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## **The Virtue and Problems of Indonesian Development Trust Funds**

## **Keutamaan dan Permasalahan Dana Perwalian Pembangunan Indonesia**

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## ABSTRACT

Development trust funds emerged along with foreign aid itself. They emerged with the evolution of aid conditionality provided by international donors to the recipient countries. The Paris Declaration in 2005, signed by over a hundred donor agencies and recipient governments, attempted to change the nature of contemporary aid relationships by adopting ownership and harmonization as the key pillars of a new aid paradigm. The Paris Declaration changed the pattern of aid and the conditions attached to aid. Development trust funds are funds established using money from either foreign or domestic grants that legally set aside from the regular state budget. The funds will be used for the development purposes and managed by the national trustee institution. Development trust funds have only recently been permitted in Indonesia based on Presidential Regulation No. 80/2011 regarding the Establishment of Trust Fund (Perpres No. 80/2011). The enactment of Perpres No. 80/2011 was followed by the establishment of two national development trust funds in Indonesia: the Millennium Challenge Account-Indonesia (MCA-I) and the Indonesia Climate Change Trust Funds (ICCTF).

Using interviews with Development Trust Funds officers and case studies of the existing development trust funds, this article explores the problems with the Indonesian development trust funds as currently constituted. After providing introduction, this thesis discusses the historical background of the development trust fund, some precedents of development trust funds in several countries and development trust funds under international law. It also identify the key principles of the development trust funds which has been established around the world. Finally, this article evaluates the Indonesian development trust funds regulation as well as the implementation of the existing development trust funds.

This research concludes that the current trust fund regulation is missing from some substantial provisions regarding the legal status, and provisions related to good and accountable governance of Indonesian development trust funds. This work suggests the government of Indonesia should amend the current trust fund regulation in order to make the development trust fund operated more accountable, effective, and efficient.

Commonly, there are four major sources that can be used for the purpose of development funding: private savings, public savings, foreign trade or investment and foreign assistance. Public and private savings and foreign investment were all, however, insufficient to meet country capital needs. The next appropriate alternative is to intensify the foreign trade or to boost exports. However, this will take longer than just one, two or three years.

External financing such loans and grants could serve a strategic role to fill the gaps and to provide vital inputs, which often are not readily forthcoming from the domestic resources. One of the alternatives in which the government can effectively make best use of prevailing resources is through development trust funds. Development trust funds are a fund established using money from either foreign or domestic grants that legally set aside from the regular state budget. The funds will be used for the development purposes and managed by the trustee institution. The trustee institution is an ad-hoc government entity established by a ministerial regulation that governed by the Board of Trustee. The member of the Board of Trustee consists of government and non-government officials, including representatives of civil society.

Development trust funds have recently been permitted in Indonesia based on Presidential Regulation No. 80/2011 regarding Trust Fund (Perpres No. 80/2011). The enactment of Perpres No. 80/2011 was followed by the establishment of two national development trust funds in Indonesia: Millennium Challenge Account-Indonesia (MCA-I) and Indonesia Climate Change Trust Funds (ICCTF). Despite Indonesia's best effort to set up development trust funds to maximize its financial capacity for development, the legal and organizational framework of the trust funds has an uncertain conceptual foundation. This situation will lead to several fundamental problems such as uncertain legal status of the trust funds, inadequate governance procedure and lack of accountability of the organization's activity. This thesis explores the problems with the development trust funds as currently constituted. It then suggest that the government of Indonesia should amend its trust fund regulation to bring the rules governing the development trust funds into compliance with the international best practices.

This article discusses the origins of the development trust fund concept and the recent evaluation of development trust funds in Indonesia. It identifies the key principles of the development trust funds which has been established around the world and the technical issues to be addressed in designing the legal and organizational framework of new development trust funds. Finally, this article evaluates the Indonesian development trust fund regulation as well as the implementation of the existing development trust funds.

