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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

PROJECT PAPER

FINANCIAL INSTITUTIONS DEVELOPMENT

497-0341

JUNE 1986

USAID/INDONESIA

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT DATA SHEET	1. TRANSACTION CODE <input checked="" type="checkbox"/> A = Add <input type="checkbox"/> C = Change <input type="checkbox"/> D = Delete	Amendment Number <u>1</u>	DOCUMENT CODE <u>3</u>
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2. COUNTRY/ENTITY Indonesia	3. PROJECT NUMBER <u>497-0341</u>
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4. BUREAU/OFFICE ANE	5. PROJECT TITLE (maximum 40 characters) <u>Financial Institutions Development</u>
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6. PROJECT ASSISTANCE COMPLETION DATE (PACD) MM DD YY <u>05/31/91</u>	7. ESTIMATED DATE OF OBLIGATION (Under "B" below, enter 1, 2, 3, or 4) A. Initial FY <u>84</u> B. Quarter <u>3</u> C. Final FY <u>87</u>
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8. COSTS (\$000 OR EQUIVALENT \$1 = Rp 1,120)						
A. FUNDING SOURCE	FIRST FY <u>84</u>			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total	10,970	5,530	16,500	19,820	6,580	28,500
(Grant)	(1,000)	(-)	(1,000)	(7,250)	(-)	(7,250)
(Loan)	(9,970)	(5,530)	(15,500)	(12,570)	(8,680)	(21,250)
Other U.S.						
1.						
2.						
Host Country	-	1,500	1,500	2,000	15,250	17,250
Other Donor(s)						
TOTALS	10,790	7,030	18,000	21,820	23,930	45,750

9. SCHEDULE OF AID FUNDING (\$000)									
A. APPRO- PRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) FN	240B	240	240	3,000	15,500	4,250	5,750	7,250	21,250
(2)									
(3)									
(4)									
TOTALS									

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)	11. SECONDARY PURPOSE CODE
12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)	
A. Code	
B. Amount	

13. PROJECT PURPOSE (maximum 480 characters).

(1) To support the development of existing local rural credit systems that provide financial intermediation for village residents at reasonable cost, (2) to produce loan portfolios of employment generating activities, primarily off-farm and (3) to promote savings mobilisation programs.

14. SCHEDULED EVALUATIONS Interim MM YY MM YY Final MM YY <u>01 88</u> <u>01 90</u>	15. SOURCE/ORIGIN OF GOODS AND SERVICES <input checked="" type="checkbox"/> 000 <input checked="" type="checkbox"/> 941 <input type="checkbox"/> Local <input type="checkbox"/> Other (Specify)
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16. AMENDMENTS/NATURE OF CHANGE PROPOSED. (This is page 1 of a _____ page PP Amendment.)

This Amendment adds a training, policy and research activity to help develop the Bank Rakyat Indonesia rural banking system. The original PP provided for similar assistance to village credit units supervised by provincial development banks in three rural provinces.

17. APPROVED BY	Signature <u>William P. Fuller</u> Title Director USAID/Indonesia	18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION Date Signed MM DD YY <u>06 06 86</u>
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PROJECT AUTHORIZATION AMENDMENT NO. 1

INDONESIA

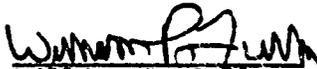
FINANCIAL INSTITUTIONS
DEVELOPMENT PROJECT
PROJECT NO. 497-0341

1. Pursuant to Section 103 of the Foreign Assistance Act of 1961, as amended, the Financial Institutions Development Project for Indonesia was authorized on May 23, 1984. That Authorization is hereby amended as follows:

Paragraph 1 is amended to authorize up to \$27,250,000 in Loan funds and up to \$7,250,000 in grant funds, and total Life of Project funding of up to \$28,500,000. The additional funding provided herein is authorized for obligation through September 30, 1987, subject to the availability of funds in accordance with the A.I.D. OYB/Allotment process. The Project Assistance Completion Date, May 31, 1991, remains unchanged.

2. The authorization cited above remains in full force and effect except as hereby amended.

3. Prior to the execution of the Project Agreement Amendments the Congressional Notification waiting period shall have expired without objection and USAID/Jakarta shall have received a cable notification that funds have been allotted.

Signature 
William P. Fuller

Clearances: EED:DMyers 
PRO:DZvinakis 
FIN:RMcClure 
A/DD:JSperling 
Drafted: LA:GBisson  5/29/86

FINANCIAL INSTITUTIONS DEVELOPMENT AMENDMENT

Project No. 497-0341

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GLOSSARY OF TERMS

BI	Bank Indonesia, the Central Bank for the GOI.
BIMAS	A GOI fertilizer and rice subsidy program administered by the Unit lesa until 1983.
BKK	Badan kredit Kecamatan, a system of village credit units in Central Java, supervised by the provincial development bank and supported under the original FID Project.
BFD	Bank Pembangunan daerah, or provincial development bank. There are 27 in Indonesia, three of which are receiving support for developing village credit systems under the original FID Project.
BRI	Bank Rakyat Indonesia, one of five large GOI state banks, and the target institution of this Amendment.
BULOG	The GOI Bureau of Logistics.
Cabang	District (Kabupaten) branches of the BRI.
CPIS	Center for Policy and Implementation Studies, a research group formerly under the Ministry of Finance and now under University of Indonesia.
FAR	Fixed Amount Reimbursement.
FID	The Financial Institutions Development Project, AID Project No. 497-C341
GOI	The Government of Indonesia.
HIID	The Harvard Institute for International Development.
kabupaten	The district-level unit of Indonesia's provincial government system.
Kantor Wilayah	The regional, or provincial, branch offices of BRI.
kaudes	Kepala Unit Desa, the head officer of an individual Unit lesa.
Kecamatan	The sub-district unit of Indonesia's provincial government system.
KIK/KMKK	Kredit Investasi kecil/Kredit Modal kerja Permanen, both GOI-sponsored nationwide small loan programs aimed at developing small businesses.

Kredit Midi (MIDI)	A BRI-sponsored medium-sized loan program, now being phased out.
Kredit Mini (MINI)	A BRI-sponsored small loan program, now being phased out.
Kupedes	Kredit Umum Pedesaan, a small loan program initiated in 1984 by BRI and a major focus of this Amendment.
Mantri	A loan officer.
MOF	Ministry of Finance, the official representative of the GOI for this Amendment.
SEDF	Small Enterprise Development Project, A World Bank - financed project to help develop the KIK/KMKP programs.
Simpedes	Simpanan Pedesaan, a BRI-sponsored savings mobilization program, and a major focus of this Amendment.
Tabanas	An on-going nationwide GOI-sponsored savings program also promoted through BRI branch offices.
Unit Desa	The sub-district (Kecamatan) branch offices of BRI, these being the primary institutional focus of this Amendment.
USAID	The United States Agency for International Development Mission in Jakarta, Indonesia.

I. SUMMARY

This \$18.0 million Amendment to the Financial Institutions Development (FID) Project is designed to support policy and institutional development of the Bank Rakyat Indonesia (BRI) Kecamatan - level (sub-district) Unit Desa system. Under this Amendment, which complements the original \$27.8 million FID effort to strengthen village-based credit systems, training funds, technical assistance, commodities and regional training facilities will be provided to help initiate a formal training program for 13,000 Unit Desa employees and to improve the policy and operating environment of the Unit Desa to meet the growing demand for free-market financial services at the Kecamatan level. In addition a major rural finance research and reporting system will be established. Activities funded under the Amendment will be implemented by BRI under the guidance of the Ministry of Finance.

II. PROJECT OVERVIEW AND RATIONALE

The FID Project is based on two premises: 1) that efficient transferring of capital to the private rural economy will spur growth and development, and 2) that capital can be generated on a self-sustaining basis within Indonesia in four ways:

- 1) Create debt, e.g. lend against future earnings or other assets;
- 2) Mobilize idle or underutilized cash or other financial assets;
- 3) Improve financial intermediation, e.g. make it cheaper, simpler, more convenient to borrow, save, invest and move money; and,
- 4) Reform pricing and prerequisites for borrowed capital to ensure money is lent at break-even interest rates or above to customers providing a reasonable probability of repayment.

Both the original FID Project and this Amendment will provide institutional development assistance to improve performance of specific institutions in the four ways noted above. To understand the role of the project we will first present an overview of the banking and finance sector in Indonesia (Section A), the USAID plan within this sector (Section B), our rationale for selecting BRI for this Amendment (Section C), the current status of BRI and its Unit Desa system (Section D), and how our assistance relates to other donor assistance in this sector (Section E).

A. Indonesian Banking and Finance

The Indonesian banking and finance sector consists of Bank Indonesia (the central bank); five large state commercial banks (including BRI); 69 private local banks; 11 foreign banks; 31 development banks (of which 27 are the regional development banks (BPDs) in each province); 141 insurance, leasing and non-bank financial institutions; and over 6,000 rural banks and pawnshops (including BKK-type credit units and Bank Pasars). Below is a summary of the number and asset base of these institutions.

TABLE 2.1: GROSS ASSETS OF THE INDONESIAN FINANCIAL SYSTEM, DECEMBER 1984

<u>Type of Institution</u>	<u>No.</u>	<u>Assets Rp. billion</u>	<u>Share of Assets (%)</u>	<u>Growth of Assets 1977-1984 (% p.a.)</u>
Bank Indonesia	1	21,618	41.8	29.4
State commercial banks	5	19,241	37.3	n.a.
Private foreign exchange banks	10	2,393	4.6	n.a.
Foreign banks	11	2,192	4.2	31.7
Other commercial banks	59	1,666	3.1	35.6
Development banks	28	2,276	4.4	34.5
Rural and savings banks	5,826	18	..	n.a.
Non-bank financial institutions	14	1,327	2.6	39.8
Insurance companies	89	597	1.2	n.a.
Leasing companies	38	386	0.7	n.a.
State pawnshops	474	59	0.1	20.5
Total	6,556	51,773	100.0	29.1

Source: World Bank Report No. 5501-IND, July 10, 1985

Despite the large number of financial institutions, Indonesia's financial system is still very shallow. The total value of money plus negotiable financial notes in the Indonesian banking system is less than 10 percent of GDP, versus 58 percent in Malaysia and 50 percent in Thailand. Within Indonesia's limited banking system, time and savings deposits represent only 66 percent of total deposits, the rest being demand deposits such as GGI savings and foreign exchange reserves. Since the Indonesian banking system is concentrated in major urban centers, the rural financial system is even more shallow than the system as a whole.

Should Indonesia be successful in "monetizing" 40-60 percent of its GDP, the near-term potential of strengthening financial institutions and markets would then amount to a three to six-fold expansion of the banking and finance system, or a \$100-200 billion dollar expansion. (Such an expansion is not unrealistic considering the recent 30 percent per annum growth of the banking system.) Given that rural Indonesia presently accounts for 78 percent of the population and approximately 50 percent of the GDP, the rural financial system is potentially the major beneficiary of any such expansion.

The roles and prospects of the various institutions within the finance sector follows. Also see Tables 2.2 and 2.3 which set forth some comparative statistics of all national banks at the end of 1983.

Bank Indonesia (BI) plays a dominant role in Indonesian banking and finance both in terms of policy and financial impact. With respect to its policy role, BI has primary responsibility for the supervision of all commercial, development, savings and rural banks. As such BI determines the posture of the entire banking sector. Financially, Bank Indonesia acts

as the Government of Indonesia bank, receiving funds from central government in the form of foreign exchange reserves, government savings and newly printed money. BI also holds deposits from state banks and non-banks (individuals included). The most influential of these deposits are government savings and new money, for BI uses these funds to provide liquidity credits to other banks. In fact, BI provides approximately 50 percent of all domestic credit in Indonesia in an average year. Thus, despite its status as a government bank, BI is the primary source of funds for the private sector, providing 30 percent of total private sector credit and nearly 60 percent of long-term private sector credit. BI credits are also made available directly to public enterprises and government organizations, but the GOI is gradually reducing the amount available for such credits. In the long run BI will play an increasingly important role in financial and monetary policy formulation and bank supervision, and a smaller but significant role in direct banking activities as well.

State Banks consist of five large institutions controlling approximately 37 percent of Indonesia's bank assets. Formerly Dutch-owned commercial banks, these five banks have operated since independence as the GOI administrators of specific sectoral programs. The general division of responsibility has been Bank Bumi Daya -- plantation crop finance; Bank Dagang Negara -- trade finance; Bank Ekspor Impor Indonesia -- export credits; Bank Negara Indonesia 1946 -- industrial finance; and Bank Rakyat Indonesia -- agriculture, fisheries and cooperatives credit. While the diversification of GOI programs and growing commercial portfolios of these banks has blurred their sectoral distinction, each bank still carries out their original mandate, especially by sponsoring large GOI sectoral programs which frequently involve substantial GOI subsidies. A summary of the type and projected size of major GOI programs to be channeled through state banks through FY89 is presented in Table 2.4. It is noteworthy that credit subsidies set forth in this Table could be reduced dramatically if program interest rates were raised by the GOI.

TABLE 2.4: PROJECTED BANK INDONESIA SUBSIDIZED NEW CREDITS BY PROGRAM
THRU FY 88/89* (Rp. billion)

<u>Program (Bank)</u>	<u>FY85/86</u>	<u>FY86/87</u>	<u>FY87/88</u>	<u>FY88/89</u>	<u>Total</u> <u>FY85/86-FY88/89</u>
Estate Crops (Bumi Daya)	6	25	45	66	112
Housing (BTN)	11	25	41	60	137
KIK/KMKP (All, esp. BRI)	8	23	43	62	136
BULOG (BRI)	187	187	185	181	740
Export Credits (BDN, EXIM)	6	10	15	18	49
Other Priority (All)	6	21	35	45	107
TOTAL	223	291	363	432	1,279

* Excludes budgetary transfers and direct credit subsidies. Source: World Bank Report No. 5501-IND, July 10, 1985.

TABLE 2.2
NUMBER OF EMPLOYEES AND NET PROFIT OF BANKING
AS OF DECEMBER, 1983

NAME OF BANKS	NO OF EMPLOYEES	TOTAL PROFIT (in billions of rupiahs)
- State Commercial Banks		
Bank Bumi Daya	6,830	35.5
Bank Dagang Negara	6,648	113.0
Bank Ekspor Impor Indonesia	4,209	59.2
Bank Negara Indonesia 1946	11,960	78.9
Bank Rakyat Indonesia	31,777	26.6
- Private National Foreign Exchange Banks		
Bank Bali	338	1.6
Bank Central Asia	2,102	10.9
Bank Umum Nasional	857	-
Bank Buana Indonesia	1,293	4.0
Bank Dagang Nasional Indonesia	538	3.3
Bank Duta Ekonomi	616	8.1
Bank Niaga	736	5.3
Overseas Express Bank	922	2.1
Bank Pacific	514	1.0
Pan Indonesia Bank	1,535	-
- Private National Non Foreign Exchange Banks		
Bank Nilai Inti Sari Penyimpan	380	1.2
United City Bank	264	0.7
Bank Agung Asia	532	1.0
Sejahtera Bank Umum	457	2.4
Bank Arta Pusara	355	2.1
Bank International Indonesia	388	-
Bank Central Dagang	128	-
Bank Perniagaan Indonesia	352	0.6
South East Asia Bank	258	0.3
Bank Rama	484	0.6

Source: Bank Bumi Daya

TABLE 2.3

COMPARATIVE STATEMENT OF TOTAL ASSETS

(in Billions of Rupiahs)

NAME OF BANKS	1983		1982		CHANGES	
	Rp.	%	Rp.	%	Rp.	%
STATE COMMERCIAL BANKS						
Bank Bumi Daya	3,467.3	19.74	2,837.7	21.82	+ 629.6	+ 22.19
Bank Dagang Negara	4,082.5	23.25	2,896.3	22.27	+ 1,186.2	+ 40.96
Bank Ekspor Impor Indonesia	2,050.5	11.68	1,555.9	11.96	+ 494.6	+ 31.79
Bank Negara Indonesia 1946	4,955.3	28.22	3,222.4	24.80	+ 1,730.9	+ 53.68
Bank Rakyat Indonesia	3,004.4	17.11	2,489.7	19.15	+ 514.7	+ 20.67
TOTAL	17,560.0	100.00	13,004.0	100.00	+ 4,556.0	+ 35.04
PRIVATE NATIONAL FOREIGN EXCHANGE BANKS						
Bank Bali	180.5	9.20	100.8	9.43	+ 79.7	+ 79.07
Bank Central Asia	393.5	20.05	246.8	20.65	+ 146.7	+ 59.44
Bank Umum Nasional	172.7	8.80	123.0	10.29	+ 49.7	+ 40.41
Bank Buana Indonesia	157.2	8.01	96.0	8.03	+ 61.2	+ 63.75
Bank Dagang Nasional Indonesia	198.6	5.53	60.1	5.03	+ 48.5	+ 80.70
Bank Duta Ekonomi	269.4	13.73	140.2	11.73	+ 129.2	+ 92.15
Bank Niaga	186.7	9.66	104.8	8.77	+ 84.9	+ 81.01
Overseas Express Bank	98.3	5.01	70.6	5.91	+ 27.7	+ 39.24
Bank Pacific	81.8	4.17	50.1	4.19	+ 31.7	+ 63.27
Pan Indonesia Bank	310.9	15.84	202.8	16.97	+ 108.1	+ 53.30
TOTAL	1,962.6	100.00	1,195.2	100.00	+ 767.4	+ 64.21
PRIVATE NATIONAL NON FOREIGN EXCHANGE BANKS						
Bank Nilai Inti Sari Penyimpan	62.4	10.93	44.8	14.97	+ 17.6	+ 39.29
United City Bank	45.3	7.94	36.1	12.06	+ 9.2	+ 25.48
Bank Agung Asia	55.6	9.74	39.9	13.33	+ 15.7	+ 39.35
Sejahtera Bank Umum	61.1	10.71	35.6	11.89	+ 25.5	+ 71.63
Bank Arta Pusara	50.6	8.87	36.3	12.13	+ 14.3	+ 39.39
Bank International Indonesia	102.3	17.92	24.0	8.02	+ 78.3	+ 326.25
Bank Central Dagang	26.3	4.61	12.7	4.24	+ 13.6	+ 107.09
Bank Perniagaan Indonesia	113.2	19.84	30.4	10.16	+ 82.8	+ 273.37
South East Asia Bank	24.4	4.28	19.7	6.58	+ 4.7	+ 23.86
Bank Rama	29.5	5.17	19.8	6.62	+ 9.7	+ 48.99
TOTAL	570.7	100.00	299.3	100.00	+ 271.4	+ 90.68
FOREIGN BANKS						
Algemene Bank Nederland	71.8	3.98	58.2	4.65	+ 13.6	+ 23.37
American Express International Banking	108.1	5.99	55.1	4.40	+ 53.0	+ 96.19
Bangkok Bank	70.8	3.92	56.7	4.53	+ 14.1	+ 24.87
Bank of America	224.8	12.45	123.0	9.83	+ 101.8	+ 82.76
Bank of Tokyo	265.5	14.71	168.1	13.43	+ 97.4	+ 57.94
Citibank	460.4	25.51	338.3	27.02	+ 122.1	+ 36.09
The Chartered Bank	44.6	2.47	33.7	2.69	+ 10.9	+ 32.34
The Chase Manhattan Bank	181.7	10.07	149.7	11.96	+ 32.0	+ 21.38
European Asian Bank	176.8	9.80	119.6	9.56	+ 57.2	+ 47.83
Bank Perdanía	120.1	6.65	91.4	7.30	+ 28.7	+ 31.40
The Hongkong and Shanghai Banking	80.4	4.45	57.9	4.63	+ 22.5	+ 38.86
TOTAL	1,805.0	100.00	1,251.7	100.00	+ 553.3	+ 44.20

Source: Bank Bumi Daya

While subsidized programs will likely continue, they will comprise an increasingly smaller portion of state bank portfolios. This reduction of subsidies was hastened by the 1983 banking reforms which encouraged free-market competition within the state banking system by removing interest rate and credit ceilings. Bank Negara Indonesia 1946 and Bank Dagang Negara, with their comparatively larger asset base and traditionally more commercial clientele, have been most successful in shifting toward free-market competitive financial services. BRI, with its large staff, rural focus, and large portfolio of GOI programs, has faced more difficulty in restructuring its lending strategy but is firmly committed to change.

