

PD-ABC-580 PPC/CDIE/DI
70799

A.I.D. LOAN NO. 497-HG-001

SECOND AMENDMENT

TO

PROGRAM AGREEMENT

BETWEEN

THE REPUBLIC OF INDONESIA

AND

THE UNITED STATES OF AMERICA

FOR

MUNICIPAL FINANCE AND SHELTER

Dated: March 14, 1991

SECOND AMENDMENT

The Program Agreement dated May 9, 1989, as amended, ("Agreement") between the Republic of Indonesia and the United States of America is hereby amended as set forth below. This Amendment shall consist of this document together with an amended Annex A attached hereto. All of the terms and conditions of the Agreement dated May 9, 1989, shall remain in full force and effect except as expressly or impliedly further amended herein.

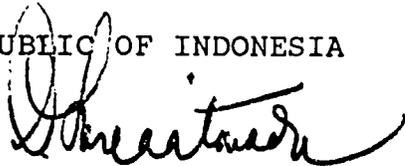
1. The purpose of this Amendment is to increase the A.I.D. guaranty obligation to an aggregate level of Seventy-five Million Dollars and to make certain agreed revisions to the Investment Plan and Policy Action Plan in Annex A. Accordingly:

- A. The reference in section 3.01 of the Agreement to a total Loan guaranty principal amount of Twenty-five million United States Dollars (\$ 25,000,000) is amended to read "Seventy - five Million United States Dollars (\$75,000,000)."
- B. Annex A of the Agreement is amended to read as attached hereto.

2. Section 5.01 of the Agreement is amended in the first sentence to delete the phrase "the disbursement" and insert in lieu thereof the phrase: "each disbursement".

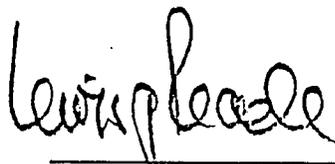
IN WITNESS WHEREOF, this Amendment is signed and executed by the authorized representatives of the parties.

THE REPUBLIC OF INDONESIA



Drs. Oskar Surjaatmadja, MSc.
Director General for
Monetary Affairs
Ministry of Finance

UNITED STATES OF AMERICA



Lewis P. Reade
Director
USAID/Indonesia

ANNEX A

PROGRAM DESCRIPTION

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Introduction

The Municipal Finance Program supports the overall goal of improving the shelter conditions of Indonesia's urban poor by facilitating the delivery of affordable, local, shelter-related infrastructure. In addition, the program will support the Government of Indonesia's existing policies of increasing local responsibility for urban development and instilling incentives for local governments to graduate from grant financing to government loans, local revenues, user charges, and non-government financing sources as economic factors allow.

By making municipalities increasingly less dependent on government grants for shelter-related infrastructure financing, the program will enable cities and towns to improve the shelter conditions of the poor in a financially replicable manner. In this way, the responsibility for improving the shelter-related infrastructure and services of the urban poor can be shifted from the central government to the cities and towns. The municipal finance system which this program supports will enable cities and towns to generate the investment resources necessary to fulfill their increased responsibilities. During the development phase of the municipal finance system, the program will help provide resources for investments which improve the shelter conditions of the urban poor.

The Municipal Finance Program will produce four outputs. Output 1 is further described in Part 2 of this Program Description. Output 2, 3, and 4 are further described in Part 1 of this Program Description.

Output 1: Provision of shelter-related urban infrastructure, valued at the equivalent of the Housing Guaranty Loans provided, suitable for families with below median incomes.

Output 2: Continued improvement in the role of the central government in funding urban infrastructure and services affordable to low-income households through a system of grants and loans that encourages local resource mobilization.

Output 3: Continued strengthening of the capacity of the local government finance system to mobilize and manage resources.

Output 4: Establishment of the basis for increased private sector participation in the provision and financing of urban infrastructure and services.

Production of these outputs will constitute achievement of the program's purpose of providing assistance to the Government of Indonesia in further developing its municipal finance system, enabling Indonesian municipalities to assume an increasing share of the financial responsibility for urban shelter-related infrastructure and services, creating conditions favorable to

private sector involvement in urban investment finance and service provision, and creating a framework for partnership between the public and private sectors.

Implementation of the program will be undertaken with inputs from the Government of Indonesia and the U.S. Agency for International Development. The Government of Indonesia will take actions to implement its National Urban Policy Statement. USAID will provide technical assistance and training (under a separate Grant Agreement) to facilitate policy analysis and implementation by the Government. USAID will also provide resources under its Housing Guaranty Loan Program to support shelter-related urban infrastructure investments suitable for families with below urban median incomes while the government implements its Policy Action Plan.

