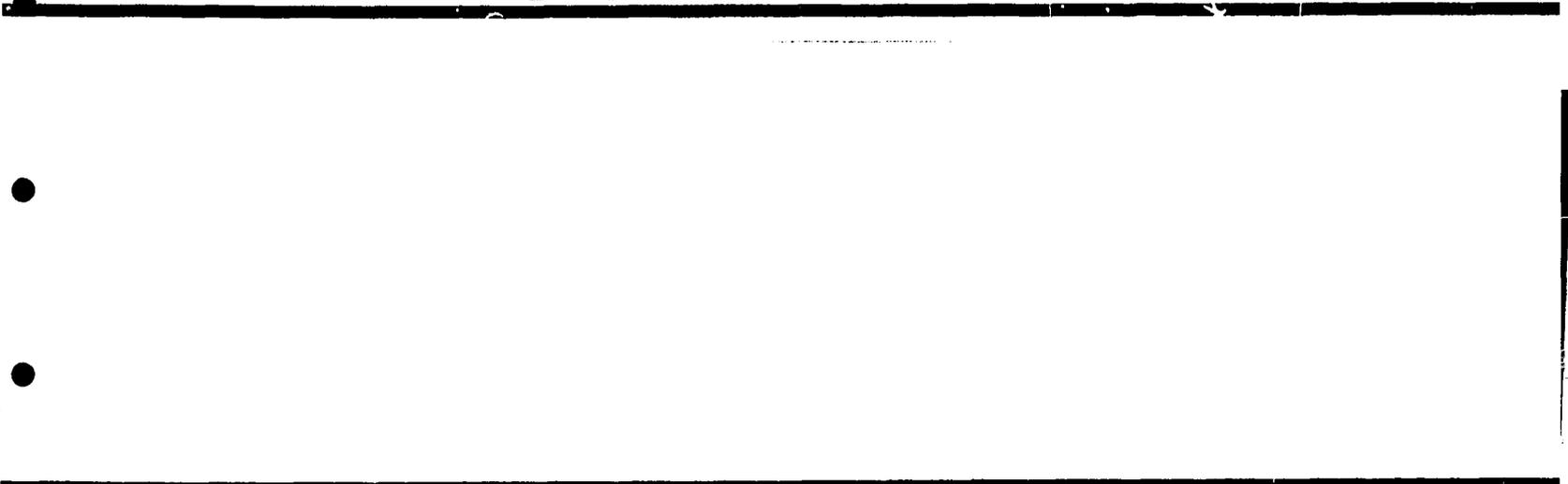


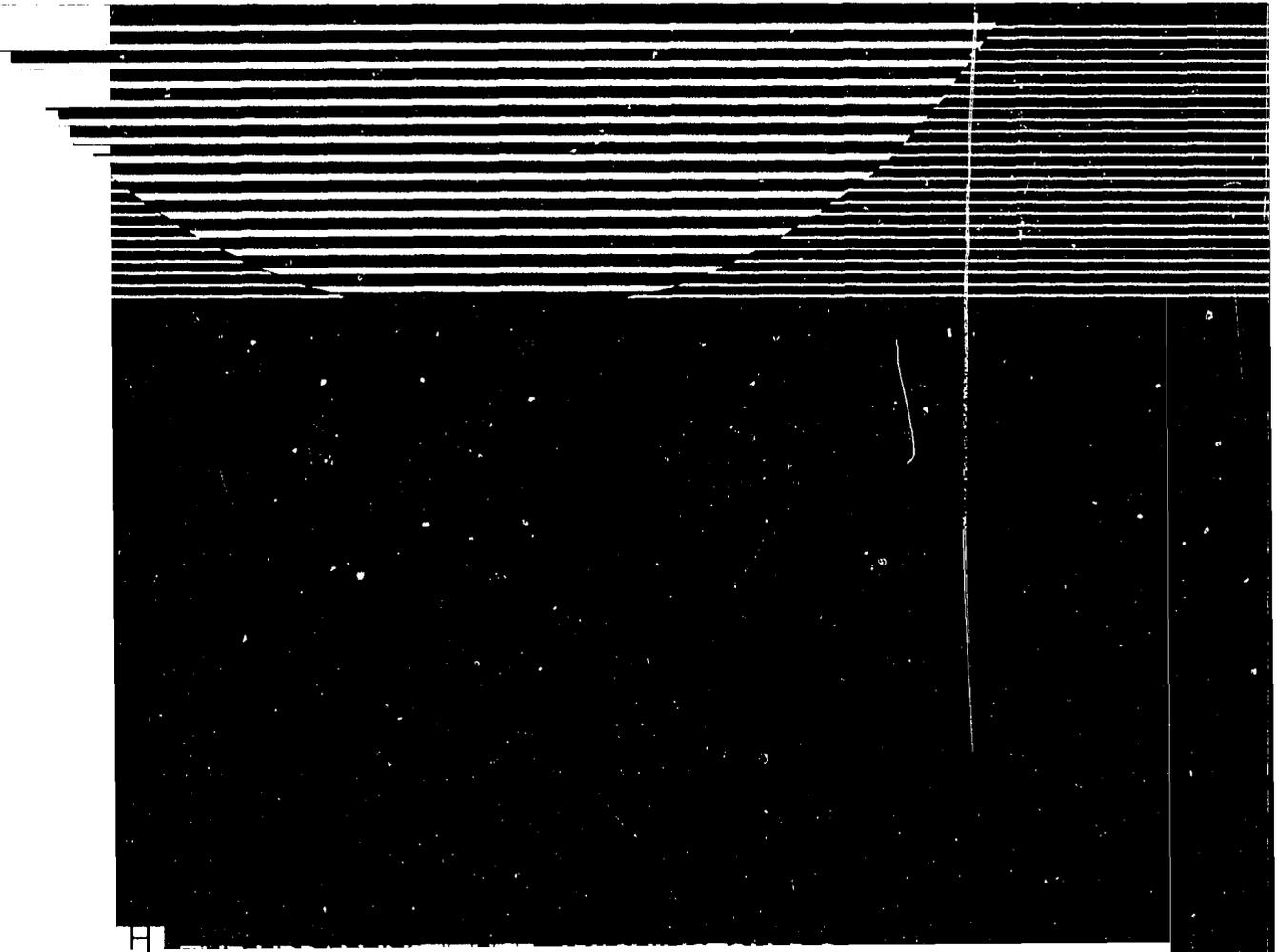
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**INTERIM EVALUATION:
INDONESIA MUNICIPAL FINANCE
PROJECT**

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ABSTRACT

This interim evaluation of Indonesia's Municipal Finance Project was conducted to provide a basis for considering the design of a possible new Housing Guaranty loan program, and possible amendments and changes to the current Project. The Project's goal is to improve the shelter conditions of the urban poor by developing the means by which municipal governments can more effectively finance shelter-related urban services and infrastructure. The evaluation entailed review of urban sector documentation provided by the GOI and written products from the Project, and interviews with counterparts, consultants, and trainees.

Major Findings and Conclusions. The Project has made, and continues to make, substantial progress. Major accomplishments include: decentralizing and coordinating (across sectors) the urban infrastructure programming process; substantially improving the management and yields of the property tax and other local own source revenues; setting a sound base for expanding private sector participation in urban services; establishing the Regional Development Account as a major step toward an effective credit finance system for local government; and institutionalizing ministerial coordination at the central level. The technical assistance and training component has been effective in advancing priority program initiatives and interagency collaboration. The Project's accomplishments are sustainable. Even so, national urban infrastructure investment is falling behind national targets and decentralization has proceeded slowly in some areas. To respond to this situation the program should give priority to developing a strategy for local finance reform that goes beyond better tax administration, preparing an action plan for building the RDA into a market-based credit system, and establishing an indigenous system for building local capacity in urban management. It is also critical that policies to address urban environmental degradation be added as a high priority. AID support has played an influential role in the program to date and the potential payoff from further assistance is high. A new HGL program and substantially expanded technical assistance and training efforts are warranted to extend sector progress. AID should continue to support the integrated urban program, as a whole, but give special emphasis to the achievement of new goals in urban environmental management and infrastructure provision, local government finance, and private sector participation.

Lessons Learned. The Project provides a model for operating a policy-based sectoral HGL. It shows how long-term involvement in an integrated program with clearly focused sub-objectives can lead to important and measurable policy change while avoiding the risks of fragmentation inherent in more narrowly defined projects.