While the state banks remain a major force in the credit market, to date they have had a relatively minor role in resource mobilization. Low interest liquidity credits from BI eliminated the incentive to accumulate deposits from the private sector. But the 1983 banking reforms limited the scope for general liquidity credits and deregulated interest rates, so state banks have recently become more active in private resource mobilization.

One of the state banks' greatest challenges is to reduce their cost of financial intermediation. Intermediation costs for state banks, which include administrative costs, write-offs and other provisions, now average 7-8 percent of a loan, compared to 2-3 percent in most developed countries. These high costs are largely a result of overstaffing, large loan write-offs, small average loan size, and a low degree of automation.

Private Banks account for approximately 12 percent of total bank assets, with 4 percent under foreign banks. Private banks represent the fastest growing segment of deposit money banks, having aggressively expanded their share of total bank credits to approximately 16 percent. Private banks also account for almost 30 percent of all time and savings deposits as can be seen in Table 2.5 below.

TABLE 2.5: RUPIAH TIME DEPOSITS BY BANK GROUP (Rp. billion)

<u>Year</u>	<u>State Banks</u>	<u>National Private Banks</u>	<u>Local Development Banks</u>	<u>Foreign Banks</u>	<u>Total</u>
1976	652	56	4	50	762
1977	737	77	5	76	895
1978	765	87	6	73	931
1979	775	123	7	86	991
1980	903	209	10	157	1.279
1981	1.093	382	19	260	1.754
1982	1.231	572	35	360	2.198
1983	2.831	1.078	56	476	4.441
1984	3.497	1.750	79	696	6.022
1985	5.439	2.747	117	660	8.963

Source: Weekly Report, No. 1397, Bank Indonesia (13 February 1986)

Despite the rapid growth and profitability of private banks, they still operate almost exclusively in the urban market. The private banks, which tend to be more efficient than the state bank and have lower intermediation costs, have so far been able to concentrate on high-margin low-risk accounts, particularly short-term working capital loans to major customers. At the end of 1985, for instance, the manufacturing, trade and services sectors accounted for 99 percent of private bank credits, whereas agriculture comprised the remaining one percent. As competition in the financial sector increases and the GOI further implements its deregulation of banking, private banks should develop more diversified portfolios and expand into the rural areas.

Development banks, consisting of the 27 provincial BPDs, and four national banks -- BAPINDO, UPPINDO, PDFCI and P.T. Bahana, constitute a fast-growing but limited segment of the finance sector. These banks focus predominantly on project financing for business ventures and regional governments, in addition to participating in GOI programs such as KIK/KMKP. While the development banks have a lower average cost of intermediation than state banks, they are hampered by a relatively high cost of funds from commercial markets due to their limited and riskier client market.

The provincial BPD network offers great promise for rural financial growth, especially as a coordinator for BKK-type efforts. However, the financial health of the BPDs themselves needs to be strengthened to help sustain such a coordinating role. As FID progresses we will be examining the case for some form of national consolidation among the BPDs to improve their financial base.

Non-bank financial institutions and insurance companies comprise a relatively new and growing segment of the financial sector. Non-banks will play an increasingly important role in providing long-term finance for rural areas, especially for housing and other real estate, capital investment and long-term savings through insurance. Most of these institutions, however, specialize within a limited market, and are therefore outside the scope of FID.

B. USAID Rural Finance Objectives and Plan ^{1/}

The USAID long-term objectives in Financial Institutions Development are 1) to help create a regulatory and policy environment conducive to development of a comprehensive open-market rural banking and finance system; and 2) to demonstrate the feasibility and benefits of such a system by supporting selected institutions or programs within each segment of the formal rural finance market. In order to characterize the

^{1/} Note the definition of "rural" throughout this Paper includes provincial cities and towns. While they might otherwise be considered "urban", we include them in our target areas because of the currently underdeveloped nature of financial institutions at this level.

rural finance system, we have divided the market into four levels based on geographic and institutional coverage. That is, we assume there exists a general correlation between the typical location of a branch facility, e.g. village, Kecamatan, Kabupaten or major provincial urban center, and the nature of the market for services at that geographic level with respect to type of and demand for credit and savings, and the mobility and financial condition of the typical customer.

The four levels listed below comprise what USAID considers as a minimum base for inclusion in FID, upon which a rural banking and finance system can be developed in Indonesia:

<u>Tier</u>	<u>Geographic Focus</u>	<u>Type of Program</u>	<u>Average Loan Size (and Range)</u>	<u>General Features</u>
I	Village	BKK-Type	\$50 (\$20-\$200)	No Collateral, 40-65% interest, savings limited
II	Kecamatan	Unit Desa (Kupedes/ Simpedes)	\$350 (\$100-\$2000)	Collateral, 30% interest, aggressive public savings program
III	Kabupaten	KIK/RMKP	\$3000 (\$2000-\$25,000)	Collateral, 12% interest, no savings provision
IV	Provincial Cities	Private Banks	(\$5000 and up)	Collateral, 20-25% interest, various savings schemes

The general parameters separating these tiers, and USAID's goals within each tier, are as follows:

1. BKK-type programs have proven to be the primary type of formal program able to penetrate the village level because of three basic characteristics. These are 1) the simplicity of the program — little paperwork, no collateral, reliance on local social pressure for repayment; 2) a post system operating at village markets which compensates for the limited mobility of most villagers; and 3) the willingness of borrowers to pay the high interest rates necessary to cover expenses for such a program. The BKK programs so far are predominantly loan-driven programs, with savings open only to borrowers. The success of the lending programs indicates the shortage of cash is constraining income generation for a very large portion of rural households. (This is further demonstrated by the thriving informal lending market, characterized by extremely high interest rates, which actively competes at the BKK village level and above). As long as this condition persists, which appears to be for the foreseeable future

lending-based EKK-programs with comparatively high interest rates will play an important financial role in Indonesian development. EKK-type savings programs, once further developed, should also play an increasingly important role.

Our current goals are to integrate and improve the EKK systems in our initial three target provinces (Central Java, West Java and West Sumatera), and to help extend the programs to provinces where none currently exist. We therefore anticipate expanding the original FID/EKK program to three additional provinces in FY 87. In the longer term, USAID plans to support financial and technical assistance coordination between the various provincial BPD's, at least with respect to their EKK-type programs, in order to promote new programs in the many provinces with weak BPDs. This last phase will largely be a GOI-assisted national effort relying on the transfer of experience gained by the BPDs and village units in the six initial FID provinces. This national consolidation of village units through the BPD network will then allow for more aggressive and secure nationwide savings mobilization at the village level.

2. The BRI Unit Desa system originated during the recent era of subsidized rural credit programs, specifically BIMAS. By preserving the tremendous investment left in place, e.g. the Unit Desa buildings, organization and personnel idled when the GOI recently phased out BIMAS, BRI has created a unique opportunity to operate profitably a full-service open market banking operation at the Kecamatan (sub-district) level.

The parameters of Unit Desa programs are established at the lower end by the Kupedes (the BRI general rural credit program) minimum loan size, collateral and paperwork requirements, which exceed EKK levels, and the distance from most villages to the Kecamatan-based Unit Desa. The upper end parameters, separating Kupedes from the KIK/KMKP levels, are established again by the long distance from most Unit Desa offices to Kabupaten centers, by the good service record of the Unit Desas, and by the minimum loan size of the KIK/KMKP level programs. Unlike the EKK-type programs, the large volume, country-wide coverage of the Unit Desa system and the large asset base offered by BRI's sponsorship means there is a tremendous savings mobilization role already in place for Simpedes (the BRI general savings program). The potential also exists for providing other banking services at the Kecamatan-level, such as money transfers, check-writing, savings instruments, etc.

Given this opportunity to take advantage of the solid Unit Desa foundation, USAID's plan is quite short-term and specific. We want to ensure that the policy base established at this critical juncture in Unit Desa development is economically sound and development-oriented, and that the training and procedures for this rural bank system are in place and of good quality. In the longer run these efforts and BRI's market-oriented management should result in BRI being able to operate effectively at the Unit Desa level without additional donor assistance.

3. KIK/KMKP programs are GOI subsidized (12% interest to borrower) nationwide loan programs for small investments (KIK) and working capital (KMKP). These two programs are characterized as Kabupaten programs

since they primarily disburse through state bank Kabupaten branches, as well as a limited number of private banks which have Kabupaten-level branches. The lower end parameters of the program are established by the average long distance to such branch bank facilities, and by an effective minimum loan size of \$ 2,000. The upper end parameters are open, primarily because the current 12% subsidized interest rate often attracts borrowers who would otherwise use normal commercial channels, and because KIK/KMKP programs are also sponsored by urban banks throughout Indonesia. Nevertheless, since KIK/KMKP is the major credit package currently available at the rural Kabupaten level, and since the \$ 25,000 maximum loan size somewhat restricts its urban market, we believe the KIK/KMKP is still a well defined and important entry into the Kabupaten level of the rural banking system.

Our primary plan at this KIK/KMKP level will be to promote market interest rates. Since these programs are small business oriented, we would also like to experiment with small-business management training and development packages to be offered to borrowers. Because there is no single institutional home for these programs, but rather they are implemented by almost all state and private banks operating in the provinces, we plan to focus on policy development at the national level, most likely through Bank Indonesia, BRI and Ministry of Finance, and on institution-building efforts offered through centralized training for all banks interested in improving their KIK/KMKP programs. We would anticipate starting this effort in FY 88, at which time a significant amount of evaluation results should be available from the World Bank financed SEDP Project (see Section E) and from our initial village and Unit Desa efforts.

4. Private commercial bank programs have been designated as provincial level because this is currently as far down as private banks penetrate in the rural areas. The relative absence of private rural banking is partly explained by the high opportunity cost of establishing a presence at lower levels, especially given the currently underdeveloped financial state of rural Indonesia. The lower end is also limited because of competition from subsidized credit programs, and by legal restrictions on establishment of new branch offices. The upper parameters for private banks are obviously unlimited, although our plan is to focus on banks who express a special interest in rural banking.

In part our support of private banking in rural areas is ongoing. USAID assistance under FID and PDP programs have already had a major impact on GOI interest rate and savings mobilization policies. We are also confident that the monetization of village economies at the BKK-level, the experience provided to both customers and the banking community concerning the success and benefits of Unit Desa rural banking programs, and the gradual reduction of credit subsidies in KIK/KMKP-type programs, will all expand the future role of private banks in rural Indonesia.

The other facet of our plan is to actively pursue further deregulation of rural banking through the central government, as needed to promote private banks. Since such activities would involve the same

institutions we would deal with on the KIK/KMKP programs, e.g. Bank Indonesia and the Ministry of Finance, we may well decide these efforts should proceed as one activity. Preliminary work on important policy issues relating to private banking is already proceeding through U.S. Federal Reserve Board assistance we are providing to Bank Indonesia. USAID also hopes to benefit from lessons learned under the ongoing PRE assistance to two private Indonesian banks — Overseas Express Bank and Bank Niaga.

Below is a summary of the long-term USAID rural banking plan. We have used the term "FID I, II, III and IV", to represent efforts within the above-described four levels of rural banking, FID II being this Amendment.

<u>Project</u>	<u>Program/Institution</u>	<u>Description</u>	<u>Time Frame</u>
FID I	a) BKK-type in Central Java, West Java, West Sumatera	Institutional develop- ment within 3 Provinces for both village units and BPDs	FY 85-90
	b) BKK-type in East Java, South Kalimantan and Bali	Institutional development in 3 additional provinces	FY 87-92
	c) BKK-type Nationwide	Focus on BPD integration at national level	FY 89-94
FID II	BRI Unit Desas	Training and institutional development for nationwide rural banking operations	FY 86-90
FID III	KIK-KMKP	Policy guidance and central training to reduce subsidy, expand services	FY 88-91
FID IV	Private Commercial Banks	Policy assistance to central government	FY 86-91

C. Public vs. Private Banks — Rationale for BRI Selection

Given our expressed desire to promote open market banking in Indonesia, it is important to explicitly review our rationale for selecting BRI, a state bank, rather than a private bank, for this Amendment activity. The rationale is as follows:

1. Timing and Risk -- Given the tremendous idled capacity of the Unit Desa system after termination of the BIMAS program, BRI Management had to make some very quick and decisive moves to redirect these resources, or else lose the system or suffer large losses. The bold and innovative decisions reached by BRI management, representing a major shift toward self-financing, service-oriented banking, are being put to test right now. Thus our primary rationale for the selection of the BRI Unit Desa system is timing, e.g. this opportunity to effect significant policy changes in one of the most important financial institutions in Indonesia. Our support will not only promote the trend toward open market banking, but will also emphasize the high priority which private sector resource mobilization should receive at this time when GOI resources are under severe pressure.

At the same time, the fact that no national private bank in Indonesia has yet established a branch at the Kecamatan level means the potential for near term significant resource mobilization through private banks at the Unit Desa level is nil.^{1/} Nor does the risk and expense of trying to promote one or more new private bank entries at the Unit Desa level appear justified now. The Unit Desa staff, for example, is presently seven times larger than the total staff of the largest private bank operating in Indonesia, with the ratio of assets being even higher. Furthermore, the Unit Desa average loan size of \$350 is far below the current \$5,000 minimum loan level of most private banks. These points are made to emphasize that the Kecamatan-level small loan and savings programs are very staff-intensive, representing high costs and risk for private banks. In addition, the credit histories for most participants in the Unit Desa portfolio are minimal, highlighting the experimental nature of the new Unit Desa programs. In short, while BRI can afford to take some risks given its sunk cost in the Unit Desa, its large asset base, and the GOI as its ultimate guarantor, private banks currently do not have the motivation to enter such a staff-intensive, high volume, high risk segment of the market.

2. Market Development -- While acknowledging the currently unfavorable conditions for Kecamatan-level private banking, we should note that the success of Unit Desa efforts would offer considerable market development promise for rural private banking by reducing the risk and broadening the market. Specifically, Unit Desa programs will:

- a. Provide invaluable education to the rural public on the procedures and benefits of banking;
- b. Help establish credit histories which would reduce risk to future entrants in this field; and
- c. Stimulate demand for larger loans as people move up the financial ladder, and for tie-in services in such areas as fund transfers, checking, etc.

^{1/} Bank Central Asia currently has the largest rural presence among private banks with only 5 branches at the Kabupaten (district) level.

3. BRI Structure -- Even though it is classified as a state bank, BRI possesses many attributes of a private bank. In particular:
- a. GOI regulations allow BRI to retain 55 percent of all after-tax profits;
 - b. BRI has moved decisively to eliminate subsidized programs and rationalize interest rates with respect to cost of business and profit targets; and,
 - c. The Unit Desas have been established as independent profit centers, with employee financial incentives based on the profitable operation of each individual unit.

In conclusion BRI offers not only a good opportunity, but the only opportunity, to open up the large Kecamatan-level rural banking market at this time. While we would have preferred a situation in which this market initially could be served directly through private banks, we are confident that the open market character of BRI operations will not adversely impact private banks in the short run, and that the Unit Desa programs will actually promote private sector banking in the long run.

D. Background and Current Status of BRI

BRI claims to be the second largest bank in the world based on its 31,000 employees and 2,700 branch and Unit Desa offices (the largest being in India). Certainly it is the largest in Indonesia, and given its charter to provide financial services for rural development, the most important rural financial institution. BRI history dates back to 1898 with the establishment of the Volksbanken, or people's bank. This Dutch-owned bank developed branches throughout Indonesia, and after several changes and crises became known as Algemene Volkscredietbank (AVB). After independence AVB was merged with a local bank, Bank Rakyat Indonesia, BRI assuming responsibility for the combined BRI/AVB operations.

Between 1950 and 1967 there was considerable integration and turf-fighting among the major Indonesian banks, with BRI, Bank Sentral and BNI 1946 being the main actors. By 1968, Bank Sentral was assigned the current role of Bank Indonesia, and BRI, which had grown even larger through a merger with Bank Koperasi, Tani dan Nelayan (BKTN), was split in two -- BRI becoming the official GOI bank for cooperatives, agriculture and fisheries (from the BKTN role), and Bank Export-Import being created from the former export and commercial sections of BRI.

BRI has since expanded to become a bank with over \$5 billion in assets, with a branch network consisting of 15 regional, 270 district and 2,443 Unit Desa offices. It ranks as the third largest bank in Indonesia (excluding BI) with respect to assets, having grown at slightly faster than the 30 percent bank industry average over the last three years. Its recent growth can be attributed to the rapid expansion of Kupedes, commercial lending and import-export credits, in addition to its steady income earned from channelling GOI priority credits such as for BULOG. The BRI 1985 balance sheet and earnings statement may be found in Section V, Financial and Economic Analysis.

While the 1983 banking reforms have considerably reduced GOI and BI direct control over state bank operations, many important ties remain. The primary relationships between BRI and the GOI/BI are set forth in the BRI charter legislation (see Appendix D). Briefly, these are:

- 1) BRI is expected to maintain its rural development focus and implement priority rural finance programs on behalf of the GOI. To the extent BI can make low interest liquidity credits available for such priority programs, the BRI will generally pass these subsidies on to the public. KIK/KMKP is the major program in BRI now receiving such priority liquidity credits.
- 2) BRI acts as a channelling agent for a large percentage of GOI funding for rural areas. This includes all local government project monies (INPRES) and the major rice and sugar procurement programs under BULOG. Most of these functions are handled through BRI cabang (sub-district) offices rather than the Unit Desa.
- 3) BRI supervises all rural banks (but not non-bank EKK-type institutions which are supervised by the BPDs) and reports to Bank Indonesia annually on their condition.
- 4) Any policy or operational changes within BRI must be approved by BI and Ministry of Finance.
- 5) The GOI receives 45 percent of annual after-tax profits earned by BRI. The remaining 55 percent is retained by the BRI.

The BRI Board of Directors, who are responsible for operations of the bank, consists of a chairman and four directors. The four directors share responsibility for the oversight of seventeen functional departments. Approximately 1,500 of the 32,000 staff are in the Jakarta central office. The Unit Desa staff comprises about 40 percent, the largest segment of personnel. All facets of the BRI organizational structure are under review and may soon be revised in order to improve management and operations.

The BRI Unit Desa System ^{1/}

The BRI Unit Desa were first conceived in 1969 as a pilot project in Yogyakarta to channel BIMAS credit to farmers, with the overall objective of increasing national food production. On the basis of this experiment's success, the BRI Unit Desa system was expanded into a national program. As BRI Unit Desas' primary function was servicing BIMAS borrowers, they were established on the basis of rice fields they could cover from a given location. On Java, one BRI Unit Desa was established per 600 to 1,000 hectares of rice fields, while off Java, the standard was one BRI unit Desa per 1,200 to 2,000 hectares of rice fields.

^{1/} Transcribed from "Upgrading the BRI Unit Desa Management Information System", a USAID-financed report by Jay Rosengard, Development Alternatives, Inc., 15 May 1985.

In 1973 BRI Unit Desa also received a general mandate to extend non-BIMAS credit, and to mobilize rural savings as future developments warranted. Thus BRI Unit Desa activities were expanded and diversified over the next seven years, as follows:

- o In 1974, Kredit Mini was introduced as a BRI Unit Desa loan window primarily for off-farm economic activities;
- o In 1976, the BRI Unit Desa were asked to mobilize rural funds via TABANAS, a national savings program; and
- o In 1980, Kredit Midi was introduced along the lines of the Kredit Mini program to allow the BRI Unit Desa to extend larger non-agricultural loans.

Given the responsibility of administering BIMAS, Mini, Midi, TABANAS, and miscellaneous smaller programs, the BRI Unit Desas expanded rapidly. While there were only 446 BRI Unit Desa in 1970, that number roughly doubled the following year, almost doubled again over the next two years, and by 1984 totalled 3,626 Unit Desa. Concurrently the number of BRI Unit Desa employees grew from 1,871 to the present total of over 13,000 employees, or approximately 4 employees per BRI Unit Desa.