Part 1: Policy Action Plan

The following pages present the Policy Action Plan agreed between the Government of Indonesia and the U.S. Agency for International Development to constitute the basis of actions intended to further the objectives of the Municipal Finance Program as outlined in Article II Section 2.01. of this Agreement.

No.	Policy Area/Objectives	Medium-term goals	Action proposed	Key steps during project period (04/87-09/89) (N.B. crucial steps indicated by *)	Description **(target)	Monitoring Indicators
1.	Strengthen Local government responsibility for urban infrastructure development operation and maintenance (a) Define and classify urban infrastructure and assign functional and financial responsibilities for planning implementation, operation and maintenance Central, Level I and II governments	1.01 Classify designated urban infrastructure in all Kotamadya's and assign functional responsibilities (1987-1991)	Assign working group that would define classification policy (by Tim Koordinasi-TK); agencies to carry out classification (by DGEM, DGKEL, DGCK, and DGPUOD)	<ul style="list-style-type: none"> * assign working group and provide TOR - formulate urban service inventory and classification policies and workplan to address all Kotamadyas Complete surveys and classification in 10 cities Continue rolling program of classification in remaining cities (Kotamadyas and urbanized Kabupatens) 	<ul style="list-style-type: none"> Completed (11/87) Completed (12/87) Completed (10/88) Being Implemented ** (/90) 	<ul style="list-style-type: none"> Working group assigned and agreed TOR Functional classification Agreed classification maps and inventories Agreed classification maps and inventories
		1.02 Define institutional responsibilities for traffic management in urban areas (1987-89)	Study and assign responsibilities for traffic management and policy coordination (by TK, DGBR, DGLT, and DGPUOD)	<ul style="list-style-type: none"> - Define issues and workplan for resolution - Assign working group - Assign phased responsibility to selected Level II cities 	<ul style="list-style-type: none"> Completed (10/87) Completed (01/89) Being Completed ** (/90) 	<ul style="list-style-type: none"> Agreed workplan Working group assigned Instructions issued
		1.03 Develop program responsibilities for local governments in Integrated Urban Infrastructure program (IUIDP)	Application of IUIDP processes to urban infrastructure services including raw water supply, flood protection, urban roads, water supply and sanitation, solid waste management, drainage and KIP (by TK, MPW, and MHA)	<ul style="list-style-type: none"> * Issues directives of MPW agencies to apply IUIDP processes in urban infrastructure planning * Issues directives to Level I and II local governments to adopt IUIDP process approved by TK 	<ul style="list-style-type: none"> Completed (08/87) Completed (08/87) 	<ul style="list-style-type: none"> Directives issued Directives issued
2.	Integrated expenditure planning and programming improvement (a) local governments to prepare investment plans on basis of guidelines from Central Government (b) financial support of local governments to be based on local capabilities and needs (c) emphasis to be given to MPW provisions and low-income group needs	2.01 Develop and refine IUIDP planning	Develop guidelines for non Cipta Karya subsectors within MPW as well as Cipta Karya sub-sectors and issues updated guidelines for all subsectors from time to time including multi-year financial information (by TK, MPW, MOF and MHA)	<ul style="list-style-type: none"> - Develop multi-year program alternatives * Issues annual updates of IUIDP guidelines 	<ul style="list-style-type: none"> Completed (12/89) Being Implemented ** (08/90) 	<ul style="list-style-type: none"> Projections issued Guidelines issued