The IMF specified that PRSPs should be formulated according to five core principles. PRSPs should be: country driven; result-oriented; comprehensive; partnership-oriented; and based on a long-term perspective. More 'ownership' of the

development process is now strongly advocated as counterweight to conditionality, the thinking being that if recipient countries can develop and commit themselves to their own national development strategies, they could persuade donors to respond to their needs, rather than the other way around.

The big theme for aid and global development in the new era of millennium was the Millennium Development Goals (MDGs). In the Millennium Summit that organized by the UN in 2001 the World Bank, IMF, OECD and almost all world leaders adopted the MDGs. Poverty eradication, environment, human rights and good governance were included, by the United Nations. In September 2002, President Bush published a national Security Strategy establishing development as third pillar of US national security, together with defence and diplomacy. It was part of the US initiatives to the Global War on Terror after terrorist attack in September 2001. A new plan for foreign aid, the first one since Kennedy's proposal in the sixties, was proposed as Millennium Challenge Account (MCA). The Millennium Challenge Corporation (MCC) was established in the early 2004 to carry out the new initiatives. MCC was established separate from USAID and with a new aid delivered concept: supporting the only best development performers; low and low middle income countries, having demonstrated strong commitment to political, economic, and social reforms.

With full implementation of the principles aid effectiveness by developing and adopting exclusively a national action plan. Jakarta Commitment, which was signed by the GoI on January 12th, 2009 and adopted by the 26 development partners is a Road Map to implement the agenda of aid for development effectiveness in Indonesia. Jakarta Commitment is a strategic step initiated by the GoI to take advantage of a large agenda of the international aid effectiveness as expressed in the Paris Declaration to push reform process and develop a wider partnership to achieve development effectiveness.

The agenda of the Jakarta Commitment is based on the Paris Declaration principles and the Accra Agenda for Action through three underlying commitments including strengthening country ownership over development, building more effective and inclusive partnerships for development and delivering and accounting development results.

The commitment highlighted three areas of reforms in the field of national development policy: (1) Planning and budgeting reform based on the Law No. 17 Year 2003 on State Budget and Law No. 25 Year 2004 on National Development Planning System; (2) Government Procurement Reform by enacting a new law regarding national procurement system and established a new agency called National Procurement Policy Agency; and (3)

The National Trust Fund (NTF) A4DES is prepared to serve as a nationally owned and administered trust mechanism for pooling external funding resources from various development partners in a manner that could improve alignment between external

assistance and national system. This is done in order to establish a stronger national ownership in defining aid architecture and processes consistent with Indonesia's Aid for Development Effectiveness agenda, particularly the Jakarta Commitment.

In the early stage, the trust fund will be administered by the UNDP (as a 'trustee'), in the form of Transitional Multi-Donor Fund (TMDF). The purpose of TMDF is to channel development partners' support for the implementation of A4DES work program in an effective, efficient, transparent and accountable manner, so that the impact of such assistance can be maximized. TMDF also serves as a mean to identify, select and develop the necessary capacity for a national entity as part of the step to form a Nationally Managed Trust Fund that is fully managed by Indonesian entity.

One important aspect which had been underlined by the WG on PFM was the idea to separate the administrative mechanism between foreign loans and grant arrangement. This is caused by fundamental differences in characters of foreign loans and grants. WG on PFM suggested that the government should amend the PP No. 2/2006 to simplify the government procedures especially for the foreign grants to be administered in the state budget. Additionally, WG PFM also tried to satisfy their second task to find alternative financing sources and/or new funding schemes. The WG on PFM had analyzed the operation of several multi donor funds in Indonesia. Some important findings include development trust fund requires a clear policy and regulation to ensure the smooth implementation of activities funded through this mechanism. The clarity of legal aspects in establishing a trust fund, such as the appointment of national trustee is also important. This was also become one of the most important recommendations from A4DES to the government of Indonesia to establish a national policy regarding a development trust fund. After conducted long discussion with various stakeholders, PP No. 10/2011 as a replacement of the PP No. 2/2006 finally was enacted by the President of Indonesia along with the provision regarding development trust fund within the regulation.