However, total lending volume did not keep pace with the increase in Unit Desa offices and staff. Overall lending activities actually began to decrease, lending having peaked in 1975 and dropping approximately 50 percent by 1979. By the end of 1984 BIMAS credit via the BRI Unit Desa had been phased out completely. Although Kredit Mini and Kredit Midi lending continued to rise through 1983, the nearly 50 percent average compounded growth rate of outstanding Mini and Midi credit per BRI Unit Desa employee was not enough to compensate for the BIMAS decline.

The consequence of these trends is vividly depicted in Table 2.8. Not only have the BRI Unit Desa been net losers in every year since their creation except for 1977, but annual operational losses tripled from 1978 to 1979, and then quadrupled from 1980 to 1984. These losses were sustainable only as long as the BRI Unit Desa continued to receive administrative subsidies from the Ministry of Finance, but with the cessation of these subsidies at the end of 1983, drastic measures were in order to ensure the profitability of the BRI Unit Desa.

TABLE 2.8: PROFITABILITY OF BRI UNIT DESA* (Rp. 000)

<u>Year</u>	<u>Expenses</u>	<u>Receipts</u>	<u>Profit (Loss)</u>
1970	77,418	4,998	(72,420)
1971	1,077,872	691,461	(386,410)
1972	851,790	804,051	(47,739)
1973	1,418,706	1,231,999	(186,707)

*Source: BRI Head Office

1974	2,913,998	2,870,015	(43,983)
1975	6,717,107	4,719,842	(1,997,265)
1976	8,092,157	6,820,366	(1,271,791)
1977	9,922,549	10,264,761	342,212
1978	11,914,852	9,793,635	(2,121,217)
1979	17,361,279	11,083,474	(6,277,805)
1980	20,140,237	13,303,305	(6,836,932)
1981	33,393,549	22,821,826	(10,292,121)
1982	30,393,589	22,255,403	(8,138,186)
1983	33,719,399	21,068,655	(12,650,744)
1984	50,975,511	25,853,017	(25,122,494)
1985	73,501,000	72,565,000	(936,000)

With the phasing out of the BIMAS credit program, the BRI introduced three principal policy changes in 1983 to revitalize its Unit Desa system

- o Transformation of the BRI Unit Desa from a BIMAS conduit to a full-service rural bank;
- o Internal treatment of BRI unit Desa as semi-autonomous units of account, that is, as discrete profit or loss centers instead of disaggregated items subsumed in the BRI branch accounts; and
- o Evaluation of BRI Unit Desa based primarily on profitability.

Implementing these policy changes has required new operational guidelines for BRI Unit Desa, as well as a new image so they will be seen as profitable rural banks providing vital financial services. Revised operational guidelines introduced by BRI can be summarized as follows:

- o Introduction of Kredit Umum Pedesaan (KUPEDES), a general line of rural credit with market interest rates, as successor to Kredit Mini and Kredit Midi;
- o Revision and reconstruction of Unit Desa internal accounting systems;
- o Physical reallocation and consolidation of individual Unit Desa and personnel based on market potential rather than rice field coverage;
- o Introduction of Simpanan Pedesaan (SIMPEDES), a new effort to mobilize rural savings;
- o Upgrading of the Unit Desa management information system to enable BRI to monitor and evaluate the effects of the above-described policy and operational changes.

The initial reconstruction of the BRI Unit Desa balance sheets was completed at the end of 1983, and KUPEDES was introduced nationwide in February, 1984; SIMPEDES has been initiated in 13 Kabupatens on a trial basis, and is scheduled to begin nationwide in 1986; the reallocation/consolidation of the Unit Desa is mostly complete, resulting in a

reduction of over 1000 units to a current total of 2,443; and MIS recommendations were prepared through an AID financed study. The initial results are reflected in Table 2.8 -- revenues almost tripled in 1985. These revenues were generated by doubling the total outstanding credits to almost \$230 million, with cumulative overdue loans (including installments) representing only 2 percent of total credits. Loans over three months past due, which are categorized as doubtful, are less than one-half percent of loans outstanding. While the Unit Desa were still not profitable in 1985, they broke into the black the last few months, a positive trend we expect will continue as loan circulation increases. (See Financial Analysis, Section V for the 1985 Unit Desa balance sheet and earnings statement.)

While this Amendment will support continuation of the above mentioned new operational guidelines, the most important task will be to upgrade the skills of the 13,000 Unit Desa and Cabang staff. This staff is comprised of approximately 3,000 office heads (Kaudes), 3,000 loan officers (Mantri), 3,500 bookkeepers and 3,500 cashiers, plus 600 Cabang-level supervisors and auditors. The typical Unit Desa employee is a high school graduate with 3-5 years experience with BRI. While some have already attended BRI Unit Desa courses, concepts of general banking, loan appraisal, cost accounting, public relations, etc. are new to them. Therefore, while all parties acknowledge the potential of the Unit Desa system and the qualifications the Unit Desa staff, the most important steps in Unit Desa development are yet to come, e.g. training, reorganization, personnel system development and other aspects of human resource development which will enable the system to progress and evolve on its own.

E. Other Donor Assistance

While there are many donor-assisted projects which include credit components designed to support a certain target activity, we will note here only those efforts aimed specifically at improving the financial sector or specific institutions therein.

The major recent financial sector projects other than FID have been the World Bank-financed Small Enterprise Development Project (SEDP) and Rural Credit Project. The Rural Credit Project, sponsored by BI, was targetted at better implementation of the KIK/KMKP programs. Since BRI disburses over 50 percent of KIK/KMKP, a great deal of the Rural Credit Project assistance focussed on BRI Cabang (district) operations vis-a-vis KIK/KMKP. This Project was phased out in 1985, but has provided useful insights into the problems and possible redirection of the KIK/KMKP program.

The SEDP, also implemented through BI, was initiated in the early 70s to develop KIK/KMKP as a means of promoting small and medium-sized businesses. SEDP has recently entered its third traunch with the addition of \$200 million in World Bank funds. Most of the SEDP funding is being used to provide liquidity credit for KIK/KMKP, but bilateral donors have also contributed by providing T/A to various implementing banks. For instance, the Australian Development Assistance Bank financed a study of BRI personnel training, completed in 1983. Many of the

recommendations of this study are incorporated in this Amendment. In addition, World Bank SEDP funds will help finance a contract to a private management consulting firm (Booze Allen) to assist BRI in improving central management and operations. Consultants under this Amendment will work closely with the SEDP-financed team, particularly to coordinate in the areas of reorganization, reporting, accounting and automation. The Scope of Work for the SEDP-financed effort is included in Appendix G.

The Dutch government is financing an ongoing computer upgrading program for all BRI Kantor Wilayah (regional offices). This multi-year effort has so far been limited to 2 out of 16 regional offices and will likely continue for some time. Any automation recommendations under this Amendment will be reviewed in light of compatibility with the regional and central reporting systems being developed.

Although funded by the GOI, also noteworthy is the ongoing policy assistance to the Ministry of Finance from the Harvard International Institute for Development (HIID) group. This group was instrumental in drafting new GOI bank legislation, and in start-up of the new Unit Desa programs. We assume HIID will continue to play an important role in advising on national banking policy.

In addition, IFAD has prepared a \$50.0 million loan proposal on Small Farmers and Landless Rural Laborers. This Project was originally intended to provide agricultural credit through the BRI Unit Desa. However, financial difficulties within IFAD and negotiation difficulties caused discussions on this loan to be suspended, and IFAD is now examining alternative project designs.

The continuing policy role of the IMF and World Bank with respect to financial deregulation should also be noted. While not necessarily Project specific, this program-wide push for free-market operations has been and should continue to be an important contribution in financial policy dialogue. USAID staff and Amendment-funded consultants will work closely with these institutions to learn, advise and coordinate policies.

III. PROJECT DESCRIPTION

A. Amendment Goal

The Project (and Amendment) goal is to encourage enterprise development, increase productivity and generate employment opportunities in rural areas.

B. Amendment Purpose

The Amendment purpose is (1) to help develop the BRI Unit Desa system in order to provide financial intermediation for middle-level rural borrowers at reasonable cost; (2) to produce loan portfolios of employment generating activities, primarily off-farm; and (3) to strengthen BRI savings mobilization programs. (The Amendment purpose differs from the original Project purpose only in its focus on a different level within the rural financial system, e.g. Kecamatan-level Unit Desa operations vs. village-level BKK-type operations.)

C. Major Outputs

The Amendment will focus on four activities -- policy assistance, training, operational improvements, and research -- as outlined below:

1. Policy Development: The Amendment will assist BRI to establish policies which integrate and account for Unit Desa operations within an overall BRI operational plan, which ensure the Unit Desa are managed in accordance with sound financial practices in a self-sustaining manner, and which maximize the availability of priority financial services to the general public at the Kecamatan level. Within these areas, specific policy issues to be addressed will include:

- How and where the Unit Desa should best fit within the BRI organization. This will include a review of the financial, organizational and reporting structures, and should involve considerable interaction with the SEDP-financed consulting group. Particular attention will be given to planning for Unit Desa staff career development within BRI. The result of this review will be a comprehensive long-range plan for development of the Unit Desa system.
- The financial relationship between Unit Desa, BRI and BI, including the role of liquidity credits, profit center accounting for services provided, profit distributions, operational ceilings and cash management. Such policy outputs should include recommendations and follow-through on specific regulatory changes required, both at the national level and within BRI.
- Loan portfolio management and marketing, especially focussing on improving management's ability to conduct risk assessment, broadening the market, rationalizing collateral requirements, improving public relations and service, and adjusting interest rates to conform to loan performance and operational costs.
- Promotion of savings mobilization, particularly as a means of replacing liquidity credits and encouraging private investment.
- Expansion of Unit Desa activities into such services as bank transfers, pension and tax transactions, pay for civil servants, and longer term savings instruments.

2. Training: The Amendment will support establishment of a high-quality BRI regional training system and the institutional capacity to maintain the system for the 13,000 Unit Desa employees and cabang supervisors of Unit Desa operations. This system shall consist of a permanent BRI regional training staff and four regional training centers, an established budget procedure and source of funds, and appropriate training materials and means of updating materials and curriculum as needed to properly train staff. Training will consist of at least three weeks of formal training for each employee during the Amendment, plus on-the-job training in selected areas such as loan portfolio management and accounting. Training provided will stress the concepts and future goals of the Unit Desa system, with less emphasis on routine procedure.

3. Operational Development: The Amendment will support improvement of Unit Desa accounting, communications and automation systems as necessary to lower the cost of financial intermediation in a cost-effective manner.

The accounting system used now is based on simple double-entry accounting, and involves a great deal of transferring written entries from ledger to ledger. The system is very labor intensive and, because of a lack of cross-verification, is error-prone. Personnel time freed up through approved accounting could allow for portfolio growth without the need for additional personnel, and savings from faster processing and fewer errors would lower the intermediation cost. Several new trial systems are now being tested, but much is yet to be done. Under this Amendment, these trial systems plus recommended additions will be evaluated, and the most appropriate system will be implemented nationwide. Personnel training in accounting and automation will also be provided.

Communications currently are extremely limited between the Unit Desa and Cabang. For instance, not one Unit Desa has a telephone. This makes cash management and reporting very difficult. Given the extent to which information transfer and communications are the basis of modern banking, this Amendment will support the development of two-way communication links between the Unit Desa and the Cabang offices.

The 2,400 Unit Desa offices currently handle over one-half million transactions a month using no automation system other than pocket calculators. Given the anticipated rapid growth of the Unit Desa programs and the need to improve efficiency, some basic measure of automation will soon be necessary. Since any proposed automation system would be linked to other operations systems, the first step will be for the specifications and level of automation to be defined in accordance with accounting and reporting recommendations to be prepared by the operations T/A team. After the appropriate staged automation plan is approved, the initial system will be procured and installed, and personnel trained to utilize the new system.

Physical facilities and location of Unit Desa will also be examined under this Amendment, with the goal of improving service and meeting market demand. However, a major program of moving or constructing Unit Desa offices is not envisaged.

4. Research: The Amendment will finance the conduct of a major research study which will provide guidance to the GOI and USAID concerning further development needed within the rural financial sector. This research will be conducted in three representative provinces under the sponsorship of the MOF. The Ministry of Finance has played an important role in the development of the Kupedes/Simpedes programs, and is well-positioned and motivated to sponsor this major research program.

The study is to be conducted over a three year period, and will focus on estimating the total supply of credit and savings within each province, broken down into source (including informal credit markets), major variables of each program or source, and how each variable affects the demand for credit and the propensity to save. The research would

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also define the coverage of existing programs, including a profile of both typical borrowers/lenders by program and the type of persons not now served under any program. Given this type of information, USAID and the GOI can then better evaluate the need for redesign, regulation or deregulation of existing programs, the need for new programs, and the market for private banking in rural areas.

D. Inputs:

Project inputs will consist of three T/A contracts, funds for training, fixed amount reimbursement for training center construction, and selected communications, automation and training commodities. A detailed description of the proposed inputs under each of the four output activities as follows:

1. Policy Assistance - There are three prominent actors who determine policies which affect the Unit Desa. First, the BRI Board of Directors determine the general structure and relationship of the Unit Desa to BRI, and issue day-to-day operational guidance. BRI policy to date has been to provide strong support to the Unit Desa but to increasingly make them independent profit centers responsible for their own operations. The other two policy actors are the Ministry of Finance (MOF) and Bank Indonesia (BI), whose policy roles are not dissimilar to the Department of Treasury and the Federal Reserve Banks in the U.S. MOF is more concerned with the policy and developmental aspects of banking, and is responsible for national legislation regulating banks. BI, on the other hand, is most concerned with the financial stability and growth of the banking system. MOF and BI also jointly sit on the Monetary Board, thereby working closely together to determine the regulatory environment for the financial sector.

We propose in this Amendment to provide two long-term policy and training advisors under contract to BRI. This technical assistance contractor would provide 8 p-y of expatriate T/A, much of which would be inputs for BRI policy decisions.

The advisory team will also assume an active role in providing policy inputs for BI and MOF, especially assisted by their already developed ties to MOF. USAID staff and U.S. Federal Reserve Bank advisors being funded under the Private Sector Project (497-0329) will also play important roles in such policy discussions.

2. Training System - The BRI training system currently consists of a central training center and staff in Jakarta, and regional training programs in 13 of the 15 provincial offices. The Jakarta training center is fully utilized for training senior and central staff. Given the very limited capacity of the Jakarta facility and the expense of transporting trainees from the Unit Desa to Jakarta, regional, rather than central, facilities are required in order to broaden the formal training system to include Unit Desa staff.

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The present provincial training facilities consist of classroom and dorm space for about 320 persons dispersed among 7 of the 15 provincial (Kantor Wilayah) offices. Six other offices currently rent hotel space for training. Each regional training program is now headed by a regional training officer, who both administers and teaches part-time. The remainder of the teaching load currently is assumed by other BRI staff on a part-time basis. These provincial centers are responsible for training of Kantor Wilayah, Cabang and Unit Desa staff. The 1985 training program for Unit Desa personnel and cabang supervisors of the Unit Desa included 45 classes for 1,350 employees at a cost of approximately \$425,000. At this rate it would take ten years to provide Unit Desa employees with even an introductory course on Kupedes and Simpedes.

Thus, while the formal training program has been helpful in giving initial technical training to some Unit Desa employees and supervisors on the Kupedes program, the system is not adequate to catch up with the current training backlog, or to address the changing and expanding needs and environment of the Unit Desa system. In particular:

- (1) No prepared training material are available. Instruction materials generally consist of circulars issued by the head office, which are the subject of lectures. Training topics tend to focus on the routine, such as filling in forms, reporting, rules and regulations. There is very little instruction in general banking principles, operations or management.
- (2) The regional training officer frequently is not professionally trained as a trainer, and often has at least one other regional job assignment; and very few of the staff volunteering to teach have any formal training experience or education. Thus the quality of training provided is very erratic, and the content is inconsistent from province to province.
- (3) The facilities are inadequate. BRI wants the capacity to provide at least one week of formal training to all Unit Desa employees every year, plus the capacity to provide six weeks of training to new or upgraded employees. Not only are current facilities much too small and scattered to reach these goals, but of the seven provinces having facilities, only a few offer a good study environment.

The BRI office of training, HIID and USAID have reviewed Unit Desa training needs over the last year, and have concluded that the minimum initial requirement to ensure a basic level of consistency and understanding of new Unit Desa programs would be an average of three weeks of formal training for all employees and supervisors over the next three years. (See Appendix E for Training program.) A similar level of training would continue after this Amendment period, although course material would differ depending on training needs.

In order to provide this training, BRI must utilize well-presented training materials and must make available motivated, trained trainers. In order to improve training materials and train trainers, a major input will be technical assistance for the training system. It is proposed

that the policy advisory team also be assigned the role of training advisors for the Unit Desa. The team will consist of two expatriates who would advise on preparations for and conduct of the initial three-year program at four regional centers. They will work with the BRI training division on all aspects of curriculum development, program administration and support, and personnel policy. The scope of work for this proposed contract is in Appendix F.

The second major input will be the establishment of four regional training centers. This will involve the construction and furnishing of new facilities at Padang and Yogyakarta, the rehabilitation, expansion and furnishing of facilities at Surabaya, and the furnishing of facilities at Ujung Pandang. (The Ujung Padang center was recently constructed under the World Bank SEDP project, and is very suitable for training). These four centers were selected to minimize new staff requirements and trainee travel expenses, and to maximize the use of current facilities.

The USAID contribution for construction and furnishing will be to reimburse up to 50 percent of the total estimated cost, to be established as a predetermined fixed amount reimbursement (FAR) for each of the four sites once preliminary cost estimates and plans are reviewed. Current estimates for each center are:

- a. Padang - Land will have to be purchased by BRI (approximately 1/2 ha.) and a center built to accommodate up to 125 students, including classrooms and dormitory. This regional facility will serve Unit Desa staff from all of Sumatera, plus near-by islands. The total cost, excluding land, is estimated at \$1,000,000, of which USAID's share would be \$500,000.
- b. Yogyakarta - BRI intends to demolish one of its two older training centers in Yogyakarta to make space for a new regional center. This new facility will be designed for a capacity of 150 students, including dormitory space, in order to serve Unit Desa staff from Central and West Java. The initial cost estimate is \$1,500,000, of which AID's share would be \$750,000.
- c. Surabaya - The present facility in Surabaya is large enough for 60 students, but is badly in need of repair and upgrading. Sufficient adjacent BRI land is available to expand the center to a capacity of 210 as required to serve Unit Desa employees from East Java, part of Central Java, Kalimantan, Bali, NTT and NTB. BRI has therefore decided to renovate and expand the existing Surabaya center. The estimated cost of renovation and expansion is \$750,000 of which USAID's share would be \$375,000.
- d. Ujung Pandang - The recently-constructed training center in Ujung Pandang has a capacity of 60 persons, which is adequate to serve Unit Desa employees from Sulawesi and the eastern islands. New furnishings will be required, e.g. study, classroom, dormitory and dining room-facilities, which are estimated to cost \$50,000; USAID's share would be \$25,000. (Additional details on capacity may be found in Appendix E.)

Whereas total USAID FAR payments are not to exceed \$1,650,000 under this Amendment, the allocation of payments among the four regional centers may change once preliminary cost estimates and plans become available. BRI has hired local A&E firms to prepare these plans and estimates. Once these estimates have been reviewed and approved by the USAID engineering office, then the FAR amounts will be agreed upon. A Condition Precedent in the Loan Agreement will require the completion of USAID's engineering review prior to the finalization of the FAR amounts. Likewise the USAID engineering office will inspect the buildings to approve actual disbursement of the FAR amounts. BRI plans to have all construction completed by January, 1988. Determination that FAA 611(a) requirements have been met is predicated on these required engineering reviews and the Condition Precedent for the FAR Agreement.