EXECUTIVE SUMMARY

This report is the interim evaluation of the Indonesia Municipal Finance Project (MFP). Under the joint agreement for this Project (a) AID is providing a \$100 million Housing Guaranty Loan (HGL) for capital investment and \$5 million in Development Assistance grants for technical assistance and training; and (b) the Government of Indonesia (GOI) is implementing a Policy Action Plan whose goal is to "improve the shelter conditions of the urban poor by developing the means by which municipal governments can finance shelter-related urban services and infrastructure at a pace sufficient to overcome present deficits and match the pace of urban population growth." The GOI has made a commitment to transfer both the responsibility and authority for the leading public sector role in urban development to local governments, and to substantially improve local management capacity and resource mobilization. The Policy Action Plan provides the framework for achieving these ends.

PURPOSE OF THE EVALUATION AND METHODOLOGY EMPLOYED

The evaluation assesses GOI progress under the Policy Action Plan and performance under the Project's technical assistance and training component. It is intended to provide a basis for decisions about amendments to the existing program and design of a possible new HGL program. The evaluation was conducted by two senior urban policy specialists (in Indonesia for three weeks) who examined the record of policy change as documented by GOI and international donor reports, interviewed GOI officials in all agencies dealing with the urban sector and gathered unpublished information regarding sectoral investment and financing, reviewed the products of the MFP technical assistance team, interviewed 14 participants in training programs supported by the Project, and met with consultants under the related IUIDP program, as well as the World Bank urban sector team.

MAIN FINDINGS AND CONCLUSIONS

Performance under the Policy Action Plan. The GOI has made, and continues to make, substantial progress toward the program's basic objectives. Over the course of the program, its major accomplishments have been: transforming the process by which urban infrastructure is programmed to one in which coordinated planning and project preparation occur across sectors for individual cities (with strong local government participation and linkage to local resource mobilization); substantially improving the management of the property tax and other local own source revenues, and enhancing their yields; setting a sound policy and technical base for expanding private sector participation in urban services; establishing the groundwork for increased municipal borrowing for urban infrastructure and operationalizing the Regional Development Account (RDA) as a major step toward a market-based credit system for local government; and establishing and maintaining a viable framework for interministerial coordination at the central level.

These accomplishments are noteworthy and are sustainable if appropriate support is given in the next stages of program development. The GOI's continuing commitment to the program was underscored by the 1992 *Issues and Priorities Report* prepared by the National Planning Agency (BAPPENAS), which presents a critical evaluation of progress under the current program and priorities for the next stages in its development. Nonetheless, the program faces serious challenges at this point. Urban infrastructure investment is falling behind in relation to needs and government targets. Urban environmental degradation, not now being addressed by the program threatens the basic objective of improving the living conditions of the urban poor. Some of the key reforms--particularly, the transition to a market-based credit system and decentralization of investment priority-setting--are vulnerable unless they receive further external reinforcement. Priority should be given to: central reforms that allow local governments to raise the revenues necessary to manage urban development effectively; preparation of a focused strategy for building on the RDA as a transition institution designed to open municipal access to private credit markets; new initiatives for effective urban environmental quality management; rapid development of an indigenous system for building local capacity in urban management; and establishing processes that allow clearer expression of local demand in framing, financing, and implementing local investment programs.

The Technical Assistance and Training Component. Performance under this component has been effective. Advisors have produced valuable outputs in all phases of the Project, and their services are clearly valued by counterparts. They have reached out strategically to address priorities under the overall Plan and to promote interagency collaboration. Their activity is in large part responsible for key achievements under the Plan since 1990, particularly in private sector participation and program monitoring. Accomplishments include issuance of a series of research reports tied to critical policy choices, several major seminars to promote management reforms, and an extensive training program. Initial planning for an indigenous urban management training program, in collaboration with other donors, is an important achievement. Still, more forceful effort should have been provided in policy analysis and design to help motivate full achievement of basic reforms in the finance agenda.

AID's Role. AID support has played an influential role in the GOI's program. It was critical in advancing the agendas for private sector participation and the RDA, has filled an important void in motivating the overall continuity of an urban sector program, and appears to have achieved true additionality in urban infrastructure investment. Continued support from AID and other donors for some years will be essential if the delivery system promised by this Plan is to become fully institutionalized and self-sustaining.

PRINCIPAL RECOMMENDATIONS

1. The overall program has been successful and should be continued through a new HGL program and extension and intensification of technical assistance support.

The Policy Action Plan

2. The basic elements of the current Policy Action Plan should be carried forward as the basis for measuring progress in sectoral reform in the new HGL.