No.	Policy Area/Objectives	Medium-term goals	Action proposed	Key steps during project period (04/87-09/89) (N.B. --crucial steps indicated by *)	Description ** (target)	Monitoring Indicators
3.	Strengthen Local Government resource mobilization and financial management	3.01 Fully implement PBB tax law (1986-96)	Improve revenue performance of Property Tax (PBB) through a program of tax administration and valuation in 1987-89 (by DG Pajak)	<ul style="list-style-type: none"> * Appoint valuation and tax management advisers to improve PBB systems and assist in organization and supervision of workplan - Value individual (approx. 10.000) top-value properties in Jakarta and two other cities - Upgrade index valuation system for other urban properties * Training of valuers and technicians - Improve tax administration through updating register, computerization of billings and improvements in collection and appeals procedures 	<ul style="list-style-type: none"> Being Implemented ** (09/90) 	<ul style="list-style-type: none"> Advisers appointed No. of properties valued No. of cities/areas/properties classified No. of trained valuers and technicians (i) property coverage (ii) billing and collection performance
		Improve cost recovery and management of all regional water enterprises (1987 onwards)	Improve user charge/cost recovery performance of PDAM's in Java (by DGCK and DGPUOD)	<ul style="list-style-type: none"> * Analyse cost recovery performance of all water enterprises subject to SKB 4/84-27/KPTS/84 and identify problem PDAMS * Implement, commencing in Java and Sumatra, the adoption of (i) water tariff structure and appropriate tariff level to cover O&M costs, depreciation of debt service (whichever is larger), and (ii) accounting system for water enterprises, based on national guidelines of MPW/MHA 	<ul style="list-style-type: none"> Completed (09/87) Completed (09/89) 	<ul style="list-style-type: none"> Improvement action plan recommendations No. of water enterprises complying (30 PDAMS)
			Assign water enterprises monitoring and development functions to Provincial DPUS throughout Indonesia (by DGCK and DGPUOD)	<ul style="list-style-type: none"> * Assign functions and provide budgets and staff to Central and West Java DPUS - Appoint consultants to (i) assist DPUS and (ii) assist water enterprises 	<ul style="list-style-type: none"> Completed (01/88) Completed (07/88) 	<ul style="list-style-type: none"> Directives issued and units operational in Java Contract signed Contract signed

No.	Policy Area/Objectives	Medium-term goals	Action proposed	Key steps during project period (04/87-09/89) (N.B. crucial steps indicated by *)	Description ** (target)	Monitoring Indicators
			Review optional water enterprises organizational arrangements for all provinces based on efficiency criteria by TK.	- Formulation of TOR - Appointment of consultants - Complete review of recommendations for initial implementation in Java	Completed (12/87) Completed (01/88) Completed (02/88)	Agreed TOR Contract extension signed Java provinces structure defined; implementation timetable agreed
		3.03 Improve revenue performance of local taxes and service charges (1987 onwards)	Improve the structure of local taxes and charges (by DGKDN and DGPUOD)	* Prepare instruments required	Completed (04/89)	Instruments prepared
			Implementation of local tax office and procedure improvements (by DGPUOD)	* Evaluate pilot tax office improvement in Urban IV (Loan 1972-IND) cities	Being Implemented ** (√/90)	Evaluation report
(d)	Encourage private sector resources mobilization and private sector participation in the provision and delivery of urban infrastructure services	3.04 Establish an acceptable legal and regulatory frame work for private sector involvement in the financing, implementation, operation and management of urban services and infrastructure	Assign working group to define and encourage the role of the private sector (by TKPP)	Assign working group and provide TOR	04/90	Working group assigned and TOR agreed. Private participation on water supply guidelines by MPW
				Assign responsibility for preparation of guidelines by TKPP working group	06/90	Responsibility assigned
			Provide guidelines for appropriate forms of private sector participation in each selected sub-sector (by MPW)	Prepare TOR for appointment of consultants	08/90	TOR prepared
				Appoint consultants	08/90	Consultants appointed
				Recommendations to be discussed by workshop	11/90	Workshop held
				Working group prepares its recommendations	03/91	Recommendation agreed
			Determine the rights and obligations of the private sector by providing appropriate model agreements between local authorities and participating private sector establishments (by MPW and MHA)	Provide model agreements between local authorities and the private sector concerning a variety of forms of private sector participation	06/91	Model agreements provided

No.	Policy Area/Objectives	Medium-term goals	Action proposed	Key steps during project period (04/87-09/89) (N.B. ---crucial steps indicated by *)	Description **(target)	Monitoring Indicators
			Introduce pilot projects in selected local authorities, with initial emphasis on the water supply and solid waste sub-sectors (by MHA)	Select local authorities and appropriate subsectors for pilot projects Commence pilot projects	12/91 06/92 12/91	Selection completed Pilot projects commence Recommendation approved
		3.05 Develop appropriate conditions to achieve the level of cost recovery required to motivate private sector investment in public services and infrastructure	Investigate policy options in relation to the main forms of private sector participation to ensure acceptable levels of return on investment, while safeguarding the interests of the general public (by MOF, MHA, and MPW)	Working group to formulate and analyze alternative policies and prepare recommendations Workshop to be held to discuss recommendations with representatives of the public and private sectors Monitoring pilot projects Review model agreements and cost recovery policies adopted and agree appropriate modifications	03/92 1992-1994 03/94	Workshop held Report Modifications approved
4.	Improve financing systems and mechanism for urban infrastructure and incentives for local resources mobilization	4.01 Provide a viable system of loan finance for local governments (1987 onwards)	Strengthen Central-local Government borrowing scheme (by DGMDN)	* Assign consultants to review policies for the recently established Regional Development Account (RDA) - Consolidate existing domestic loan schemes and review (i) commitments and disbursements to local governments (ii) lending terms and interest rates and (iii) level II debt service ratio guidelines - Appoint consultants to assist in operationalizing RDA - Prepare operating procedure appraisal and eligibility criteria, accounting system, and organization arrangements - Train staff and operationalize RDA	Completed (03/89) Being Implemented **(/90) Completed (04/89) Being Implemented **(/90) Being Implemented	Consultants assigned Consolidated loan mechanism policies defined and revised guidelines issues if necessary Contract signed Operating and accounting manuals Staff trained. RDA effective.
	(a) create a consolidated loan fund for local governments					
	(b) improve grant allocation criteria					