In order to meet training staff requirements, BRI has agreed to recruit 21 new regional trainers from within the BRI staff. Seven of these staff would be assigned to Yogyakarta, five to Surabaya, five to Padang and four to Ujung Pandang. The new staff will be given intensive training at the central training facility and then would be assisted by the training T/A consultant as they initiate the regional programs. New staff will report to the regional training officer who will be responsible for administering the regional program. It is expected that employees selected for the new trainer positions will be rotated to other BRI assignments after approximately four years to provide a reasonable career development path for trainers. Also several perquisites for the trainers will be added to the standard BRI package, such as free housing. These are seen as essential steps in changing the present aversion toward regional training positions within BRI, which to date have been perceived as dead-end, undesirable jobs. The 21 new training positions, to be funded by BRI, represent one of the most important inputs into the new training system.

One immediate training input, as mentioned above, is the preparation of course materials for the Unit Desa training program. This effort will require approximately one year, and will involve the HIID staff, the BRI training staff and a BRI-contracted local publisher. Concurrently the combined training team will select and begin intensive training of the new regional training staff. It is BRI's intent to begin the new Unit Desa training program in June, 1987, which will require at least a six month phasing-in period of new staff and training material. Since the new buildings will not be ready in 3 of the 4 centers, outside space will be rented for the first year.

In addition to the above mentioned input, funds will be required for actual training expenses. These expenses will include student travel and per diem, facility rental, and course teaching materials. In addition BRI must fund teacher salaries, administrative support, domestic staff salaries and building upkeep. Total annual non-recurring expenses for the initial three-year program are estimated at slightly over \$1,000,000. AID will reimburse BRI for non-recurring training expenses such as trainee travel and per diem, course materials and expenses, and facility rental, up to a maximum of \$500,000 per year, for a three year total of \$1.5 million.

BRI will fund all recurring costs, such as salaries and upkeep, plus the balance of non-recurring costs. Details on training program cost estimates are set forth in Appendix E.

3. Operations - Under current operations, a typical Unit Desa consists of a rented building (approximately 30' x 50') located on the outskirts of a Kecamatan small town, staffed with a head officer (Kaudes), loan officer (Mantri), bookkeeper (Pembukuan) and cashier (Kasir). Equipment consists of a safe and pocket calculator. Some units have recently been provided a motorcycle to cover field operations. A unit on Java would see an average of about 75-100 customers a day, the off-Java units being less busy. Daily cash transactions at least involve the bookkeeper and cashier, and are entered by hand. The Mantri and head officer share daily responsibility for assessing and preparing new loan applications, opening savings accounts, and tracking down overdue payments. The average unit has approximately Rp. 100,000,000 in outstanding loans, again the average on Java being considerably higher. At the end of a week all entries and activities are transferred to summary reports. The head officer at the Unit Desa then reviews all accounts and submits the reports to the Cabang office.

At the Cabang, one or more Unit Desa supervisor/auditor (penilik) would be responsible for overseeing four to six Unit Desa. The penilik are supervised by the Unit Desa section head (kepala seksi) who in turn reports to the Unit Desa Officer (UDO), one of the senior Cabang officials. A typical Cabang would be responsible for supervision and audit of approximately 10 Unit Desa. On a monthly basis the Cabang officials would prepare a myriad of reports on the Unit Desa to pass through the regional (Wilayah) office to Jakarta.

The major operational problem with this system, in addition to training needs cited above, is that it will soon be overloaded. With the Kupedes program expected to triple in the near future, the task of loan review, processing and accounting will also increase almost three-fold. On the savings side, Simpedes has yet to go nationwide. When it does, the number of daily bookkeeping transactions will more than double since most savings are transacted in smaller amounts than loans. Thus personnel in all job categories will soon be swamped. Considering the current size of the Unit Desa staff, a major increase in personnel is not economically justifiable, although extra Mantris may be required in many Unit Desa. Instead the most cost effective route is to improve the efficiency of the operating systems. This particularly includes three systems:

1. The loan processing system, which requires a complete review of policies, forms, collateral requirements, payments, etc;
2. The accounting, reporting and auditing systems, which are voluminous, inefficient, not particularly helpful to management, and error-prone. These systems must be upgraded for content and automated in order to lower intermediation costs and improve management's ability to control and evaluate operations.

3. The cash management system. Kupedes is currently a fully "cash" operation, and a constrained one at that. To control liquidity the BRI cabangs must limit the weekly cash allotment to each Unit Desa. Add the fact that the Unit Desa have no means of communicating with the cabang office, and cash management becomes most difficult at the Unit Desa. In general there is no recourse but to turn people away when the cash is gone. In such cases the Kaudes must travel to the cabang and apply for more cash.

In conclusion, while the Unit employees are a motivated group working on great new programs, they presently lack the operational support and facilities to cope with what's in store. Along with intensive training, the Unit Desa need the following additional operational inputs.

- o Technical assistance for accounting, reporting, automation and audit systems is essential. To develop these we propose that BRI contract an operations T/A team, comprised of two long-term advisors in accounting and bank automation, one long-term audit advisor, and one short-term communications advisor for a total of 7.5 p-y. This team would assist with the technical aspects of the regional training programs, advise on procurement, installation and operation of commodities discussed below, assist BRI in the redesign of all operational systems, and consult with individual Unit Desa on an as needed basis. The scope of work for this T/A contract may be found in Appendix F.
- o Commodity assistance in the form of radio communications and automation equipment are also required. With respect to communications, BRI proposes to provide selected Unit Desa with a 10-watt two-way VHF radio set capable of communicating with the Cabang office. Antenna will be required in most cases. This will allow the Unit Desa to report to the cabang office on a daily basis, to request cash transfers from other Unit Desa as required, and to receive information on loan applications and other management needs. The per unit cost for each VHF radio set is estimated at \$1,000, which means if all 2,300 units were equipped, the total estimated expenditure would be \$2,300,000. BRI will prioritize Unit Desa and probably phase in the communications systems as funding permits.

Automation inputs will be required as the system expands. While the specific automation plan and timetable will require initial investigation by the accounting and automation advisors, the probable configuration is a desk-top micro computer at each Unit Desa, possibly employing some form of cash entry system such as register. The initial Amendment budget averages \$1,500 per Unit Desa for a total approximate cost of \$3,450,000. Again a phase-in plan based on priority locations will probably be developed in order to balance system cost with funds available.

For all commodities, AID would agree to pay 50 percent of the total actual cost, or \$2,500,000, whichever is less.

4. Research - The research activity is to be designed to fill the current information gaps concerning the rural financial system. No statistics exist on the informal credit markets, very little is available on total volume of Bank-Pasar and BKK-type operations, statistics from GOI-sponsored programs have not been analyzed as a composite, the Kabupaten-level competition to the KIK/KMKP program is not well-defined, and the role of private banks in rural areas is not yet researched. In addition, the nature of the beneficiaries of various programs is in need of better definition. This information is essential, both to the GOI and donor community, in order to effectively pursue regulatory and operational improvements in the rural finance sector.

The focal point of the Amendment research activity will be the MOF Directorate General of Domestic Monetary Affairs, which will serve as the GOI contracting agent and research supervisor. The research will most likely be conducted by a consortium of locally contracted institutes and firms. To assist the local research team, AID will fund 5 p-y of expatriate T/A, presumably 2 research experts working periodically over a three year period. The T/A contractor will primarily assist in research and survey design, data verification and data analysis.

Due to the complexity of the research proposed, USAID intends to contract for 2 person-months of expatriate assistance during the summer of 1986 to assist in research design and in drafting the terms of reference for the research T/A contract. USAID anticipates taking advantage of an ongoing S&T Bureau contract with Ohio State University, whose staff are well regarded with respect to rural credit research, to assist in this design effort. This initial assistance would also provide an opportunity for MOF and USAID to coordinate with BI, BAPPENAS and Ministry of Manpower officials who have also expressed a keen interest in such rural credit research.

E. End of Project Status:

As a result of the above Amendment inputs and outputs USAID expects the following results to be achieved by the end of the Amendment in June, 1990:

1. To triple Kupedes loans outstanding to Rp. 800 billion while maintaining a long-term loss ratio^{1/} of 2.5 percent or less;
2. To increase Unit Desa savings deposits to cover at least 50 percent of Kupedes loan volume;
3. To reduce Unit Desa administrative cost portion of intermediation cost by 2 percent, e.g. from 14.5 to 12.5 percent; and
4. To have established an on-going research and reporting network to monitor rural financial programs and trends within three provinces.

^{1/} Total overdue installments and final payment divided by the total amount which has become due.

The financial projections relevant to these end of project status are described in more detail in Section V, Financial and Economic Analysis.

IV. COST ESTIMATE AND FINANCIAL PLAN

The following tables summarize the cost estimates and plan for the various inputs and outputs described in Section III, Project Description.

TABLE 4.1: COSTING OF AID INFUTS (\$000)

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>ESTIMATED COST</u>	
I. Technical Assistance			
a. Training/Policy Adv.	8 p-y @ \$ 200,000	1,600	
b. Operations Adv.	7.5 p-y @ \$200,000	1,500	
c. Research Adv.	5 p-y @ \$200,000	1,000	
d. Reserve for Audits		<u>150</u>	4,250
II. Training			
	3 yrs @ \$1,000,000 x 50%		1,500
III. Commodities			
a. Communications Eqp.	2,000 @ \$1,000 x 50%	1,000	
b. Automation Eqp.	2,000 @ \$1,500 x 50%	<u>1,500</u>	2,500
IV. Construction			
a. Padang	\$1,000,000 x 50%	500	
b. Yogyakarta	\$1,500,000 x 50%	750	
c. Surabaya	\$ 750,000 x 50%	375	
d. Ujung Pandang	\$ 50,000 x 50%	<u>25</u>	1,650
V. Evaluation			
TOTAL			<u>100</u> \$10,000

TABLE 4.2: COSTING OF GOI INPUTS (\$000)^{1/}

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>ESTIMATED COST</u>	
I. Technical Assistance			
a. Training/Policy Adv.	All local support	500	
b. Operations Adv.	All local support	300	
c. Research Adv.	Local contractor	<u>1,000</u>	1,800

^{1/} The local research contractor and local support for the expatriate research assistants, estimated as \$1.0 million (equivalent), will be funded by MOF. All other line items, totalling \$7.0 million (equivalent) will be paid by BRI. This will be detailed in Subsidiary loan and grant agreements between MOF and BRI.

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II. Training	3 yrs @ \$1,000,000 x 50%		1,500
III. Commodities			
a. Communications Eqp.	2,000 @ \$1,000 x 50%	1,000	
b. Automation Eqp.	2,000 @ \$1,500 x 50%	<u>1,500</u>	2,500
IV. Construction			
a. Padang	\$1,000,000 x 50% + land	750	
b. Yogyakarta	\$1,500,000 x 50%	750	
c. Surabaya	\$ 750,000 x 50%	375	
d. Ujung Pandang	\$ 50,000 x 50%	<u>25</u>	1,900
V. Contingency			<u>300</u>
TOTAL			<u>\$8,000</u>

TABLE 4.3: SUMMARY COST ESTIMATE & FINANCIAL PLAN (\$000)

Source:	AID GRANT		AID LOAN		GOI		TOTALS		
	FX	LC	FX	LC	FX	LC	FX	LC	TOT
I. Tech Asst	4,250	-	-	-	-	1,800	4,250	1,800	6,050
II. Training	-	-	-	1,500	-	1,500	-	3,000	3,000
III. Commodity	-	-	2,500	-	2,000	500	4,500	500	5,000
IV. Construction	-	-	-	1,650	-	1,900	-	3,550	3,550
V. Evaluation	-	-	100	-	-	-	100	-	100
VI. Contingency	-	-	-	-	-	300	-	300	300
TOTALS	4,250	0	2,600	3,150	2,000	6,000	8,850	9,150	18,000

TABLE 4.4: COSTING OF PROJECT OUTPUTS/INPUTS (\$000)

INPUTS	Policy	PROJECT OUTPUTS			
		Training	Operations	Research	Total
<u>AID:</u> Tech Assistance	650	1,400	1,100	1,100	4,250
Training	-	1,500	-	-	1,500
Commodities	-	-	2,500	-	2,500
Construction	-	1,650	-	-	1,650
Evaluation	100	-	-	-	100
Sub total	<u>750</u>	<u>4,550</u>	<u>3,600</u>	<u>1,100</u>	<u>10,000</u>
<u>GOI:</u> Tech Assistance	200	300	300	1,000	1,800
Training	-	1,500	-	-	1,500
Commodities	-	-	2,500	-	2,500
Construction	-	1,900	-	-	1,900
Contingency	300	-	-	-	300
Sub total	<u>500</u>	<u>3,700</u>	<u>2,800</u>	<u>1,000</u>	<u>8,000</u>
TOTALS	1,250	8,250	6,400	2,100	18,000

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TABLE 4.5: PROJECTED EXPENDITURES BY FISCAL YEAR (\$'000)

<u>FY</u>	<u>AID GRANT</u>	<u>AID LOAN</u>	<u>(AID TOTAL)</u>	<u>GOI</u>	<u>TOTAL</u>
FY86	200	-	(200)	450	650
FY87	900	2,350	(3,250)	3,050	6,300
FY88	1,100	2,650	(3,750)	2,525	6,275
FY89	1,100	500	(1,600)	1,150	2,750
FY90	.950	250	(1,200)	825	2,025
	<u>4,250</u>	<u>5,750</u>	<u>(10,000)</u>	<u>8,000</u>	<u>18,000</u>

V. FINANCIAL AND ECONOMIC ANALYSIS

A. Financial Analysis of Unit Desa Operations

At the end of 1985, the Unit Desa were operating 3 lending programs, with Kupedes being by far the largest with Rp. 229,028,935 outstanding. Lending under the other two programs, MINI and MIDI, was phased out at the end of 1983. The bulk of monies outstanding under these two programs, totalling Rp. 14 billion, is long overdue, and will be written off over the next two years as bad debts if not collected.

On the other hand, the growth and repayment record under the Kupedes program, with its market rates and new procedures, has been quite good as shown:

TABLE 5.1: GROWTH OF KUPEDES
(Rp. 000)

<u>Quarter</u>	<u>Loans Outstanding</u>	<u>Overdue Loans*</u>	<u>Percent Overdue**</u>
March '84	30.622.274	31.965	0.1%
June '84	71.229.839	127.452	0.2%
September '84	88.624.173	306.095	0.4%
December '84	110.697.507	544.646	0.5%
March '85	142.603.191	995.495	0.7%
June '85	179.468.399	1.965.055	1.1%
September '85	200.365.251	2.958.403	1.5%
December '85	229.028.935	4.804.983	2.1%

The latest status of the various Unit Desa programs are summarized in the Unit Desa balance sheet and earnings statement, Tables 5.2 and 5.3. As seen in Table 5.2, most of the overdue Kupedes loans are overdue installments, the under three month category dropping to 0.14 percent. These solid initial results are primarily due to the public's perception of Kupedes -- loans are screened thoroughly, market interest rates are charged, and prompt repayment is emphasized. In short, Kupedes is characterized as a commercial lending facility, not a government program.

* Both installments and final payments.

** Differs from loan-loss ratio in that percent overdue compares overdue loans to loans outstanding rather than to payments which should have been made.

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TABLE 5.2: UNIT DESA BALANCE SHEET - DECEMBER 1985 (Rp. Millions)

ASSETS			LIABILITIES		
Name of Account	Amount	Total	Name of Account	Amount	Total
Cash:			Demand Deposits:		
Cash on Hand	212		Company Accounts	n/a	
Cash at Branch	62595	62807	Personal Accounts	n/a	
Kupedes:			Impres Desa	n/a	13830
Loans Outstanding-Current	224224		Savings:		
Overdue Installments	3576		Tabanas/Taska	63604	
less than 3 mo. overdue	917		Simpedes	5134	
Over 3 mo. overdue	312	229029	Time Deposits	2018	
Midi:			Certificates of Deposits	134	
Loans Outstanding-Current	1291		Others	153	71043
Overdue Installments	946		Funds Held for Customers:		
less than 3 mo. overdue	1523		Future Interest Payable	28	
Over 3 mo. overdue	3338	7098	Future Tabanas Interest	n/a	
Mini:			Reserves	n/a	
Loans Outstanding-Current	70		Other	8539	8567
Overdue Installments	120		Loans from BRI Cabang:		
less than 3 mo. overdue	689		Investment Liquidity	16275	
Over 3 mo. overdue	6857	7736	Working Capital Liquidity	125250	
Channeled Credit:			Other Credit	929	142454
Rural Electrification credit		1580	Capital:		
Reserve for Bad Debts		(10524)	Capital (Investment)	7034	
Errors & Commissions		384	Capital (Cash)	56601	
Other Receivables:			Management Funds	1609	65244
Internal	829		Sundry Accounts:		
External	99	928	Reconstructed Balance Sheet	212	
Fixed Assets & Inventory:			Administrative	57	269
Land	133		Net Income:		
Buildings	491		Balance as of last year	0	
Vehicles	405		Income as of this year	(-936)	(936)
Equipment	50				
Furniture, etc.	59				
Land/Buildings in process	1	1139			
Sundry Accounts:					
Reconstructed balance Sheet	293				
Others	1	294			
TOTAL ASSETS		300471	TOTAL LIABILITIES		300471

TABLE 5.3: UNIT DESA PROFIT AND LOSS STATEMENT
JANUARY - DECEMBER, 1985 (Rp. million)

<u>EXPENSES</u>			<u>INCOME</u>		
<u>Name of Account</u>	<u>Sub-Total</u>	<u>Total</u>	<u>Name of Account</u>	<u>Sub-Total</u>	<u>Total</u>
Interest Expenses			Interest Earned		7639
Loans			Credit		
KMKP	46		Investment	1973	
KIK	9		Working Capital	59458	
Midi			Midi	753	
Kupedes	13593		Mini	341	
Others	113	13761	KIK/KMKP Massal & Khusus	1102	63627
Deposits & Savings			Commissions		91
Demand Deposits	82		Other Operations Income		
Tabanas	5593		Overdue Payments	200	
Simpedes			Printing Expenses	367	
Time Deposits	216		Others	234	801
Others	51	5942	Non-operational expenses		407
Transfer for Repayment Incentive		13971	TOTAL INCOME		72565
Insurance		36	TOTAL PROFIT/LOSS		(936)
Personnel					
Salaries	26170				
Others	4367				
Benefits	2581				
Training	2	33210			
Rent		406			
Taxes		219			
Maintenance					
Vehicles	1605				
Others	284	1889			
Depreciation		525			
Transfer to Reserves for Bad Debts		2368			
Third Party Expenses		1038			
Supervision		50			
Other		166			
Non-Operational Expenses		10			
TOTAL EXPENSES		73501			

The weighted average cost of funds for Kupedes as of December, 1985 was 10 percent based on the following sources of funds:

<u>Source/Type</u>	<u>Amount (Rp. mil.)</u>	<u>Avg. Cost</u>
MINI	Rp. 67,000	0%
BI Investment Capital	Rp. 10,000	3%
BI Liquidity Credits	Rp. 120,000	15%
Tabanas/Simpedes	Rp. 32,000	13%
	<u>Rp. 229,000</u>	

The cost of 13 percent for Tabanas and Simpedes represents a weighted average of the deposit rates. The Tabanas interest rate is 15 percent, and Simpedes rates are as follows:

Less than Rp. 25,000	No interest
Rp. 25,000 up to 200,000	9 percent
Rp. 200,000 and up	12 percent

Because Simpedes has yet to go nationwide, the interest rate structure is not fully tested and changes can be expected. However the 13 percent average cost of savings mobilization should still be a good overall estimate. (These rates are relatively high by world standards because of 1) the open foreign exchange market in Indonesia which competes for local savings, 2) exchange rate risks, and 3) inflation expectations.)

With respect to future sources of funds, the MINI capital, originally provided by the GOI as a start-up grant for Kupedes, will remain with the Unit Desa but no additional MINI funds will be available. The BI investment capital, at 3 percent, will remain a small percentage of liquidity credits available for investment credit only. The Tabanas and Simpedes savings programs will be expanded and therefore should provide an increasing percentage of Unit Desa credit funds.