3. Emphasis in a new HGL should be placed on key policy elements where AID's technical assistance can have the most effect: development of a market-based credit system for municipal lending, new initiatives to create effective (and locally directed) urban environmental quality management, and the introduction of a greater element of local choice into local revenue generation and investment planning.

4. The RDA should be strengthened as the principal source of municipal credit in the near future. It should operate according to an intermediate-term plan for opening municipal access to private credit markets.

5. Local sample surveys of household beneficiaries should be conducted to monitor more effectively the income targeting of investments and tariff policy.

Technical Assistance

6. Technical assistance will be required over the lifetime of a new HGL, and should be planned by AID.

7. Although the long-term advisors will have to continue to be responsive to work requests from counterpart agencies, greater effort should be made to focus TA products on the principal bottlenecks to implementing the Policy Action Plan. The quarterly meetings recommended below should be used to agree on priority tasks.

8. Short-term TA should be used more directly to reinforce the long-term TA advisors. The new long-term TA agreement should include a budget for short-term TA.

9. Topics deserving more TA emphasis include: development of a strategy for building the RDA into a market-based credit system; introduction of strategic planning and forceful implementation for environmental quality enhancement into urban investment planning and management; institutional devices for building community and private-sector demand into the process of local investment priority setting and for streamlining processes of project appraisal, financing, and implementation; implementation of plans for indigenous training in urban management; design and implementation of household surveys to determine the income incidence of the urban investment program.

Investment Plan

10. Resource allocations under the Investment Plan should more directly reinforce the policy objectives of the Policy Action Plan. This implies directing a larger proportion of funds through the RDA and using the Investment Plan to finance public-sector support for private participation in urban services and environmental infrastructure.

Administration and Monitoring

11. Quarterly meetings of the MFP Interministerial Counterpart Committee, AID, and the TA team should be held. Objectives would be to agree on a work program that reflects Policy Action Plan priorities, and to monitor progress on previous TA work plans.

12. The MFP Indicators report should be updated semi-annually, and be incorporated within a broader regular report on Policy Action Plan progress to be reviewed as a basis for planning and corrective actions in regular meetings of TKPP.

13. BAPPENAS should be clearly invited to participate as a member of the MFP Counterpart Committee. Because of its central role in relation to the Policy Action Plan, the addition of MFP technical assistance support directly to BAPPENAS should also be considered.

LESSONS LEARNED

1. The Project provides a model for how a policy-based sectoral HGL should function. It demonstrates that long-term involvement in an integrated program with clearly focused policy sub-objectives can lead to important, measurable policy change while avoiding the dangers of project fragmentation.

2. Decentralization to the local level of revenue sources must occur in tandem with decentralization of investment planning for either to be fully effective.

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Chapter 1

**INTRODUCTION AND MAIN
FINDINGS AND CONCLUSIONS**

INTRODUCTION AND PURPOSES

This report evaluates the progress of Indonesia's Municipal Finance Project (497-0365, 497-HG-001). Under their joint agreement for this Project (a) the U.S. Agency for International Development (AID) is providing a \$100 million Housing Guaranty Loan (HGL) for capital investment and \$5 million in Development Assistance (DA) grants for technical assistance and training; and (b) the Government of Indonesia (GOI) is implementing a Policy Action Plan whose goal is to "improve the shelter conditions of the urban poor by developing the means by which municipal governments can finance shelter-related urban services and infrastructure at a pace sufficient to overcome present deficits and match the pace of urban population growth" (AID/Indonesia, 1988).

The first \$25 million tranche of HGL funds was authorized soon after the Project was initiated in 1988, and three more tranches in the same amount have been authorized since then, based on assessments of performance during the Project's first three years (Johnson, 1989, and Kingsley, 1990 and 1991). The specific purposes of this report are (1) to evaluate progress under the Policy Action Plan, particularly since September 1991, and (2) to evaluate the performance of the Project's technical assistance and training component; in order to provide a basis for decisions about amendments to the existing program and about design of a possible new HGL program.

STRUCTURE OF THE REPORT

The remainder of this chapter summarizes the main findings and conclusions of the evaluation. The next three chapters present findings related to progress under the Policy Action Plan: Chapter 2 dealing with local responsibility and the investment program (Policies 1 and 2); Chapter 3 covering finance system objectives (Policies 3 and 4), and Chapter 4 reviewing activity related to local institutional capacity and program

coordination (Policies 5 and 6).¹ Chapter 5 presents the evaluation of the Project's technical assistance and training component. Annexes provide supporting materials: references, a review of progress in relation to the Project's Logical Framework, the updated Policy Action Plan showing goal achievement, and details on the training program.