Since the increasing number of trust funds that are governed by international law, there are already desirable attempt to create a codification of the fundamental principles that should be observed in the administration of the trust funds. Many development practitioner, scholars and international donor agencies have issued guidebooks, handbooks or standard manuals in order to promote accountability in setting up, managing, monitoring, and evaluating a development trust fund in various area.

The legal status of the development trust funds may take one of two distinct legal forms. The most common form is without independent legal personality, involves setting up the trust fund under the auspices of the host institution. The other form of the trust funds is legally independent, involves setting up the trust fund as a legal entity under the national law.

## **Without Independent Legal Personality**

From the international institutional law perspective, trust funds are technically a financial vehicles without independent legal personality, created by an administrative agreement between donor(s) and multilateral trustee. Donors maintain effective control over trust funds, which are not commingled with the general resources of multilateral agencies.

The legal person of the trust is distinct from that of the donor, as well as from the other assets of the trustee, even though the assets of the trust pass to the ownership of the trustee for the duration of the trust relationship. Due to this constrain, they generally cannot enter into contracts or to be subject of privileges and immunities. For that purpose, the international organization acting as trustee, or another organization or entity having legal personality under international or local law, must act on contractual matters.

Some example of non-legal personality trust funds are various trust funds administered by the United Nations, the Food and Agriculture Organization, the World Health Organization, the International Labor Organization, and the Inter-American Development Bank.

In the area of conservation trust fund, a study conducted by the Global Environment Facility found that in order to be successful, trust funds must be more than just financial mechanisms. They should be self-governing institutions and play key roles in the development of national conservation strategies.

Under this approach, donors create a new collective financing effort as an independent legal entity under the national law of a country whose location and legal provisions for non-profit entities meet donors' needs.<sup>382</sup> They may be created by Deeds of Trust, chartered by the government<sup>383</sup>, by article of incorporation or by a statute.<sup>384</sup> The establishing document not only will create a legal right for the board of trustees to initiate suits on behalf of the trust, it also forms the basis for removing the board when there is any wrong-doing or dissolving the trust when the objectives are not being carried out.

The independent legal status will effectively ensure the trust fund independence from government that has clear and well enforced laws concerning private non-governmental organizations (including foundations or trusts). Most international donors will only contribute to a Fund that is legally independent and not controlled by government. For example, in the interest of promoting and building civil societies, the United States Agency for International Development (USAID) and the Global Environmental Funds (GEF) refuse to contribute to the capital of a fund whose board has more than 50 percent government representation.

Trust fund with independent legal personality is emerged as a widely accepted option when the G8 countries set up the Global Fund to Fight AIDS, Tuberculosis and Malaria (the Global Fund) in 2001. The alternative the Global Fund's donors selected was to set the Fund up as a non-profit foundation under Swiss law.

This study has explore the development of Indonesian Development Trust Funds. The most important conclusion is that there are set of guidelines or regulations that should be added in the future development trust funds in Indonesia such as regulation in the area of state budget that specially governed for development trust funds and tax regulation for development trust funds activity. A clear and reliable guideline and regulation will protect both the trust funds institution and donors, also to encourage efficient and fair use of development money.

The foundation of Indonesian development trust fund actually has already crystalized prior to the enactment of regulation regarding development trust fund in 2011. It is created from the government's experience with various multi-donor trust funds ranging from large multi-donor trust funds to quite small and ad hoc trust funds to support very specific government's activities. However, the current regulation is still absent from some substantial provisions regarding the legal status, and provisions related to good and accountable governance of Indonesian development trust funds. The lack of substantial provisions of the development trust fund has created some problems in the operational level such as an uncertain legal status, inadequate governance procedure, lack of efficiency and accountability of the organization's activity.

This work has made clear that the government of Indonesia should amend the current trust fund regulation in order to make the development trust fund operated more accountable, effective, and efficient.

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