BI, subject to availability of funds, will continue to provide working capital for the balance of Kupedes liquidity credit needs. However, effective March, 1986, the BRI cabang are charging the Unit Desa an additional 2 percent for BI credit, so that the cost to the Unit Desa is 17 percent. This has been done to ensure there is an incentive for Unit Desa staff to promote savings. The actual cost of mobilizing savings is calculated as the 13 percent interest plus 3 percent administrative costs, for a total of 16 percent. The near term marginal cost of funds for Kupedes will therefore be between the 16 percent cost of savings mobilization and the 17 percent cost of BI working capital. The average cost of funds will then gradually rise from the recent 10 percent toward the approximate 16.5 percent marginal cost level. As a matter of policy, the savings and Kupedes rates will be examined and adjusted throughout the Amendment to reflect changing costs and market demand.

The cost of administering kupeces, as a percentage of loans outstanding, is also in a state of flux, since the relatively fixed administrative costs are being spread over a rapidly expanding loan base. The estimated administrative cost for the 1985 Kupedes program was Rp. 40 billion, which if compared with December 1985 loans outstanding represents 17.5 percent. While one of the major points of the Amendment is to reduce total administrative costs as a percentage of loans outstanding, the policy team will also work on better allocation of 'hidden' administrative costs. For instance, the Rp. 40 billion administrative cost for 1985 does not yet fully reflect BRI cabang and central support costs which should be transferred to Unit Desa accounts to better identify the actual cost of lending. BRI is aware of this and will be working with the consulting team to reallocate such costs.

The cost of bad debts under the Kupedes program is set forth in Table 5.5. Bad debts are considered as loans which are over 3 months past due. Once loans are one year overdue then they are officially written off as bad debts. From Table 5.5, the best measure of bad debts is the long-term loan loss ratio (Column 11), which is payments overdue as a percentage of total payments scheduled. The long-term loss ratio was 2 percent at the end of 1985, and we have projected this ratio will level off at approximately 2.5 percent at the end of this Amendment.

In order to cover the above costs, Kupedes charges a flat interest rate of 1.5 percent per month. An additional 0.5 percent incentive for on-time payment also is initially charged, this amount being refunded lump-sum to the borrower when the loan is paid on-time. The flat rate for on-time borrowers of 1.5 percent per month thus results in a 2.7 percent effective interest rate per month on a declining balance. This translates to an effective 30 percent annual interest rate. Kupedes loans are commonly available for 4, 6 or 12 month term, with payment due lumpsum at the end. Many variations of this are and will be experimented with, including multi-year term loans. However, the current package and rate appears appropriate for a very large segment of the market.

Looking at the Kupedes program as of December, 1985, the 30 percent interest rate just started to cover the 10 percent December cost of funds, an allowance for up to 2 percent bad debts and 17.5 percent administrative costs. This is borne out by the near break-even performance in 1985 as shown in the Unit Desa balance and income statements, Tables 5.2 and 5.3.

In the future the Unit Desa can anticipate a gradually rising cost of funds and a somewhat more rapid spreading of administrative costs, which should lead to more profitable operations. Current projections show Unit Desa lending, deposits, liquidity credit needs and profits increasing as set forth in Table 5.4. As mentioned above, loan losses are projected to level off at 2.5 percent (see Table 5.5). These projections, based on joint opinions of BRI, HILD, MOF and BI staff, are subject to many factors which need to be monitored throughout the life of the Amendment. However, one obvious point is that the programs can't continue to meet projected demand without improving the Unit Desa system and perhaps adding staff at some point. Thus the need for operational improvements under the Amendment, and the need for training, clear personnel policies and analysis of costs involved.

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TABLE 5.4: MEDIUM PROJECTIONS FOR KUPEDES, SAVINGS,
AND LIQUIDITY CREDIT REQUIRED (Rp. billions)

	<u>Kupedes Outstanding</u>	<u>Savings Deposits</u>	<u>Profit*</u>	<u>Accumulated Profit**</u>	<u>Equity From MINI</u>	<u>Liquidity Credit Required</u>
Jun 1984	179	41	-3.4	-28.4	66.7	100
Dec 1985	229	71	2.5	-25.9	66.7	117
Jun 1986	308	78	1.5	-24.4	66.7	189
Dec 1986	389	125	1.9	-22.4	66.7	220
Jun 1987	479	137	2.4	-20.0	66.7	295
Dec 1987	569	206	2.8	-17.2	66.7	313
Jun 1988	669	227	3.3	-13.8	66.7	389
Dec 1988	769	318	3.8	-10.0	66.7	395
Jun 1989	869	349	4.3	- 5.6	66.7	459
Dec 1989	969	489	4.8	- 0.8	66.7	414
Jun 1990	1069	538	5.3	4.6	66.7	460
Dec 1990	1169	753	5.8	10.4	66.7	339
Jun 1991	1269	828	6.3	16.7	66.7	357

B. Financial Analysis of BRI Operations

A basic summary of BRI's financial status is presented in the 1985 balance and income statements, Tables 5.6 and 5.7, and in Table 5.8 which sets forth the calculation of BRI's debt equity ratio, return on assets, and return on equity. From these tables it is noted that BRI profits were approximately \$38 million in 1985, a figure roughly equal with 1984 profits and almost three times the 1983 and earlier profits. The asset base is expanding rapidly and the financial ratios compare very favorable with other state banks. An additional indicator is the 15 percent ratio of deposits to equity, which is very favorable by international banking standards.

The reader is cautioned, however, that the financial statements and ratios reflect a state banking accounting and operations system which has not yet caught up with the major banking reforms of 1983. The Ministry of Finance is currently preparing a second major banking reforms act to resolve many of the operational and accounting inconsistencies, which we assume will not only improve the reporting system but further broaden the banking system scope.

In particular the amount of BRI debt, equity and total BI assistance received are not now accurately reflected. With respect to debt the actual liability of BRI for BI and GOI funds is not well-defined,

* Based on the assumption that profit will be pegged at one percent on assets from 1986 on.

** Since the beginning of Kupedes.

Table 5.5 RUFFINS LOSS RATIOS *

ALL INDONESIA

(IN MILLIONS OF RUPIAH)													
	(from SIP)**	(from 2)	(5+7)	(from 6)	(3-10)	(from 8)	(from SIP)	(from 10)	(from SIP)	8/ (6+8)	(7/4)	(8/10)	(N/3)
Month	Amount Loaned During Month	Cumulative Amount Loaned	Repayment Due During Month	Amount Repaid During Month	Cumulative Amount Repaid	Increase in Amount Overdue This Month	Total Amount Overdue	Increase in Amount Outstanding This Month	Total Losses Outstanding	Long Term Loss Ratio	Short Term Loss Ratio	Portfolio Status Measure	Alternative Long Term Loss ratio
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
1985													
Jan.	18123	169921	10627	10517	51617	110	655	7606	118304	1.25%	1.0%	0.55%	0.39%
Feb.	22224	192145	10342	10105	61722	237	892	12119	130423	1.42%	2.29%	0.68%	0.46%
Mar.	22927	215072	10851	10747	72469	104	996	12180	142603	1.36%	0.96%	0.70%	0.46%
Apr.	25987	241059	13476	13271	85740	205	1201	12716	155319	1.38%	1.52%	0.77%	0.50%
May	28871	269930	13177	12987	98727	190	1391	15884	171203	1.39%	1.44%	0.81%	0.52%
June	23114	293044	15423	14849	113576	574	1965	8265	179468	1.70%	3.72%	1.09%	0.67%
July	22366	315410	15751	15579	129155	172	2137	6787	186255	1.63%	1.09%	1.15%	0.68%
Aug.	26395	341805	18094	18607	147762	477	2614	7788	194043	1.74%	2.50%	1.35%	0.76%
Sept.	26971	368776	20993	20649	168411	344	2958	6322	200365	1.73%	1.64%	1.48%	0.80%
Oct.	30689	399465	22371	21963	190374	408	3366	8726	209091	1.74%	1.82%	1.61%	0.84%
Nov.	34488	433953	23572	22870	213244	702	4068	11618	220709	1.87%	2.98%	1.84%	0.94%
Dec.	29459	463412	21876	21139	234383	737	4805	8320	229029	2.01%	3.37%	2.10%	1.04%
1986													
Jan.	31741	495153	24036	23440	257823	596	5401	8301	237330	2.05%	2.48%	2.28%	1.09%
Feb.	36946	532099	24793	24000	281823	793	6194	12946	250276	2.15%	3.20%	2.47%	1.16%

*) Without Advanced Payment

**) SIP is Kredit Status report (monthly)

although one must assume that several of the accounts are not actually debt. With respect to equity, BRI is limited by law to a capital base of \$300,000, and retention of profits is controlled. The restriction of capital base will hopefully change with the new banking legislation. With respect to BI accounts, there are many programs and grants available to BRI which are not reflected on any of the regular financial statements, but rather are funded within a BI/banking system development budget.

It is noteworthy that most expected changes in the banking system would strengthen BRI's balance sheet and potential to raise capital outside of normal GOI channels. Once such changes are enacted, perhaps more valid conclusions can be reached when measuring state bank operations against generally accepted financial standards. In the meantime, it can at least be concluded that the relative profit and asset picture is improving, and that BRI's increasingly free-market orientation will lead to even greater improvements as costs are reduced, interest rates are increased, and loan portfolios are better managed.

Concerning Amendment loan repayment, the BRI will assume a pass-through loan from the Ministry of Finance for all USAID loan funds received. Given the projected improvements in Unit Desa and BRI commercial programs, we foresee no difficulty in BRI fulfilling the proposed loan commitments.

TABLE 5.6: BRI BALANCE SHEET
31 December 1985. (Rp. 000)

<u>ASSETS</u>		<u>LIABILITIES</u>	
Cash	155,124,324	Demand Deposits	957,576,129
Deposits - BI	128,815,098	Accounts Payable	147,481,875
Deposits - Other banks	1,232,521	Savings	265,517,716
Domestic Notes	398,474,423	Time Deposits	708,251,298
Securities	--	Borrowings	3,058,570,128
Time Deposits	--	Guaranteed Deposits	6,103,305
Rupiah Loans Outstanding	4,356,775,980	Foreign Liabilities	
Foreign Assets		a) Accounts Payable	16,930,642
a) Liquid	295,562,837	b) Others	63,676,225
b) Foreign Currency Loans	--	Sundry Accounts	310,533,104
c) Others	67,358,676	Capital	
Investments	3,213,903	a) GOI	300,000
Fixed Assets & Inventory	70,493,210	b) Other	35,000,000
Sundry Accounts	320,598,725	General Reserves	39,262,637
		Other Reserves	145,901,213
		Profit of Past Years	--
		Profit Current Year	42,545,425
Total	5,797,649,697	Total	5,797,649,697

TABLE 5.7: BRI PROFIT AND LOSS STATEMENT
JANUARY 31 - DECEMBER 31, 1986 (Rp. 000)

I.	Income		
	1. Operational		
	1.1. Interest Earned	516,502,360	
	1.2. Commissions Earned	32,616,537	
	1.3. Currency Exchange	37,833,053	
	1.4. Sundry Income	26,976,310	
	2. Non-Operational	1,364,624	
	Total	615,292,884	
II.	Expenses		
	1. Operational		
	1.1. Interest & Commissions Paid	305,830,073	
	1.2. Currency Exchange Expense	4,094	
	1.3. Salaries	143,222,805	
	1.4. Write-Offs	72,685,204	
	1.5. Sundry Expense	50,313,728	
	2. Non-Operational	691,555	
	Total	572,747,459	
III.	Profit Before Taxes	42,545,425	

TABLE 5.8: BRI DEBT EQUITY, RETURN ON ASSETS AND RETURN ON EQUITY
(Rp. million)

I.	Total Assets as of December, 1985: Rp. 5,825,501 (Net assets & reserve for bad debts & depreciation)	
II.	Equity as of December, 1985 consists of:	
	1. Base capital	300
	2. Reserves:	
	a. General reserves	300
	b. Targetted reserves	13,998
	c. Employee benefit reserves	-
	d. Service reserves	2,578
	e. Accumulated profits	-
	f. Capital reserves	35,000
	g. Other	9,838
	3. Reserves for bad debts	146,629
	4. Depreciation	27,862
	5. Investments	12,549
	6. Profit (loss)	42,545
		<u>291,599</u>
III.	Debt: I - II = 5,825,501 - 291,599 = 5,533,902	
IV.	Net income before taxes: 42,545	
	1. Debt equity ratio : $\frac{5,533,902}{291,599} = 19:1$	
	2. R.O.A. : $\frac{42,545}{5,825,501} \times 100\% = 0.73\%$	
	3. R.O.E. : $\frac{42,545}{291,599} \times 100\% = 14.59\%$	

The relationship between BRI and Unit Desa financial performance is noted as a priority policy concern for this Amendment, and will have an impact on longer term BRI-Unit Desa financial performance. Currently all Unit Desa profits are lumped within BRI profits and distributed according to BRI charters legislation (see Appendix D). Thus the Unit Desa employees receive a modest bonus from profits, but no profits are currently retained for Unit Desa development. A profit-sharing arrangement between the BRI and Unit Desa, such as the one percent Unit Desa retention as projected in Table 5.4, will need to be developed along with the system to allocate BRI support costs to Unit Desa cost centers.

C. Economic Analysis

The basic assumption of this economic analysis is that the current 30 percent interest paid by Kupedes customers equates to the minimum value of benefits received based on the willingness to pay concept. Given the healthy state of the informal credit markets in rural Indonesia, and the significantly higher interest rates charged in informal markets, it appears that the 30 percent value is reasonable.

While the current 30 percent interest also represents the current cost of providing Kupedes credit, the end of project status for this Amendment calls for a 2 percent reduction in intermediation costs, an expansion of Kupedes to Rp. 800 billion (See Table 5.4), and the containment of the loan-loss ratio to 2.5 percent or less. Looking at the potential to reduce costs under Kupedes, the following parameters have been calculated by the BRI and USAID staff:

1. The weighted average cost of funds by the end of this Amendment will rise to about 12.5 percent.
2. Unit Desa profits will probably be targetted at 1 percent on assets.
3. If all support costs for the Unit Desa were properly assigned, Unit Desa administrative costs would presently be approximately Rp. 50 billion. Also, without any changes in the current operational system, Kupedes loans outstanding could probably be expanded 50 percent, to Rp. 345 billion, without additional personnel and administrative costs. Thus we estimate the base cost of administering Kupedes under current operational guidelines is approximately 14.5 percent (Rp. 50 billion divided by Rp. 345 billion).

The intended result of this Amendment is therefore to reduce the above-calculated base cost of administration by 2 percent, from 14.5 to 12.5 percent, through upgrading staff and operations. At the same time the costs of funds and bad debts are to be controlled or contained. The ultimate benefit we intend to pass on to the consumer is valued equal to this 2 percent savings, which will be passed on in the form of lower interest rates, better service, higher deposit rates, or cost offsetting.

Assuming Kupedes meets the medium projection (See Table 5.4) of Rp. 800 billion loans outstanding level at the end of the Amendment, a 2 percent interest reduction would translate into a Rp. 16.0 billion (\$14.3 million)

saving for the rural borrowers each time the Kupedes loan portfolio turns over. The portfolio now turns over in approximately one year. Based on a \$14.3 million annual saving which would accrue as of the PACD (June, 1990), Table 5.9 provides a ten year projection of Amendment costs and benefits, including corresponding net present values (NPV). Also included in Table 5.9 are annual benefits based on the Kupedes low projection of Rp. 600 billion loans outstanding to test the sensitivity of results to program size. The low projection translates to a \$10.7 million annual saving. As seen from Table 5.9, the NPV of accrued benefits after 10 years, based on the medium projections, is \$13,688, or a benefit/cost ratio of 2.0. The NPV of accrued benefits based on the low projection is \$6,794, or a benefit/cost ratio of 1.5. The medium and low projections result in internal rates of return (IRR) of 33 percent and 26 percent respectively.

The above calculations do not include the potential benefits of savings mobilization because of the complexity of quantifying the potential benefits and the interrelationship between credit and deposits. It is assumed, however, that savings mobilization benefits will be substantial, both to the GOI as liquidity credit requirements are reduced, and to rural savers as their financial condition improves.

VI. SOCIAL ANALYSIS

A. Beneficiaries

The new Unit Desa programs, Kupedes and Simpedes, were initiated in late 1983 and 1985 respectively. During this start-up phase most of BRI and MOF attention has been focussed on developing a sound institutional and policy base so that the Unit Desa could support themselves. Relatively little data has been collected to date concerning the profile of typical borrowers and savers. Two of the objectives under this Amendment, therefore, will be to conduct survey research in order to better define the beneficiaries and perceived benefits of Unit Desa programs, and to assist in policy development which will broaden the market for Unit Desa services.

The survey work proposed is to be conducted as part of the Amendment research activity. The U.S. research T/A team will assist CPIS in designing a survey format which will provide beneficiary profiles for both the Unit Desa and BKK-type programs, in addition to other programs which may be targetted for comparison. The beneficiary survey work is scheduled to begin in January, 1988, approximately nine months after the research contract begins. An initial beneficiary impact report will then be completed by the end of 1988. The research activity also will be establishing a systematic reporting system, relying on repeat interviews and informants over time, so that the beneficiary analysis should become an integral part of the credit reporting system to be established. This system is to be monitored by MOF - sponsored research team.

With respect to policy development, there must be two distinct areas of focus -- borrowers and savers. Unlike the BKK-type programs where memberships are required and thus borrowers become savers, Kupedes and Simpedes are both open to the general public. In many cases those who save are not those who borrow.

Table 5.9: ECONOMIC ANALYSIS
TEN-YEAR PROJECTION OF COSTS AND BENEFITS (\$000)

	<u>FY:</u> 86	87	88	89	90	91	92	93	94	95	<u>TOTAL NPV</u>
1. Annual Costs	650	6,300	6,275	2,750	2,025	1,000	1,000	1,000	1,000	1,000	
Net Present Value	565	4,764	4,126	1,572	1,007	432	376	327	284	247	13,700
2. Annual Benefits (MED)	-	-	-	-	7,150	14,300	14,300	14,300	14,300	14,300	
Net Present Value	-	-	-	-	3,555	6,182	5,376	4,675	4,065	3,535	27,388
3. Annual Benefits (LOW)	-	-	-	-	5,350	10,700	10,700	10,700	10,700	10,700	
Net Present Value	-	-	-	-	2,660	4,626	4,023	3,498	3,042	2,645	20,494

Notes:

1. All NPV calculations based on 15 percent discount value, the current BI prime lending rate.
2. Annual costs for FY 86-90 are based on Table 4.5 projections of Amendment expenditures by fiscal year. Annual costs for FY 91-95 are \$1.0 million, representing the on-going cost of Unit Desa staff training.
3. Fifty percent of benefits are included in FY 90, 100 percent thereafter.

Concerning Kupedes, the current program design allows for a minimum loan size of Rp. 25,000 and a maximum of Rp. 2,000,000, the average loan size being Rp. 350,000 based on latest data available. The effective minimum loan is closer to Rp. 100,000 since the time and effort required for loan application and the Unit Desa's cost of processing tend to discourage smaller loans. The loan application process requires approximately two weeks, and involves the posting of collateral for the full amount of the loan. Collateral is generally land, either owned or leased, but may be any fixed asset. In addition most loans have a co-signer, although no financial data is required of the co-signer and the co-signer is usually the borrower's spouse.

As of December, 1986, there were just over 1 million borrowers in the Kupedes program. The general statistics available on borrowers indicate that about 25 percent are engaged in agriculture, 2 percent in small industry, 72 percent in trade and processing, and 1 percent in other activities. The borrower categories, however, are not necessarily representative of loan use since Kupedes is a general purpose lending facility. Most traders, for instance, also earn part of their income from agriculture, and frequently use a portion of their loans for agricultural purposes.