PROGRESS UNDER THE POLICY ACTION PLAN

At 5.4 percent per annum, Indonesia's urban growth rate is among highest in the world. In the 1980s, its cities and towns had to accommodate an average of 2.3 million new inhabitants per year (more than twice the 1.1 million average of the 1970s). Through the mid-1980s, virtually all of the nation's new infrastructure to serve urban growth had been planned and implemented by central government agencies--without coordination across sectors-- and funded directly from the central budget. Sensing the acceleration of urbanization that was upon them, and in the face of declining oil revenues, Indonesia's leaders recognized that this approach was no longer sustainable.

They made the commitment to transfer both the responsibility and authority for the leading public sector role in urban development to local governments, implying the need for dramatic improvements in local management capacity and resource mobilization. Their Policy Action Plan is a framework for coordinating achievement toward these ends. It was initially established in 1987 (TKPP, 1987a), and has been updated several times since then (most recently in May 1990--TKPP, 1990) to serve as the base for the Government's management of its own activities, as well as the support of all external donors, in this sector. The program is administered by an interministerial coordinating group (Tim Koordinasi Pembangunan Perkotaan--TKPP) chaired by Deputy V of the National Planning Agency (BAPPENAS). Objectives and targets were specified under six policy themes:

1. Strengthening and clarifying local government responsibility for urban infrastructure.
2. Implementing a coordinated and decentralized process for programming urban infrastructure investment.
3. Enhancing local government resource mobilization, financial management, and involvement of the private sector in infrastructure and service delivery.
4. Establishing effective mechanisms to support municipal borrowing and improving the system for allocating intergovernmental grants.
5. Strengthening the institutional capacity of local governments.
6. Improving intergovernmental coordination and consultation in urban development.

¹In these Chapters, background sections that explain the program's rationale and early development are provided for readers not familiar with the program. These are essentially the same as similar sections in the Second and Third Year Assessments.

Long-Term Accomplishments. This evaluation indicates that the GOI has made, and continues to make, substantial progress toward the program's basic objectives. Over the course of the program, its major accomplishments have been: (1) transforming the process by which urban infrastructure is programmed to one in which coordinated planning and project preparation occur across sectors for individual cities, with strong local government participation and linkage to local resource mobilization; (2) substantially improving the management of the property tax and other local own-source revenues, and enhancing their yields; (3) setting a sound policy and technical base for expanding private sector participation in urban services; (4) building the base for expanded municipal borrowing for urban infrastructure and operationalizing the Regional Development Account (RDA) as a major step toward a market-based credit finance system for local government; and (5) establishing and maintaining a viable framework for interministerial coordination at the central level.

1991-92 Accomplishments. Accomplishments over the past year have included (1) establishing and issuing guidelines for the RDA and setting a positive real interest rate for RDA loans; (2) designing and initiating the PURSE project in support of expanded private participation; (3) taking steps toward rationalizing urban management information systems; (4) developing initial plans for coordinated technical assistance and training for local governments in urban management; (5) establishing an experimental grant fund (Inpres Perkotaan) earmarked for urban development; (6) establishing and maintaining a system of quantified indicators of program performance; and (7) completing (by BAPPENAS) an "Issues and Priorities Report" that confirms continuing GOI commitment to the program and sets the basis for updating its agenda.

Program Sustainability and the Role of AID. It is the judgment of this evaluation that the themes of the GOI Policy Action Plan will be sustained in national policy in the future. They have remained as constant guideposts since the mid-1980s and, while progress has not always been as rapid as desired, there have been no reversals or backsliding with regard to any of them. It is also important to note that, while the GOI established the Policy Action Plan before AID support was in place, that support has since become central to the program. First, AID policy dialogues and technical assistance have been critical to the establishment of the RDA and serious initiatives to expand private sector participation. Second, AID's continued support and monitoring of the overall program have been important to its momentum, particularly since no other donor is conditioning its assistance on coordinated achievements under the program as a whole (even though others such as the World Bank and Asian Development Bank strongly support the overall program in principle and finance individual investment project within it). Third, HGL funds have become vital to the investment program, as the level of capital support from other donors has declined. Analysis of their use to date suggests that additionality has been achieved. The investment of \$72.6 million in HGL funds over the first three tranches, plus \$45.6 million in HG-eligible GOI own-source funds during 1991/92 alone, has so far been documented.