No.	Policy Area/Objectives	Medium-term goals	Action proposed	Key steps during project period (04/87-09/89) (N.B. crucial steps indicated by *)	Description **(Target)	Monitoring Indicators
		4.02 Improve allocation mechanisms of grant finance (1987-89)	Improve allocation criteria and guidelines for Central - Local grant system (by TK)	<ul style="list-style-type: none"> * Assign working group - Review recommendation of on-going Central - Local grant system - Prepare instruments required for improvements in Central-Local fiscal relations 	<ul style="list-style-type: none"> Completed (06/87) Being Implemented **(/90) Being Implemented **(/90) 	<ul style="list-style-type: none"> Working group assigned Working group report with specific improvement proposals Instruments prepared
		4.03 Improve information base for policy development and operational decisions on local government finance	Improve local government financial and demographic information system (by TK, BPS, DGMND, DGPUOD and DG Agraria)	<ul style="list-style-type: none"> - Reach agreement between BPS and other agencies on institutional roles - Complete detailed information system design - Implement system - Re-activate existing urban mapping users committee-prepared action plan - Appoint consultants to assist DG Agraria in line map production for PBB purposes 	<ul style="list-style-type: none"> Completed (08/87) Being Implemented ** (02/90) Being Implemented ** (/90) Being Implemented ** (/90) Completed 	<ul style="list-style-type: none"> Agreement reached Tested system design Complete set of local government revenue and expenditure accounts and demographic data for 1987/88) Committee active Contract signed
(c) Utilize central-local development grant funds with appropriate attention being paid to the requirements of low-income households.		4.04 Develop a system for the identification of target groups for poverty alleviation programs and for channelling financial and technical assistance to the target groups and for monitoring and evaluating the effectiveness of such programs.	Assign a working group to define policies in relation to poverty alleviation (by TKPP). Determine criteria for the identification of low income target groups, the number of such households and their distribution by province and local authority (by DGCK and DG BANGDA)	<ul style="list-style-type: none"> Assign working group and provide TOR Working group to prepare TOR for appointment of consultants Appoint Consultants Hold workshop on poverty alleviation Agree criteria for the identification of target groups 	<ul style="list-style-type: none"> 09/90 08/90 09/90 09/90 10/90 	<ul style="list-style-type: none"> Working group assigned and TOR agreed TOR prepared Consultants appointed Workshop held Criteria agreed

No.	Policy Area/Objectives	Medium-term goals	Action proposed	Key steps during project period (04/87-09/89) (N crucial steps indicated)	Monitoring Indicators
			Determine the grant requirements of the alleviation packages and the spatial distribution of such requirements (by DGCK and MOF). Identify the appropriate channels for the delivery of poverty alleviation packages (on-site sanitation, community water supply, house improvement, etc) within the IUIDP framework (by DGCK and DG BANGDA)	Agree on appropriate poverty alleviation packages and grant/loan implications Agree on channels for delivering poverty alleviation packages including guidance requirements monitoring evaluation	Packages agreed Channels for delivery agreed
5.	Improve local government capabilities	5.01 Strengthen Local Govt: institutions responsible for urban infrastructure	Carry out a comprehensive study of urban institutional and manpower development needs of local governments (by MHA and Civil Service Administration Agency - BAKTI)	- Assign working group to prepare TOR - Appoint consultants - Review recommendations the Bank	Agreed TOR Signed contract Final report and agreed recommendations to be reviewed by TK
	(a) evaluate Local Government needs, with particular emphasis on urban managers and coordinate long-term training programs				
	(b) raise staff capabilities of local revenue administration, planning and programming, and operations and maintenance	Strengthen management and staffing capabilities in MPW DGs and Provincial Dinas PU, to provide guidance to local governments (1987-1989)	Review coordination arrangements between MPW DGs in IUIDP process	- Issues directives to D	Directives issued
	(c) provide guidance to all govt. units in coordination of urban development		Identify staff skills and training experiences required to provide adequate management, technical and financial advice to Local Govts (by MPW, MHA and MELIPAN)	- Carry out internal review DGCK with assistance of management consultants	Assessment finalized
6.	Strengthen coordination and consultation in the urban development sector	6.01 Develop effective policy coordination in the urban sector as well as the development of mechanisms to support policy review and decision making	Establishment of an Interagency Coordination Team for Urban Development (TKPP and an executive secretariate)	* Ministerial Decree (SK) establishing structure resources of TK issued	Decree issued Extension date on April 1, 1989
	(a) establish an interagency coordination team and an executive secretariate				