From sample surveys BRI has also found that approximately one-fourth of all borrowers and three-fourths of all co-signers are women, which supports the spouse as co-signer assumption. The age and sex distribution of borrowers from the latest BRI survey is as follows:

TABLE 6.1: SAMPLE OF KUPEDES BORROWERS
BREAKDOWN BY AGE AND SEX

<u>Age Group</u>	<u>No. of Borrowers</u>		<u>No. of Co-Signers</u>		<u>Total</u>		<u>Total</u>
	<u>M</u>	<u>F</u>	<u>M</u>	<u>F</u>	<u>M</u>	<u>F</u>	
18 - 25	112	78	22	285	134	363	497
26 - 35	1,123	469	263	1,043	1,386	1,512	2,898
36 - 45	1,199	643	412	1,003	2,411	1,646	4,057
46 - 55	1,556	450	293	693	1,849	1,143	2,992
56 - 65	724	152	87	152	811	304	1,115
66 - 75	139	14	10	7	149	21	170
TOTALS	5,655	1,806	1,087	3,83	6,740	4,989	11,729

Given the collateral requirements, average loan size and initial data on borrowers, we can draw at least a tentative picture of Kupedes borrowers. They tend to be better off than EKK-type borrowers, having sufficient assets to provide collateral for a loan. They probably tend

to be heads of households trying to improve small business or agricultural operations rather than the BKK-type borrowers who generally are supplementing other household incomes. And they are probably a more mobile, small town-based clientele rather than residents of smaller villages. In sum the Kupedes borrower probably typifies the lower income entrepreneurial class in rural Indonesia.

Policy issues relevant to broadening the Kupedes market will specifically involve two issues. First, the current collateral regulations are restrictive and expensive to administer. The training and policy T/A team will be working closely with BRI to reduce the percentage of collateral as appropriate, and to broaden the types of collateral accepted. The second issue is that the short-term Kupedes loans are probably inappropriate for investments with a longer pay back period, such as tree crops and new tambaks. Through spot surveys and the major research activity, BRI and MOF will be dealing with this and other relevant policy issues in an effort to make Kupedes available to a wider spectrum of producers and to lower-end potential borrowers who are creditworthy but excluded due to lack of collateral.

The pilot program for Simpedes has just been completed, and indications are that there is a very broad range of participation in Simpedes and the ongoing Tabanas program. Simpedes has pioneered the concept of unlimited savings withdrawals in Indonesia. In addition the public perceives the Unit Desa as a safe place to save. According to initial surveys, these two factors alone — unlimited access and safety — far outweigh all other factors, including interest earned, in the decision to save. Therefore there are presently many persons willing to deposit Rp. 25,000 or less at the Unit Desa without earning interest in order to have instant access to funds. Those less concerned with liquidity could earn 15 percent under Tabanas, and longer term certificates of deposit are also being initiated. The success of the Unit Desa in introducing these new savings programs is a solid indication that savings mobilization in the rural areas depends more on the development of sound financial institutions rather than programs, and that the beneficiaries of such institutions will include all levels of rural society.

B. Role of Women - As noted above, sample surveys show the percentage of women borrowers is approximately 25 percent. However, most loans appear to benefit family units, so determination of the actual beneficiary is difficult given the current limited data. The beneficia / profile research will therefore include analysis of the impact of Kupedes and Simpedes on women with respect to improving income generating capacity. Policy inputs will depend on research results.

In addition to looking at borrowers, the training and policy T/A team will be reviewing BRI personnel policies with respect to women. Although the central offices tend to have a large percentage of female staff, the Unit Desa employees are almost exclusively males. Recommendations will therefore be presented with respect to ensuring training accommodations and opportunities are made available to women candidates for Unit Desa positions.

VII. IMPLEMENTATION AND MONITORING PLAN

A. Implementation and Monitoring Responsibilities

The Amendment will be executed on behalf of the GOI by the Director General, Domestic Monetary Affairs, Department of Finance (MOF). Within this Directorate General, the responsible office will be the Directorate of Financial Institutions. This Directorate has been instrumental in developing the revised Unit Desa system and its start-up activities. The Directorate's responsibility under this Amendment will be to coordinate national-level policy discussions raised as a result of Amendment activities, to monitor BRI progress on training and operational developments, and to supervise the major research study. In addition the Directorate General's office will be responsible for the AID loan pass-through to BRI. Given MOF's dedication to starting up Kupedes and Simpedes, its well qualified staff, and its desire to see the program succeed, we are confident MOF will faithfully and professionally carry out its implementation and monitoring responsibilities.

The BRI representative who will be delegated implementation responsibility for Amendment training and operations activities will be the President Director of BRI. The President Director will share policy development responsibility with the BRI Board of Directors, as well as with MOF and BI when matters of national regulation are concerned. The President Director will delegate day-to-day responsibility for various aspects of the training and operations activities through the appropriate Director to one or more selected BRI section head. These delegations will be established in the Condition Precedent nominating authorized representatives. The BRI sections currently active in Unit Desa development include training, rural credit (KTN), and organizational development, and these sections will most likely continue to share implementation responsibilities. The USAID Project staff has found the BRI staff, from the central office down to the Unit Desa, to be competent and quite committed to transforming the Unit Desa into a going concern as planned in this Amendment. In many cases they are one step ahead of the planners, in others they are very receptive to new ideas. While not underestimating the difficulty of changing an institution of BRI's size and scope, BRI has presented itself as an active advocate for change and for the concept of free market operations. We fully expect BRI to meet or exceed the implementation responsibilities and goals under this Amendment.

The USAID monitoring responsibilities will be charged to the Office of Employment and Enterprise Development (EED). Since EED is already very involved in financial institution and policy reform, this Amendment matches well the current 'private sector' program. However, given the expanded scope of the FID Project and other financial sector activities, EED will be recruiting a qualified Indonesian finance expert to assist the FID Project Officer in fulfilling implementation and monitoring responsibilities.

Monitoring and evaluation tasks of all parties involved will be supported by both the automation system to be initiated and by the major research activity. These will provide invaluable and timely data on system performance, beneficiary impact, general trends and activities requiring greater attention.

E. Contracting Plan

Technical assistance contracting will involve three separate contracts, and procurement will involve two contracts. All technical assistance is grant-financed and will therefore be U.S. (Code 000) or Indonesian source. The commodities are all loan-finance and will be open to Code 941 source/origin. Most of the contracting actions will be BRI's responsibility. The USAID Project staff has reviewed BRI contracting procedures, and has concluded that their procedures and capabilities are much better than generally found in host country institutions. BRI will also be responsible for obtaining SEKNEG and other necessary GOI approvals for contract actions. Reserve funds of \$ 150,000 for audit of non-USG contracts has been allocated (see Section IV Cost Estimates).

The plan for each of the five activities is as follows:

1. Training and policy T/A - It is proposed that this be a host country contract awarded by BRI on a competitive basis, including HIID as an eligible source. Since prompt start-up of this contract is essential, we envisage going directly to an RFP stage without prequalification. The scope of work is in Appendix F.
2. Operations T/A - This is also proposed as a host country contract, with BRI to competitively solicit proposals. It is anticipated that a prequalification step will be included to narrow the field. USAID will actively support and recruit potential S (A) or other disadvantaged firms or entities in the prequalification process. The scope of work for this contract may also be found in Appendix F.
3. Research T/A - There remains a fair amount of preparation before the terms of reference for this activity can be completed. The intent is for a U.S. institution, most probably Ohio State University, to come to Jakarta during July - August, 1986 to prepare the T.O.R. for the research component. This assistance would be financed from PL&S funds. The choice of Ohio State as a possible candidate is based on their on-going contract with the S&T bureau to provide agency-wide assistance on rural credit projects.

Once the T.O.R. is available the decision on the contracting mode for the U.S. research T/A will be made. This will likely be a host country contract, competitively bid and administered by MOF. MOF will separately be contracting from GOI funds for the Indonesian research team.

4. Communications equipment - This will be a BRI competitively bid contract, awarded on the basis of lowest price. Draft specifications for the VHP radio equipment are being prepared by BRI staff. Once

they are available in draft, USAID will request AID/W assistance in reviewing the specifications. Bids will then be solicited through the CBD and other appropriate media.

5. Automation equipment - This will also be a competitively bid BRI procurement. The specifications are to be provided by the operations T/A team as part of the automation plan, which is a CP for this procurement.
6. In approving this Project Paper Amendment, the Mission Director certifies that use of Gray Amendment entities to implement this Amendment has been considered to the maximum extent possible.

C. Disbursement Plan

The proposed method for disbursing USAID funds for the various Amendment activities is as follows:

1. The training, operations and research T/A contracts will all use a standard cost-reimbursable contract format. Funds should therefore be reimbursed directly by USAID to the contractor upon receipt of approved monthly invoices.
2. The training matching funds are limited to \$500,000 (rupiah equivalent) per year for three years. BRI will be prefinancing all training costs and will submit regular training expenditure invoices directly to USAID. USAID will then reimburse BRI for all eligible non-recurring training expenditures until the total for each calendar year reaches \$500,000 equivalent. The training/policy advisory team will assist ERI in tracking and invoicing these expenditures. (See Appendix E for training expense details.)
3. Commodities will all be paid lump-sum based on delivery of goods (up to 90 percent) and final acceptance (balance due). Since USAID is financing 50 percent or up to a total of \$ 2.5 million, whichever is less, USAID will pay only that portion of each invoice attributable to USAID's share of the total cost.
4. Construction activity will be financed on a fixed amount reimbursement (FAR) basis, USAID paying up to 50 percent of the total cost for each of the four construction sites. Details concerning the FAR payments will be negotiated once the local A&E firms submit preliminary cost estimates and plans. Negotiation of FAR procedures and amounts will be a Condition Precedent to disbursement for construction activities. It is assumed all FAR payment will be lumpsum, either on a percentage of completion basis or one-time final payment basis. All payments will be subject to USAID engineering staff approval.

D. Evaluation Plan

Scheduled evaluation of Amendment activities will consist of three events:

1. A one-month two person study will be conducted at the end of the first year of formal BRI regional training to evaluate the new training system, including quality of training materials, BRI trainers, Amendment-financed T/A team, and program content. The two-person team will consist of one Indonesian banking expert and one U.S. training expert, the team to be jointly finance by EKI and AID under the Amendment. The estimated USAID budget is \$20,000.
2. The initial study of beneficiary profile and impact will be conducted during CY 1988. This will be conducted under the major research contract, and will focus on both the BKK-type and Unit Desa beneficiaries. Data collection will be planned for and perhaps initiated early in the research contract, except that a more intensive survey and official report will be required at the end of the scheduled evaluation. The budget for this study is included within the research line item.
3. A final evaluation will begin in January, 1990. This evaluation will be conducted before the PACD to provide feedback on any possible need for extension or final revisions to the Amendment. This evaluation will cover all activities under the Amendment, particularly progress toward end of project status and results of the research component. This evaluation will be financed by USAID under the evaluation line item. The estimated USAID budget is \$80,000, the total evaluation budget therefore being \$100,000.

E. Schedule

The schedule of proposed activities and important events under the Amendment is as follows. (Note: TRTA = training and policy team, RESTA = research technical assistance team, OPTA = operations technical assistance team.)

<u>Date</u>	<u>Responsible Party(s)</u>	<u>Event</u>
1. June 86	MCF/USAID	Project Agreement signing
2. July 86	MOF/BRI	Initial CPs met
3. July 86	BRI/USAID/TRTA	TRTA T/A contract signed, team mobilized
4. July 86	BRI/TRTA	Begin preparation of training manuals
5. July 86	BRI	Select BRI regional training staff, fulfill training CP
6. July 86	USAID	Recruit AID consultant to design research program
7. Aug 86	BRI/TRTA	Begin training for new BRI regional trainers

8. Aug 86	BRI/USAID	Review A&E plans for regional training center construction, negotiate FAR payments, fulfill construction CP
9. Aug 86	BRI	Advertise for prequalification of operations T/A Contract
10. Sep 86	MCF/USAID	Complete T.O.R. for research contract, advertise for proposals
11. Sep 86	BRI	Solicit bids for local construction contracts
12. Nov 86	BRI/USAID	RFP for operations T/A contract issued to prequalified firms
13. Jan 87	BRI	Local construction contractors selected, work begins on regional centers
14. Jan 87	BRI/USAID	Complete specs for communications equipment, advertise procurement
15. Feb 87	BRI/USAID	Operations T/A contract awarded
16. Mar 87	MCF/USAID	Research contracts awarded
17. May 86	BRI	Rental space arranged for 1987 regional training program, trainers sent to the regional centers, administrative operations for training in place
18. June 87	BRI/TRTA	Training manuals completed
19. June 87	BRI/TRTA	Regional training programs begin
20. June 87	BRI/USAID	Award communications equipment contract
21. June 87	MCF/RESTA	Initiate research survey work
22. Jan 88	BRI/OPIA	Complete accounting review, recommend changes
23. Jan 88	BRI	Complete construction of regional training centers

24. Jan 88	RESTA/MOF	Begin beneficiary survey
25. Feb 88	BRI/OPTA	Complete automation plan and specifications, advertise for automation procurement
26. June 88	BRI/USAID	Evaluate first year training
27. Aug 88	BRI/USAID	Award automation contract, begin equipment installment
28. Dec 88	USAID/RESTA/MOF	Evaluation of beneficiary impact
29. Mar 89	BRI/OPTA	New accounting and automation system operational nation wide
30. June 89	BRI/TRTA	Final year of training program begins
31. Jan 90	USAID	Final evaluation begins
32. Mar 90	MOF/RESTA	Final research report received, research contract expires
33. June 90	BRI/OPTA/TRTA	Operations and training contracts completed
34. June 90	BRI	Three year training program completed
35. June 90	MOF/BRI/USAID	Close out Amendment activities

F. Conditions Precedent

Conditions Precedent (CPs) to be included in the loan and grant agreements should include the following:

1. Initial CPs - These would include standard requirements such as a legal opinion, plus a requirement for executed Subsidiary Loan and Grant Agreements between the Ministry of Finance and BRI.
2. CP to Disbursement of FAR Construction Funds - This CP will require the completion, review and approval of preliminary cost estimates and plans for all construction sites to the satisfaction of the USAID engineering staff, and the negotiation of a FAR payment agreement between BRI and USAID.

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APPENDIX A

REPUBLIC OF INDONESIA
NATIONAL DEVELOPMENT PLANNING AGENCY
JAKARTA, INDONESIA

No. : *(M)* /D.I/6/1986

Jakarta, June 5 , 1986

Mr. William P. Fuller
Director
USAID/Indonesia
c/o American Embassy
Jakarta

Dear Mr. Fuller ,

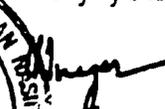
On behalf of the Government of Indonesia we hereby request an additional loan of \$ 5.75 million and an additional grant of \$ 4.25 million under the ongoing Financial Institutions Development Project No. 497-0341 to allow for additional funding for institutional development within the Bank Rakyat Indonesia.

These additional loan and grant funds would increase the project amount to \$ 21.25 million loan and \$ 7.25 million grant over the 7-year life of project. The Government of Indonesia will provide an additional rupiah equivalent of \$ 6.75 million in cash and in kind contributions or total contributions of rupiah equivalent of \$ 16.0 million in cash and in kind in support of this project.

This project will be implemented by the Ministry of Home Affairs and the Ministry of Finance and their implementing units.

We look forward to your favourable consideration.

Sincerely yours,


M. Farudin Siregar
Deputy Chairman



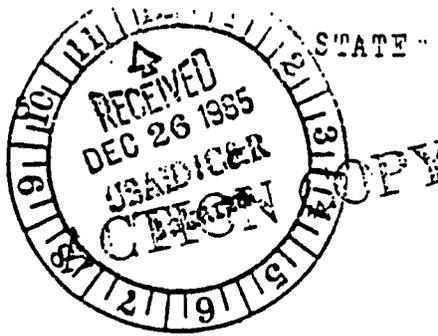
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APPENDIX - B

ACTION AID 3 INFO ECON CHRON



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CN: 02691
CHRG: AID
DIST: AID

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DE RUEHC #0380 3590029

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TO AMEMBASSY JAKARTA PRIORITY 5265

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PRIORITY

WORKING COPY

F.C. 12356: N/A

TAGS: N/A

SUBJECT: FINANCIAL INSTITUTIONS DEVELOPMENT PROJECT
(497-0341): PROPOSED PROJECT PAPER AMENDMENT

REFS: (A) JAKARTA 20188, (B) STATE 362919 AND (C)
JAKARTA 18494

1. AA/ANE APPROVES USAID'S REQUEST FOR REDELEGATION OF AUTHORITY TO APPROVE SUBJECT PROJECT AMENDMENT, INCREASING TOTAL FUNDING TO DOLS 28.5 MILLION. PROJECT COMMITTEE GUIDANCE FOR AMENDMENT PREPARATION FOLLOWS.

2. LOAN GUARANTEE FUND: THE PROJECT COMMITTEE CONCURS WITH MISSION DECISION (REFTEL A) TO DELETE THE PROPOSED LOAN GUARANTEE FUND AND INCREASE TRAINING COMPONENT BY DOLS 1.0 MILLION IN LOAN FUNDS.

3. SUPPORT FOR PUBLIC CREDIT INSTITUTION: THE COMMITTEE RAISED THE CONCERN WHETHER THE ORIGINAL PROJECT JUSTIFICATION FOR SUPPORTING A PUBLIC CREDIT INSTITUTION REMAINS VALID. THE BUREAU JUSTIFIES USE OF PUBLIC SECTOR CREDIT INSTITUTIONS ON THE BASIS THAT IT IS THE ONLY WAY TO REACH RURAL MICRO-ENTERPRISE AND DOES NOT NOW COMPETE WITH PRIVATE INSTITUTIONS. IN THE

ORIGINAL PROJECT, SMALL BANK KREDIT KECAMATAN-TYPE LOANS ARE CLEARLY NOT ATTRACTIVE TO PRIVATE BANKS. BANK RAKYAT INDONESIA (BRI) LOANS WILL BE LARGER AND MAY SERVE A SOMEWHAT DIFFERENT CLIENTELE. IN VIEW OF THE LARGER SCALE ACTIVITY, COMMITTEE IS CONCERNED THAT THE JUSTIFICATION FOR SUPPORTING PUBLIC SECTOR INSTITUTIONS REMAINS VALID. IN PARTICULAR, AID SHOULD NOT HELP DEVELOP A PUBLIC SECTOR FINANCIAL INSTITUTION WHICH WOULD, OVER TIME, PRESENT SUBSIDIZED PARASTATAL COMPETITION TO THE EXPANDING PRIVATE SECTOR FINANCIAL SYSTEM RATHER THAN SERVE TO CREATE A NEW MARKET FOR PRIVATE LENDERS. MISSION SHOULD ADDRESS THIS ISSUE IN THE AMENDMENT, INDICATING HOW YOU WOULD ENSURE THAT THE ASSISTED PROGRAM WOULD FOSTER AND NOT DETER THE GROWTH OF PRIVATE BANKING IN THAT MARKET.

USAID	ROUTING
TO	ACT. INFO
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DDPA	<input type="checkbox"/>
REG/DEV.	<input type="checkbox"/>
LA	<input type="checkbox"/>
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PES	<input type="checkbox"/>
DMC	<input type="checkbox"/>
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4. LINKAGE BETWEEN BRI AND POLICY REFORMS: AMENDMENT SHOULD SPELL OUT HOW RURAL CREDIT POLICY REFORMS IN PARA 4 (C) (1) REPTEL C WILL BE LINKED TO BRI PROJECT ACTIVITY.

5. AGRICULTURAL VERSUS NON-AGRICULTURAL FOCUS: ORIGINAL PROJECT FOCUSES EXCLUSIVELY ON NON-FARM ENTERPRISE AND PROPOSED BRI EXPANSION WILL APPARENTLY INCLUDE AGRICULTURE PRODUCTION CREDITS AS WELL. RATIONALE FOR CHANGING PROJECT TO COVER MORE COMPLETELY THE CREDIT REQUIREMENTS OF RURAL FAMILIES/BUSINESSES MUST BE MADE MORE EXPLICIT IN AMENDMENT.

