacity of 19,370 km of road, so the East Cross Pantura Sumatra and Java have a minimum width of 7 m, with the Jakarta-Surabaya Pantura meet highway specifications; Southern Cross West Cross Borneo and Sulawesi have the minimum width of 6 m long decline of sub-standard roads 10% and the addition of lanes along the 13,000 Kilometers Km; and the long road that meets the specifications highways increased 400 | | | | | |
| | 3. Reduction of the number of accident-prone locations related to road conditions. | | | | | |
| | 11. Facilitate the development and preservation of local roads to improve accessibility of the centers of agricultural production to the national road network and further develop and mempreservasi national road network to the marketing centers in urban areas, ports, airports and major industrial areas of agriculture related. | | | | | |
| | 12. Facilitate the development and preservation of national roads to the border area (the front and the outer and many are still left) in Aruk, Entikong, Nanga Badau, Simanggaris, and Nunukan on the island of Borneo and Sota (Merauke) in Papua and to facilitate the development of local roads to provide access transportation in the area behind the front, outer and post-conflict. | | | | | |

³⁷ "The Blue Book contains projects that have been proposed by ministries, regional government agencies and state owned enterprises. The compilation of the project proposals is part of national development planning in the context of attaining the targets of the RPJMN (National Medium-Term Development Plan). Out of the total of project proposals that have been received by the Ministry of National Development Planning/National Development Planning Agency, only proposals that have been deemed as eligible for being funded by external loans and/or grants and proposals that are in accordance with the direction national development, will be entered into the Blue Book." See Republic of Indonesia, List of Medium Term Planned Loans and Grants (DRPHLN-JM) 2006 - 2--9, 2nd Revision, p. i.

| Criteria | Renstra objective | | Score for each Initiative | | | |
|----------|---|-----------------|---------------------------|--------------|---|---|
| | Objective | Priority weight | Initiative 1 | Initiative 2 | 3 | 4 |
| | 14. Development and preservation of the highway network along the 700 Km long held by the Government and facilitation of 57.45 Km highway development undertaken by the private sector as well as along the 656 km highway to access the development on corridors with the intensity of movement of goods and services and export-oriented high as: Development of Tanjung Priok Access Road, Dry Port Cikarang and Gedebage, and Kualanamu Juanda Airport, as well as non-toll roads that are access roads of the Eastern Cross Sumatra to Port of Belawan and Dumai, and construction of access roads from the island of Java to Pantura Tanjung Priok Port, Port of Cirebon, Port of Tanjung Mas, Port of Tanjung Perak, and others. | | | | | |
| | 18. Revision of Presidential Regulation No. 67/2005 which includes: (i) appropriate adjustments to the auction provisions of Government Regulation on Toll Road (if participant is less than 2 auctions, negotiations may be conducted after obtaining approval from the Minister); (ii) changes in shareholders before operating the toll road permits the Minister; and (iii) changes in preferences for Business Enterprise initiative from 10% to 20%. | | | | | |
| | 19. The formation of government units to carry out highway construction that is financially / commercially is still marginal and the unit can immediately use toll revenue to build more highways. | | | | | |

| SCORING TABLE FOR CHOOSING BETWEEN ALTERNATIVE ROAD INITIATIVES | | | | | | |
|---|-------------------|-----------------|---|--------------|---|---|
| Based on Multi-Criteria Analysis | | | See following worksheet for scoring table | | | |
| Criteria | Renstra objective | | Score for each Initiative | | | |
| | Objective | Priority weight | Initiative 1 | Initiative 2 | 3 | 4 |
| | | Priority weight | | | | |
| B. Is 'immediate' funding of the Initiative in 2011(rather than deferral to 2012 or 2013) vital to achieving the Renstra goal? | | | | | | |
| C. How much will this initiative support other RPJMN objectives outside DGH? | | | | | | |
| D. To what extent does this Initiative cross-cut positively with other sectors? | | | | | | |
| E. To what extent are donors able to deliver the equivalent | | | | | | |
| TOTAL SCORE FOR EACH INITIATIVE | | | | | | |

| GUIDANCE FOR SCORING EACH PROPOSED INITIATIVE | | | | | |
|--|----------------|--|---|---|--|
| This table accompanies the scoring table | | | | | |
| Criteria ↓ | Score → | 4 points | 3 points | 2 points | 1 point |
| A. How critical is the proposed Initiative to the achievement of each goal in the Renstra? Give a separate score for each Renstra goal | | Vital – goal cannot be achieved otherwise | Important – this Initiative will make a substantial contribution to achieving the objective | Moderate – this Initiative will make some contribution to achieving the objective | Limited – the Initiative will make no significant contribution to achieving the objective |
| B. Is 'immediate' funding of the Initiative in 2011 (rather than deferral to 2012 or 2013) vital to achieving the Renstra objective? | | Vital – if not funded in 2011 the objective will not be achieved | Important – funding this Initiative in 2011 will increase its impact substantially and accelerate achieving this goal | Moderate – funding in 2011 may increase the impact of the Initiative | Limited – funding the Initiative in later years will not impact on the Initiative or achievement of the goal |
| C. How much will this initiative support other RPJMN objectives outside DGH | | Substantially - direct impact on other goals | Materially – will provide limited direct support for other goals | Somewhat – may indirectly support other goals | None – Will not impact on any other goals |
| D. To what extent are donors able to deliver the equivalent outcome | | Not at all | Somewhat - donors could provide, but there is substantial uncertainty about a donor commitment | Largely – donors have identified this area for future support | Completely - a donor has committed to support this Initiative |

ANNEX 4: INDII ACTIVITY PROPOSALS PROJECTS