No.	Policy Area/Objectives	Medium-term goals	Action proposed	Key steps during project period (04/87-09/89) (N.B. crucial steps indicated by *)	Description **(target)	Monitoring Indicators
3	(b) develop coordination arrangements and ability to support future urban development policy review and recommendations	6.02 Evaluate existing urban infrastructure programs and prepare recommendations for medium-term sector plan and program structure criteria and targets, and institutional arrangements (1987-1990)	Assign working group to guide medium-term planning and programming and assign support teams to respective agencies as needed in policy option formulation and recommendation (by TK)	- Assign standing working groups interalia for planning and programming, program implementation, financial resources and training, and institutional development	Completed (/87)	Assignments made
				- Draft work program and TORs for respective agency activities and technical assistance	Completed (/87)	Agreed work program
				Appoint consultants to respective agencies as needed	Completed (12/87)	Contract signed
				Conduct policy and technical option analyses and formulated alternative scenario proposals and recommendations	Being Implemented **(09/90)	Working papers and recommendations to be reviewed by TK
				Issue guidance memorandum on selected strategy	Being Implemented **(/90)	Memorandum issued
				Issue guidelines and procedures for medium-term planning	Being Implemented **(/90)	Guidelines issued
				Prepare medium-term (5-year) plan for sector	Being Implemented **(/90)	Medium-term plan recommended by TK

Part 2: Investment Plan

The following pages present the annual Investment Plan (GOI Fiscal Year) agreed between the Government of Indonesia (the "Government") and the U.S. Agency for International Development as part of the Municipal Finance Program. The Investment Plan consists of a menu of eligible expenditures in an amount equal to or greater than the loan guaranteed under U.S.A.I.D.'s Housing Guaranty Program.

Each eligible program/project expenditure is specified in terms of: (1) the Government's planned level of total annual expenditure not financed by other donors; (2) the percentage of such expenditure which is deemed to be eligible for financing under the Municipal Finance Program; and (3) the total amount of Eligible Expenditures for each program/project which can be financed under the Municipal Finance Program. When the total of all Eligible Expenditures exceeds the amount of the loan guaranteed, the Government may determine during the course of the program which expenditures will be financed by the guaranteed loan. U.S.A.I.D. reserves the right to adjust the percentage of expenditures eligible for financing based on reviews at sites of the investments after agreement with the Government.

The percentage of expenditures eligible for financing under this program will be based on the percentage of the investment which is reasonably judged to be suitable for families with incomes below the urban median. The Government will provide the information necessary to determine the percentage of investments suitable for low income families. U.S.A.I.D. will take the steps necessary to verify this information, and propose an eligibility percentage for each program/project to be included in the Investment Plan. The Government and U.S.A.I.D. will then jointly agree to the percentage to be included in the Investment Plan. No program/project expenditures can be financed by the Municipal Finance Program before an eligibility percentage has been jointly agreed by the Government and U.S.A.I.D. for that program/project.

HOUSING GUARANTY LOAN INVESTMENT PLAN (agreed by GOI and USAID) 1/

From: April 1, 1991

To: March 30, 1992

<u>Eligible Activity</u>	<u>Planned Expenditure 2/</u> (Rps. Billion)	<u>Estimated Eligible Percentage</u>	<u>Eligible Expenditures</u> (Rps. Billions)
Kampung Improvement Program	30.6	100.0	30.6
Water Supply Program	83.8	50.0	41.9
Human Waste Program	20.0	40.0	8.0
Drainage/Flood Program	14.0	40.0	5.6
Solid Waste Program	12.0	30.0	3.6
Access Roads Program	24.0	30.0	4.0
Urban Planning	13.0	10.0	1.3
TOTAL	197.4		95.0

NOTES: 1/ This Investment Plan can be adjusted by mutual agreement between GOI and USAID.

2/ Planned expenditures are GOI's own resources only and do not include other donor support for the named program/project.

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