6. EVALUATION: THE COMMITTEE ACCEPTS MISSION ARGUMENT FOR PROCEEDING WITH THIS AMENDMENT WITHOUT AN EVALUATION OF ORIGINAL PROJECT. NEVERTHELESS, IT WISHES TO EMPHASIZE THAT FIRST EVALUATION REMAINS CRITICAL (NOW SCHEDULED FOR FIRST QUARTER OF FY 87) TO ENSURE ADEQUATE MONITORING AND ASSESSMENT OF OVERALL ACTIVITY.

7. WID CONCERNS: THE COMMITTEE HAS RAISED CONCERNS ABOUT THE IMPACT OF AMENDMENT ON WOMEN. ANE/PD IS PREPARING MEMORANDA ON THIS CONCERN TO MISSION FOR CONSIDERATION IN DEVELOPING COMPONENTS AND EVALUATION BENCHMARKS FOR PROJECT. ARMACOST

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Appendix C

FAA SECTION 611 (e) CERTIFICATION
FINANCIAL INSTITUTIONS DEVELOPMENT PROJECT AMENDMENT

As part of the \$ 18.0 million Amendment to the Financial Institutions Development Project, which primarily involves the provision of training assistance for the Bank Rakyat Indonesia (BRI) rural banking system, USAID will assist in financing the construction of three regional training centers. Design, construction management and maintenance of these facilities will all be supervised or conducted by the BRI. The USAID contribution will be 50 percent of construction costs or \$ 1.65 million, whichever is less, and will be in the form of Fixed Amount Reimbursements.

This is to hereby certify my determination that BRI has the financial and human resource capability to effectively maintain and utilize these project facilities, particularly taking into account BRI's past record of sound facilities management and effective utilization of donor assistance.



William P. Fulier
Director

Legislation of the Republic Indonesia
Number 21,
Bank Rakyat Indonesia

With the Grace of the Lord Almighty the President of the Republic of Indonesia considers:

- a. With the issuance of the Bank Indonesia's legislation No. 13 in 1968 it is considered necessary to establish a state owned bank to receive responsibility and obligations, property and equipment from the Bank Negara Unit II;
- b. That the Bank Negara Unit II stated in (a) above originally was the Bank Koperasi Tani dan Nelayan (Farmers and Fishermen's Cooperatives Bank) established with the Legislation No. 41;
- c. That the task and function of this state owned bank, besides as a general bank as to the whole extend, need be directed to serve the cooperatives sector, farmers and fishermen and to be in accordance with Bank Legislation.

With the approval of DPR - Gotong Royong
Legislation Concerning Bank Rakyat Indonesia

Part I: Determination of the Establishment

Chapter 1

- (1) With the name "Bank Rakyat Indonesia" a state owned bank was established.
- (2) Bank Rakyat Indonesia with the legal status has the right to operate and do business in accordance with this legislation.
- (3) Without decreasing any determinations of this legislation, any other Indonesian laws are valid to this Bank Rakyat Indonesia.

Part II: General Determinations

Chapter 2

What is meant in this legislation with:

- a. "Government" is the President of the Republic of Indonesia.
- b. "Bank Indonesia" is the Central Bank, established based on the legislation of Bank Indonesia in 1968.
- c. "President Director" is the President Director of the Bank Rakyat Indonesia.
- d. "Director" is a Director of Bank Rakyat Indonesia.
- e. "The management" is the President Director and the Directors of Bank Rakyat Indonesia.
- f. "Supervisory Council" is the Supervisory Council of Bank Rakyat Indonesia.
- g. "Bank" is the Bank Rakyat Indonesia.

Chapter 3

- (1) The bank is located and the head office is in Jakarta.
- (2) The bank may have offices/branches or representatives in-country and abroad.

Part III: Bank's Capital

Chapter 4

- (1) The Bank's total capital is Rp. 300,000,000 (three hundred million rupiahs) from the set-aside State property.
- (2) The Bank's capital mentioned in (1) above could be added with the approval of DPR.

Chapter 5

- (1) Bank established a reserved general funds and should be developed in accordance with the determination stipulated in Chapter 21 paragraph (6) a.
- (2) The reserved general funds will be used to cover possible of loss against the banks' capital.

Chapter 6

- (1) Bank established reserved funds for goals in accordance with the determination stipulated in Chapter 21 paragraph (6) b.
- (2) Any reserved funds developed should be clearly shown in the banks' accounting books.

Part IV: Task and Bank's Business

Chapter 7

The task and business of the bank is directed to improve people's welfare and develop the national economy thru general banking services which will give the priority to:

- (1) Credit extended to cooperatives, farmers and fishermen thru:
 - a. assisting development of cooperatives primarily in agriculture and fisheries;
 - b. assisting farmers and fishermen who are not yet integrated in a cooperative to develop their efforts in agriculture and fisheries fields, encourage and lead them to a mutual effort based on cooperative foundation.
- (2) Assist people who are not yet integrated in a cooperative carrying out activities in handicrafts, small industries, small enterprises and small trading;
- (3) Assist government's effort in the implementation of the agrarian policy;
- (4) Assist government's efforts in the development of rural people;
- (5) Develop and supervise village credit units, market banks and other similar banks in accordance with the direction and guidance of Bank Indonesia.

Part V: The Management

Chapter 8

- (1) The bank is managed by the President Director with a minimum of two and maximum four Directors.
- (2) a. The President Director and the Directors will be appointed by the Government as proposed by the Minister of Finance for a five-year term.
- b. To be able to be appointed as President Director and Directors they should be Indonesian citizen who have the expertise and of in good and moral conduct.

Chapter 9

- (1) The task and obligation of the management are to set forth policy of the bank.
- (2) For the implementation of the tasks and obligations stated, the management is to be responsible to the Government.
- (3) Decisions made by the management are to be based on through discussions leading to agreement.
- (4) The management appoints and discharges bank's personnel in accordance with the bank's personnel regulations without decreasing any valid determinations based on Government's regulations.
- (5) The management may determine salary, retirement and retirement allowances and other income of the bank's personnel.
- (6) Procedures for implementation of the management tasks and obligations are set forth in regulation determined by the management.

Chapter 10

- (1) The Government may discharge member of the management although the length of their services has not ended, for the following reasons:
 - a. death;
 - b. conduct or acts that result in damage to the Bank or are not in line with Government's interest;
 - c. for any reason that he/she is unable to carry out his/her task normally;
 - d. at his/her own request.
- (2) In matters where there is assumption of accusation under paragraph 1b, the member of the management could be discharged temporarily by the government as proposed by the Minister of Finance. That temporary disposition will be conveyed to the concerned party by written notification along with the reasons of the action.
- (3) Any member of the management who is on temporary disposition status will be given a chance for a written appeal to the Government within two weeks after the notification of the decision.
- (4) If within a month after the date of the temporary disposition there is no certification or decision made by the Government, therefore the temporary disposition will not be in force in accordance with law.
- (5) If the violation as stipulated in (1b) is a violation of the criminal law, therefore the disposition will be categorized as a dishonored disposition.

Chapter 11

- (1) Within members of the management there should be no relative relationships thru the third degree, vertical or horizontal line, including in-laws. If when after the assignment they are found to be involved in that prohibited relationships, therefore one of them may not be allowed to continue the assignment without approval from the government.
- (2) Members of the management may not be involved in business or interest in any other enterprises, directly or indirectly.
- (3) Members of the management may not be involved in other function except with the approval of the Minister of Finance.

Chapter 12

Salary and other income of members of the management are to be determined by the Government as proposed by the Minister of Finance.

Chapter 13

Valid regulations concerning prosecution for repayment or loss toward civil servants non treasurer, will also be valid to the members of the management and the bank employees.

Chapter 14

- (1) The management represents the bank in or outside court.
- (2) The management may delegate its authority stipulated in paragraph (1) to an individual or to several directors particularly appointed for that capacity or to someone or several employees of the bank individually or as group or to other people/other organizations.

Part VI: Supervisory

Chapter 15

- (1) The supervisory council is to supervise the management of the bank by the Directors.
- (2) The number of the supervisory council shall consist of a minimum of 3 and maximum 5 members appointed by the Government as proposed by the Minister of Finance. One of the members is to be appointed as chairperson of the supervisory council.
- (3) To be able to be appointed as member of the supervisory council they should be Indonesian citizen who have the expertise and are of good and moral conduct.
- (4) The appointment of a supervisory council member will be for three years. When the first three years appointment is completed, members of the supervisory council involved can be reappointed.
- (5) Within members of the supervisory council and members of the management there should be no relative relationships thru the third degree, vertical or horizontal line, including in-laws.
- (6) If when after the appointment a member of the supervisory council is involved in that prohibited relationships with the member of the management as stipulated in paragraph (5), therefore the supervisory council member involved may not continue the appointment without approval from the government.

Chapter 16

- (1) The supervisory council, within its limited authority, is to supervise so the bank's operation and management to determine if they are implemented properly.
- (2) The chairperson and the other members of the supervisory council individually or as a group have the right to request any information and review books and documents, and have the right to appoint experts for investigation of the books and documents or anything considered necessary to implement their obligations.
- (3) The management is obliged to provide any information that is required.
- (4) Bank Indonesia may establish a general outline of the tasks and responsibilities of the management and supervisory council of the bank.

Chapter 17

- (1) The supervisory council shall hold a meeting at least once every three months or at any other time in accordance with the consideration of the chairperson or at a written request of one of the members of the supervisory council or the management. All expenses will be borne by the bank.
- (2) Decisions made by the supervisory council will be based on the wisdom of discussions leading to an agreement.
- (3) Procedures for the supervisory council will be determined by the supervisory council itself.
- (4) The supervisory council may appoint a secretary and the salary will be decided by the council and to be charged to the bank.
- (5) The chairperson and members of the supervisory council are to receive compensation for their services. That amount is to be decided by the Minister of Finance and will be charged to the bank.

Chapter 18

- (1) Bank Indonesia will conduct supervision and direction of the development of the bank's management in accordance with the determination set forth in the 1968 Bank Indonesia law and the Banking law of 1967.
- (2) The management is obliged to provide any information required to implement the supervision stipulated in paragraph (1) above.

Part VII: Retirement Regulations and Allowances, Bank's Employee

Chapter 19

- (1) The bank shall develop a retirement fund and allowances for the bank's employees as a set-aside property.
- (2) The bank is obliged to make every effort so that the amount of the reserved funds will be equal to the lumpsum amount to be received by the employees as well as to make every effort to maintain the value of the lumpsum.
- (3) The Bank shall provide contribution to the formation of the funds stated in paragraph (1).
- (4) The retirement and old age allowance fund for the bank's employee's as stated in paragraph (1) and the bank's contribution to the funds as stipulated in paragraph (3) are not computed in the fund as stated in Chapter 21, Paragraph 6 a and c.

- (5) Further determination concerning the fund stated in paragraph (1) as well as contribution stated in paragraph (3) will be decided by the management.

Part VIII: Budget and Work Plans

Chapter 20

- (1) The management will set up budget and work plans annually for the supervisory council for the new fiscal year during the month of September at the latest.
- (2) At the beginning of a new fiscal year the supervisory council has not yet conveyed any objection, therefore the budget and the work plans will be completely in force.
- (3) Any changes in the budget and work plans during the on-going fiscal year should be approved by the supervisory council prior to implementation.
- (4) When a fiscal year has ended the management will report to the supervisory council (within 3 months at the latest) concerning implementation of the company budget and the work plans.
- (5) The approved budget and work plans and the implementation thereby will be reported to Bank Indonesia.

Part IX: Annual Computation

Chapter 21

- (1) The bank fiscal year is the calendar year.
- (2) The management is to prepare and submit an annual computation particularly on the balance and the computation of profit and loss to the supervisory council, six months at the latest after the fiscal year ends further forwarded to the Minister of Finance for certification. The balance and the computation of profit and loss will also be submitted to Bank Indonesia.
- (3) The Directorate of State Accounting will then review the annual computation.
- (4) When, if after three months after the Minister of Finance receives the annual computation he does not convey any objection, it means that the annual computation has been certified by the Minister.
- (5) The certification of the balance sheet and the computation of loss and profit will completely release responsibility of the management.
- (6) The certified profit after the deduction of taxes will be distributed as follows:
 - a. 20% (twenty percent) to the general reserved funds until it reaches the total amount of the bank's capital.
 - b. 20% (twenty percent) to the goal reserved funds.
 - c. 7.5% (seven point five percent) to the welfare of the bank's employees; the use of these funds will be in accordance with the Government's directions.
 - d. 7.5% (seven point five percent) for bonuses for the Bank's employees to a maximum of three months salary.
 - e. The use of the remaining profit (45%) will be decided by the Government.

Part X: Crime Determination

Chapter 22

- (1) Members of the management and the bank's employees, members and secretary of the supervisory council shall not release any information unless as needed for the implementation of duties and obligations in accordance with the Banking law of 1967 and Bank Indonesia law of 1968.
- (2) When members of management or the banks' employees, members or secretary of the supervisory council passed out information which is in contrary to paragraph (1), they will be punished in jail maximum 1 year and or maximum Rp. 10,000 fine.
- (3) The act in paragraph (2) is considered criminal.

Part XI: Disolution

Chapter 23

- (1) The disolution of the bank and the appointment of a liquidator will be decided by laws.
- (2) When the bank is disolved, all debts and other financial obligations will be paid by the bank's property. Anything left will become the State property.
- (3) The responsibility for the liquidation by a liquidator is delegated to the Government who shall release responsibility of the liquidator upon completion of the job.
- (4) When if after liquidation there still remain other financial obligations, that will be the responsibility of the Government.

Part XII: Transition

Chapter 24

- (1) All rights and obligations as well as property and equipment of the Bank Negara Indonesia Unit II as stipulated in the President's Decision (PENPRES) NO. 17 of 1965, was transferred to the rights and obligations, property and equipment of the bank.
- (2) At the time this law comes into effect, members of the management and other employees of the Bank Negara Indonesia Unit II will continue to work on their job until further decisions are made.
- (3) At the time when the Import and Export Bank law comes into effect therefore:
 - a. All rights and obligations as well as property and equipment of the ex Bank Negara Indonesia Unit II, EXIM Department will be handed over to Bank Expor Impor Indonesia.
 - b. All employees of the ex Bank Negara Indonesia Unit II, EXIM Department will become the employees of the Bank Expor Impor Indonesia until further determination.

Chapter 25

To keep continuity of leadership within the bank's management, the first appointment of member of the management may deviate from the determination of the terms of services as stipulted in Chapter 8 paragraph (2) a.

Chapter 26

The date of the bank's first fiscal year as determined by the Minister of Finance will end on 31 December 1969.

Part XIII: Closing Determination

Chapter 27

Matters that have not been sufficiently described in this law will be determined by Government regulation.

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Appendix E

Unit Desa Training Plan

The following tables set forth the plan and costs involved in conducting the three-year Unit Desa training program under this Amendment. Tables E.1 and E.2 show the number of Unit Desa staff, and Cabang supervisors and auditors, and provide a summary of staff vacancies, training already received and training required.

Table E.3 shows the calculations of the cost for each type of course. As noted, the Type 1 will be a four week course for Cabang staff and heads of Unit Desa (each position will be taught separately, but costs will be the same); Type 2 will be a four week course for loan officers; Type 3 will be a two week course for bookkeepers; and Type 4 will be a one week field course for cashiers and post attendants. All costs represent actual rates approved for various job categories and best estimates of current lodging and food costs for each of the four regional training locations.

The fourth table then summarize the three year training costs, showing the number of employees to be trained, number of courses required, and multiplying each course by the estimated cost of the course from Table E.3. The total estimate of non-recurring costs is Rp. 4,007,600, which is the equivalent of \$3,578,214. Since hotel charges in two provinces will only be required until the new regional centers are completed, we have estimated total non-recurring costs will be slightly lower, or approximately \$3,000,000.

INVENTORY OF EMPLOYEES
UNIT DESA
BANK RAKYAT INDONESIA

Regional Office	Head of Unit Desa						Unit Desa Loan Officer						Unit Desa Bookkeeper						Unit Desa Cashier					
	TN	AT	T-/+	ALT	FT	NFT	TN	AT	T-/+	ALT	FT	NFT	TN	AT	T-/+	ALT	FT	NFT	TN	AT	T-/+	ALT	FT	NFT
Banda Aceh	73	-	-73	27	-	-	73	69	-4	42	60	9	73	72	-1	4	30	42	73	65	-8	-	17	40
Medan	183	143	-40	-	143	-	183	93	-90	10	90	-	183	183	-	-	-	183	183	179	-4	-	-	171
Padang	134	160	+34	35	156	4	134	137	-	-	130	7	134	144	+10	-	-	-	134	142	-9	-	-	-
Palembang	246	215	-31	39	151	64	246	194	-52	30	106	88	246	220	-26	37	-	220	246	220	-26	37	-	220
DKI Jaya/Kalbar	31	24	-7	-	7	14	31	24	-7	-	-	17	31	29	-	-	-	30	31	30	-1	-	-	30
Bandung	354	527	+173	173	512	178	575	537	+38	41	401	135	381	624	+243	243	-	624	354	576	+222	223	-	576
Semarang	497	646	+149	-	612	34	497	652	+155	-	622	30	497	623	+126	-	623	-	497	632	+135	-	632	-
Yogyakarta	66	65	-1	7	54	11	85	66	-19	9	55	11	82	82	-	6	7	75	66	66	-	5	-	66
Surabaya	441	450	+9	-	386	64	441	521	+80	-	461	60	615	656	+41	-	-	656	615	613	-2	-	-	613
Denpasar	97	130	+33	-	113	17	121	114	-7	-	66	48	162	143	-19	-	-	143	162	110	-52	-	-	110
Banjarmasin	69	63	-6	-	40	14	69	46	-23	-	34	12	69	67	-2	-	-	67	69	65	-4	-	-	65
Ujung Pandang	139	170	+31	31	170	-	280	140	-140	-	106	34	215	188	-27	-	-	188	215	197	-18	-	-	197
Manado	76	71	-5	-	55	16	76	42	-34	-	40	3	76	74	-2	-	-	74	76	48	-28	-	-	48
Kupang	37	37	-	9	8	27	37	49	+12	9	17	28	37	75	+38	9	75	-	37	75	+38	9	75	-
Total	2443	2701	328	321	2415	443	2848	2684	(95)	149	2275	402	2801	3180	(53)	299	735	2302	2758	3010	243	274	724	2599

TN = Total Needed, No. of employees
 AT = Actual total, No. of employees
 +/- = Total Minus/Plus
 ALT = Alternate Staff
 FT = Formally Trained (e.g. having already attended BRI formal training)
 NFT = Not yet Formally Trained (through BRI)

TABLE E-2
INVENTORY OF EMPLOYEES
UNIT DESA SUPERVISORS AT BRANCH OFFICES (CABANGS)
BANK RAKYAT INDONESIA

Regional Office	No. Unit Desa	No. Cabang	Unit Desa Officer						Unit Desa Section Head						Unit Desa Auditor					
			TH	AT	T-/+	ALT	FT	NFT	TH	AT	T-/+	ALT	FT	NFT	TH	AT	T-/+	ALT	FT	NFT
Banda Aceh	73	10	-	-	-	-	-	-	3	3	-	-	-	3	13	9	-4	-	2	7
Hedan	183	15	2	2	-	-	-	-	-	-	-	-	-	35	23	-12	-	23	23	
Padang	134	20	-	-	-	-	-	-	-	-	-	-	-	33	29	-4	-	28	1	
Palembang	246	25	4	3	-1	1	-	3	-	-	-	-	-	44	39	-5	20	39	-	
DKI Jaya/Kalbar	33	14	-	-	-	-	-	-	-	-	-	-	-	3	1	-2	1	1	1	
Bandung	354	30	20	20	-	-	-	20	44	39	-5	-	44	111	117	+6	7	80	31	
Semarang	497	41	10	10	-	-	-	10	40	37	-3	-	32	5	121	119	-2	-	111	8
Yogyakarta	66	6	-	-	-	-	-	-	4	4	-	-	4	-	11	11	-	2	9	2
Surabaya	441	33	9	16	+7	9	12	4	40	36	-4	9	17	29	92	95	+3	-	65	30
Denpasar	97	14	-	1	1	-	-	1	-	-	-	-	-	19	22	-3	-	20	2	
Banjarmasin	69	24	-	-	-	-	-	-	-	-	-	-	-	14	2	-12	-	2	12	
Ujung Pandang	139	30	-	-	-	-	-	-	27	4	-23	-	-	4	30	34	+4	4	34	-
Manado	74	14	-	-	-	-	-	-	3	3	-	-	-	3	16	11	-5	-	4	6
Kupang	37	13	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	2,443	289	45	52	7	10	12	38	161	126	-35	9	53	88	54	512	13	34	418	86

TH = Total Needed, No. of employees
 AT = Actual Total, No. of employees
 T -/+ = Total Minus/Plus
 ALT = Alternate Staff
 FT = Formally Trained (e.g. having already attended BRI formal training)
 NFT = Not yet Formally Trained (through BRI)

TABLE E-3: UNIT DESA TRAINING
SUMMARY OF NON-RECURRING EXPENSES PER COURSE (Rp. 000)

EXPENSE ITEM	PADANG				YOGYAKARTA				SURABAYA				UJUNG PADANG			
	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
1. Food	2,880	2,880	1,530	810	1,920	1,920	1,020	540	1,920	1,920	1,020	540	2,880	2,880	1,530	810
2. Hotel	4,800	4,800	2,550	1,350	-	-	-	84	-	-	-	-	7,200	7,200	3,825	2,025
3. Laundry/Misc.	3,150	2,700	1,350	630	3,060	2,610	1,305	525	3,060	2,610	1,305	609	3,150	2,700	1,350	630
4. Travel	3,000	3,000	3,000	-	3,000	3,000	3,000	-	3,000	3,000	3,000	-	3,000	3,000	3,000	-
5. Course Matl.	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500
6. Supplies/Rep.	300	300	300	300	300	300	300	300	300	300	300	300	300	300	300	300
7. Staff Honor	648	540	270	135	648	540	270	135	648	540	270	135	648	540	270	135
8. Testing/Cert.	632	544	544	544	632	544	544	544	632	544	544	544	632	544	544	544
Sub-total	16,910	16,264	11,044	5,269	11,060	10,414	7,939	3,628	11,060	10,414	7,939	3,628	19,310	18,664	12,319	5,944
Contingency	90	36	56	31	40	86	61	72	40	86	61	72	90	36	81	56
Total	17,000	16,300	11,100	5,300	11,100	10,500	8,000	3,700	11,100	10,500	8,000	3,700	19,400	18,700	12,400	6,000

- 1 - 4 week course for 30 staff, including Cabang supervisors and Unit Desa heads
 2 - 4 week course for 30 staff, including Unit Desa loan officers
 3 - 2 week course for 30 staff, including Unit Desa bookkeepers
 4 - 1 week course for 30 staff, including Unit Desa cashiers

TABLE E-4: UNIT DESA TRAINING
THREE-YEAR TOTAL NON-RECURRING TRAINING COSTS (Rp. 000)

	PADANG			Total Costs	YOGYAKARTA			Total Costs	SURABAYA			Total Costs	UJUNG PANDANG			TOTALS	
	# Student	# Courses	Cost per Course		# Student	# Courses	Cost per Course		# Student	# Courses	Cost per Course		# Student	# Courses	Cost per Course		Total Costs
UDO	6	-	17,000	-	30	1	11,100	11,100	9	-	11,100	-	-	-	19,400	-	11,100
Kepala Seksi	66	2	17,000	34,000	75	3	11,100	33,300	74	3	11,100	33,300	38	2	19,400	38,800	139,400
Penilik UDES	125	4	17,000	68,000	246	8	11,100	88,800	125	4	11,100	44,400	46	2	19,400	38,800	240,000
Kaudes	636	21	17,000	357,000	548	31	11,100	344,100	644	21	11,100	233,100	215	7	19,400	135,800	1,070,000
Mantri	636	21	16,300	342,300	1188	39	10,500	409,500	668	22	10,500	231,000	356	11	18,700	205,700	1,188,500
Pembuku	636	21	11,100	233,100	991	33	8,000	264,000	883	29	8,000	232,000	291	9	12,400	111,600	840,700
Kasir	636	21	5,300	111,300	948	31	3,700	114,700	883	29	3,700	107,300	291	9	6,000	54,000	387,300
TPD	21	1	5,300	5,300	586	20	3,700	74,000	267	9	3,700	33,300	78	3	6,000	18,000	130,600
TOTALS:				1,151,000				1,339,500				914,400			602,700		Rp. 4,007,600 (Rp. 3,578,200)

Appendix F

SCOPE OF WORK FOR POLICY & TRAINING TECHNICAL ASSISTANCE

The contractor will provide two rural banking and finance experts for four years each as may be supplemented by short-term personnel. The principle task of the contractor will be to help BRI prepare for, conduct and administer a three-year intensive training program for approximately 13,000 Unit Desa and Cabang staff. This three year training shall consist of an estimated 35,000 person-weeks of formal training at four regional training centers. Training topics will cover all aspects of Unit Desa operations, development, supervision and audit.

In addition the contractors will act as principle policy advisors to the BRI and GOI concerning development, management and operation of the Unit Desa system.

The more specific tasks shall include but not be limited to:

I. TRAINING

Work with the Kepala and staff of Urusan KTN, POR, and Pendidikan, and especially the staff of the Bagian Pengembangan Unit Desa in the Urusan KTN in the following:

- A. Prepare training manuals as deemed necessary for each of the new formal Unit Desa training courses;
- B. Assist in the design and teaching of special courses for the new Regional Training staff;
- C. Assist in the design, including the preparation of curricula, for all regular training programs for Unit Desa staff, and for staff of the Kantor Cabang that are responsible for Unit Desa operations such as the Penilik, the Unit Desa officer, and head of the Unit Desa section;
- D. Assist in the design of training programs to meet special training needs, for instance to address special identified problems, utilize new accounting machines, initiate special efforts in savings, or make loans to special categories of borrowers;
- E. Advise on administrative needs and budget for the training programs;
- F. Recommend outside resources including individuals and/or organizations such as local consultant firms that can be utilized to further strengthen the training effort;
- G. Help initiate training efforts at the training centers, monitor the progress of training efforts, and assist the new training staff as time permits; and
- H. Report on a quarterly basis the progress on the training program.

II. POLICY

Advise ERI, the Ministry of Finance, and the Bank Indonesia on policy, including but not limited to:

- A. Unit Desa organizational issues including the relationships between all levels of the ERI - Kantor Pusat, Kantor Wilayah, Kantor Cabang, the Unit Desa, and the Unit Desa Service Posts.
- B. Unit Desa personnel policies including the salary, benefit and incentive structures of personnel; the status of Unit Desa employees within the ERI organization; potential promotion paths within the larger ERI organization; recruiting policies for new employees; and movement of Unit Desa Staff between locations.
- C. Financial issues related to future sources of funds for ongoing Unit Desa operations such as from bank of Indonesia liquidity credits, foreign sourced loans, special grants, internal savings mobilization, etc.
- D. Special accounting issues affecting Unit Desa long-term efficiency and effectiveness such as the methods of determining bad debt reserves; the methods for writing off bad debt from these reserves; the determination of supervision charges from the cabang attributable to Unit Desa operations; interest rate structures; collateral requirements; cash management; and policies for the retention of profits.
- E. Development of new service areas for the Unit Desa, such as money transfers, payment of government salaries, pension or tax collections, and check cashing.



SCOPE OF WORK
OPERATIONS T/A CONSULTANT

The Operations T/A Consultant shall consist of one long-term (3 year) advisor on audits, one long-term (3 year) advisor on accounting and automation, and several short-term (18 p-m) advisors in such areas as ADP, computer hardware, audit, communications and/or accounting. The consultant team shall report to the President Director of BRI and his designees, and shall serve as BRI's principle advisor on improving the efficiency of Unit Desa operations.

Specific tasks shall include but not be limited to:

I. AUDIT:

1. Assist the central and regional BRI training staff in the design and conduct of training courses for the Cabang Penilik Udes (auditors).
2. Review the current Cabang audit procedures and make recommendations to the BRI Board of Directors on needed changes.
3. Review the current reporting system from the Unit Desa to Cabang to BRI central, and design and help implement revised reporting as deemed appropriate. Also review Bank Indonesia reporting requirements and assist BRI to lobby for changes as appropriate.
4. Review Penilik staffing, selection criteria and personnel policies, and advise on appropriate changes.
5. Assist as possible with on-the-job training and supervision of Penilik Udes to ensure that recommended changes are properly carried out.

II. ACCOUNTING AND AUTOMATION:

1. Assist the BRI regional and central training staff in the design, updating and conduct of training for Unit Desa accountants.
2. Review the Unit desa accounting and reporting systems and make detailed recommendations on needed redesign of the program. With an eye to lowering intermediation costs, determine to what extent this design should provide for automation of Unit Desa and/or Cabang and central accounting functions. Also review, in coordination with the audit advisor, the reporting system. As a result of these reviews, recommend to the BRI Board of Directors the format, regulations and detailed implementation plan of a revised accounting and automation system. Working with short-term ADP and computer hardware experts as needed, prepare a phased plan for any proposed automation, and detailed procurement specifications.

3. Together with ERI staff, help implement the redesigned accounting system including provision of on-the-job training as possible, and assist with the supervision of computer installation and initial training of Unit Desa staff.
4. Assist ERI in the planning for provision of new services, particularly advising on how new services would affect the various Unit Desa operating systems.
5. Advise ERI on personnel policy related to accounting, cashier and automation staff.

TERMS OF REFERENCE

WORLD BANK-FINANCED MANAGEMENT CONSULTANCY TO BRI

GENERAL

1. Bank Rakyat Indonesia (BRI) is one of five major government-owned banks in Indonesia and has as its specific mission the finance of the nation's agricultural development. Pending a broader review of the financial sector and state banks, and until totally different mechanisms are instituted for financing priority programs, the nature of BRI's operations would continue as at present. A preliminary review of BRI's operations was recently undertaken to identify institutional changes which would improve efficiency under the presently defined mandate of BRI, among others: (a) Head Office Organization; (b) Planning and Budgeting; (c) Profit Center Accounting; (d) Credit Procedures; (e) Branch Operations and Procedures; (f) Computer Systems; (g) Funds Mobilization and Management; (h) Customer Services; and (i) Personnel Management and Training.

As a result of greater liberalization in the banking regulation since June 1983, banks are free to determine the rates to be applied to both assets and liabilities. Further, the Central Bank has stated its desire that the government-owned banks compete more effectively in the market place, and finally the Government has asked the banking system to be the vehicle to substantially increase public savings. In order to meet these challenges, Bank Rakyat Indonesia needs to develop a more cost effective and profitable organization. For the achievement of which BRI would enter into a technical assistance program with a large commercial bank/a suitable consulting firm which would provide a suitably staffed banking team and on-the-job training.

2. In consultation with the World Bank, BRI has decided that the best approach would be to choose and enter into negotiations with a management consulting firm or a commercial bank. This firm/bank should be willing and able to provide the necessary specialists, including a senior banker for coordination purposes under a package scheme. It is proposed that an experienced banker would be seconded to BRI for about two years to manage this assistance, including coordination with ongoing efforts, and focus on institutional issues. In addition, experienced staff would be provided for a period of 6-12 months in the field of inter alia head office organization, planning and budgeting, profit center accounting, credit procedures, financial product development and marketing, manpower planning and training, and credit analysis.

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The Senior Bank Consultant as the team leader would meet with BRI's President Director and Board of Directors on a regular basis. To each consultant a full-time counter-part would be provided. Further more, each consultant would work closely with concerned division and department heads.

Following is a list of specialists required to assist BRI over the next one to two years in the development of programs aimed at improving the performance of BRI (TOPs in Annex):

<u>Specialists</u>	<u>Time required</u>
1. Senior Bank Consultant (will act as team leader)	2 years
2. Planning and Budget Consultant (liaison with Planning Division)	1 year
3. Work-Flow Specialist (liaison with Organization and Methods Division)	1 year
4. Computer Systems Designer (liaison with MIS Division)	6 months
5. Treasury Specialist (liaison with Funds and Banking Services Division)	6 months
6. Foreign Department Specialist (liaison with Funds and Banking Services Division)	6 months
7. Financial Marketing Specialist (liaison with Funds and Banking Services Division)	6 months
8. Credit Specialist (liaison with all credit related divisions)	1 year
9. Management Information Specialist (liaison with MIS & Accounting & Management Control Div)	6 months
10. Man Power Specialist (liaison with Personnel Division)	1.5 years
11. Training Needs Specialist (liaison with Training Division)	1.5 years

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12. Internal Audit Specialist (liaison with General Audit Division)	1 year
Total	<u>11.5 years</u> (138 man-months)

Sequence of employment and arrival of specialists is to be determined and arranged by the Senior Banking Consultant in consultation with BRI.

In addition to the above specialists the use of the following is also requested for the further development of staff:

1. On-the-job training at a large bank, especially in treasury operations, exchange trading and letters of credit.
2. Use of practical courses offered by major banks.
3. Visit to other banks in countries with more or less similar socio-financial condition.

(all the above is estimated to be 50 man-months)

CONTRACT TERMS

BRI would endeavour to obtain offers from leading commercial banks. Evaluation of These offers will be based on:

1. its reputation as a leading commercial bank;
2. ability to provide consulting personnel and quality of personnel provided;
3. the bank's past experience in similar projects;
4. availability of training materials and ability to provide on-the-job training facilities.

Thus evaluation and selection of the "consulting bank" will be based on capability, while prices will be negotiated afterwards as part of the legal contract governing all terms and conditions of the contract.

The "consulting bank" will provide all services covered in the contract and would be responsible for the assignment of individual consultants and for replacing personnel as needed during the contract period. However, BPI based on its appraisal of quality of each respective consultant reserves the right to approve or reject individual consultants proposed by the consulting bank.

Payments in foreign exchange and local currency will be made by BPI to the consulting bank under the agreed procedures of the contract.

The selection and execution of contracts although financed by the World Bank would be the responsibility of BPI. However, it is understood that relevant World Bank Group procedures will be followed.

Financial Institutions Development Project (497-0341) PP Amendment
5C(2) PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A. includes criteria applicable to all projects. Part B. applies to projects funded from specific sources only:
B.1. applies to all projects funded with Development Assistance loans, and
B.3. applies to projects funded from ESF.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

Yes. See GPT II PP Amendment 2 Annex F.

A. GENERAL CRITERIA FOR PROJECT

1. FY 1986 Continuing Resolution Sec. 524; FAA Sec. 634A.

Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project.

A CN has been prepared. Obligation will occur upon expiration of the notification period without Congressional objection.

2. FAA Sec. 611(a)(1). Prior to obligation in excess of \$500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

(a) Yes.

(b) Yes.

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No further legislative action is required.

4. FAA Sec. 611(b); FY 1986 Continuing Resolution Sec. 501. If for water or water-related land resource construction, has project met the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See AID Handbook 3 for new guidelines.)

N/A.

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed \$1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?

The Director has so certified (See Appendix C.) The AA/ANE has taken the Director's action and the GOI's capability to effectively maintain and use the capital component under consideration.

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

No.
N/A.

7. FAA Sec. 601(a). Information and conclusions whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

The amended Project should directly encourage (b), (c) and (e) and indirectly encourage (d) by providing credit to private borrowers.

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).
9. FAA Sec. 612(b), 636(h); FY 1986 Continuing Resolution Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.
10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?
11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?
12. FY 1986 Continuing Resolution Sec. 522. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

The amended Project will finance small entrepreneurs who may be involved in procurement arrangements with local suppliers of U.S. private business.

Approximately 38% of the total Project's costs will be provided from the Indonesian public or private sectors.

No.

Yes.

N/A.

13. FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16. Does the project or program take into consideration the problem of the destruction of tropical forests?

The amended Project has a limited impact on the environment, since it primarily provides technical assistance, capital and training funds for rural banks

14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?

N/A.

15. FY 1986 Continuing Resolution Sec. 533. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution?

No.

16. ISDCA of 1985 Sec. 310. For development assistance projects, how much of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

No set amount of DA has been set aside for Gray Amendment entities, but USAID/Indonesia is actively pursuing with the GOI the possibility of a large Section 8(a) set aside under the amended Project.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance
Project Criteria

- a. FAA Sec. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, ~~spreading investment out~~ from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status, (e) utilize and encourage regional cooperation by developing countries?

The amended Project is designed to benefit the rural poor. It focuses on developing rural banks that provide small loans to labor-intensive family enterprises. These banks will operate with a interest rate structure that insures long term viability. Loan operations will be located close to the village ~~to lower borrower transaction~~ costs. All supported financial institutions are autonomous and locally managed. A majority of borrowers are women.

- b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used? The amended Project meets fully the criteria under Section 103 of the FAA.
- c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)? Yes.
- d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed country)? The GOI and the Indonesian private sector will contribute approximately 38% of the total amended Project's costs.
- e. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth? Yes

f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

Yes. See discussion in paragraph g, below.

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

The amended Project builds on a credit system model well accepted by Indonesians. It supports institutional development of a rural banking network and develops manpower skills in rural areas.

2. Development Assistance Project
Criteria (Loans Only)

a. FAA Sec. 122(b).
Information and conclusion on
capacity of the country to
repay the loan, at a
reasonable rate of interest.

The GOI has an
established ability
to repay this and
other development loans

b. FAA Sec. 620(d). If
assistance is for any
productive enterprise which
will compete with U.S.
enterprises, is there an
agreement by the recipient
country to prevent export to
the U.S. of more than 20% of
the enterprise's annual
production during the life
of the loan?

N/A.

3. Economic Support Fund Project
Criteria

a. FAA Sec. 531(a). Will this
assistance promote economic
and political stability? To
the maximum extent feasible,
is this assistance
consistent with the policy
directions, purposes, and
programs of part I of the
FAA?

N/A.

b. FAA Sec. 531(c). Will
assistance under this
chapter be used for
military, or paramilitary
activities?

N/A.

c. ISDCA of 1985 Sec. 207.
Will ESF funds be used to
finance the construction of,
or the operation or
maintenance of, or the
supplying of fuel for, a
nuclear facility? If so,
has the President certified

N/A.

that such country is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin America (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

- d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N/A.

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. Procurement

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? Yes.
2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?? Yes.
3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? Indonesia does not so discriminate.
4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) N/A.

5. FAA Sec. 604(a). Will construction or engineering services be procured from firms of countries which receive direct economic assistance under the FAA and which are otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one of these areas? Do these countries permit United States firms to compete for construction or engineering services financed from assistance programs of these countries? No.
6. FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates? No.
7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Yes.
If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? Yes.

8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

Yes.

9. FY 1986 Continuing Resolution Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

Any direct AID contract under the amended Project will so provide.

Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used?

No. The Construction contemplated will be under FAR procedures with local Indonesian firms.

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

Yes.

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the CP)?

N/A.

C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? Yes.

2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? N/A.

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? Yes.

4. Will arrangements preclude use of financing:
 - a. FAA Sec. 104(f); FY 1986 Continuing Resolution Sec. 526. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo

1) Yes.

(2) Yes.

sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

(3) Yes.

b. FAA Sec. 488. To reimburse persons, in the form of cash payments, whose illicit drug crops are eradicated?

Yes.

c. FAA Sec. 620(g). To compensate owners for expropriated nationalized property?

Yes.

d. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

Yes.

e. FAA Sec. 662. For CIA activities?

Yes.

f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

Yes.

- g. FY 1986 Continuing Resolution, Sec. 503.
To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel? Yes.
- h. FY 1986 Continuing Resolution, Sec. 505.
To pay U.N. assessments, arrearages or dues? Yes.
- i. FY 1986 Continuing Resolution, Sec. 506.
To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? Yes.
- j. FY 1986 Continuing Resolution, Sec. 510.
To finance the export of nuclear equipment, fuel, or technology? Yes.
- k. FY 1986 Continuing Resolution, Sec. 511.
For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? Yes.
- l. FY 1986 Continuing Resolution, Sec. 516.
To be used for publicity or propaganda purposes within U.S. not authorized by Congress? Yes.