Program Status and Challenges. While its accomplishments as cited above are noteworthy in world terms, the program faces extremely serious challenges at this time. The real level of urban infrastructure investment nationally is about what it was when the program began, and is now falling substantially behind government targets and the needs implied by accelerating urbanization. It is not surprising that so massive an institutional transformation as that implied by the program has not been fully completed in just four years. Nonetheless, critical tasks have still to be accomplished. The program remains too much "public sector supply driven" and is not yet sufficiently demand and market-oriented. Local governments do not yet feel sufficient "ownership" of the urban development process, and do not yet have the orientation or capacity to mobilize human and financial resources as will be required.

In performance to date, two elements must be regarded as major disappointments: (1) the financing system has not been modified to give local governments significantly greater control over local investment; local authorities cannot raise sufficient own-source revenues to finance their investment plans, while central government resources continue to be distributed primarily through direct central spending rather than block grants; (2) a major coordinated technical assistance and training program has not yet been mounted to develop local government capacity in urban management (although an initial plan for doing so has been prepared). Some of the Policy Action Plan goals related to these issues have been met, but the goals have not been ambitious enough.

Among the highest priorities now is to rethink and re-establish a forceful overall strategy for local government finance in Indonesia in light of recent events. The Policy Action Plan was accepted as the basis for performance assessment in the final HGL-001 agreement. There are, however, three actions suggested in the Project Paper that have never been made explicit nor incorporated in the final Plan. Their omission was noted in the Second Year Assessment. These are (1) developing a written strategy for urban resource mobilization (with stated targets and institutional milestones); (2) preparing an overall plan to monitor subsidy allocations and target them more effectively to low-income groups; and (3) analysis and planning to create the conditions that would encourage private capital market involvement in lending for urban infrastructure.

In our judgment, these activities are now more vital to program achievement than before and should be carried out expeditiously. Part of the strategy should entail reorienting policies of the RDA to ensure that it serves as a transition vehicle helping to open access to private-market lending to municipal governments, and does not become a dead-end public institution substituting for private market credit.

This review suggests several additional priorities for action over the next few years. All are endorsed in the BAPPENAS (1992) *Issues and Priorities* report. The most vital is building a serious program of urban environmental quality management and infrastructure provision into the agenda. Environmental degradation is now becoming Indonesia's most severe urban problem. The goal of the MFP is to improve shelter and living conditions for the urban poor, yet rates of serious illness and death among the poor

due to waterborne diseases and other pollution are accelerating. It is clear, therefore, that the MFP is itself fundamentally threatened unless some way is found to address environmental concerns more effectively. Since the solution to most environmental problems will depend on improved urban infrastructure and services, it is also clear that an adaptation of the present urban sector program is the only sensible vehicle for addressing these concerns. There are many issues to be resolved. For example, the current emphasis on water provision in the urban sector is bound to create new environmental problems unless accompanied by a strategy for 63 wastewater disposal and treatment. This same approach should also be the most effective context for a program of prevention, mitigation, and preparedness (PMP) for disasters in urban areas.

A second, and related, priority is further strengthening the investment programming process and expediting its full transition to local control. New targets should give more emphasis to strategic analysis and planning by local leadership--including greater private and community participation in investment priority setting--and to streamlining and eliminating bottlenecks in project preparation, appraisal, and disbursement.

Third, a new agenda should be mapped under the Policy Action Plan to recognize expected achievements in private participation consistent with implementation of the PURSE project. And fourth, fresh targets should be established to substantially improve central monitoring and information programs recognizing that doing so will be essential to effective decentralization linked to national objectives.

TECHNICAL ASSISTANCE AND TRAINING

The Project's grant funded technical assistance component includes the Municipal Finance Project Contract (MFPC), a \$3.9 million contract awarded to the Research Triangle Institute on the basis of a competitive procurement, and a \$1.1 million fund for short-term consultancies and training administered directly by AID/Indonesia.

The basic design of the MFPC created a challenging assignment for the consultant team. Four long-term consultants were assigned to separate offices, in three different ministries, each working in one of the key agencies involved in Policy Action Plan implementation. Their original terms of reference gave clear mission statements but retained flexibility so that product priorities and schedules could be adjusted in consultation with counterparts. The consultant team reported to an interagency steering committee chaired by an official of the Ministry of Finance. They were not charged with major coordination responsibility related to the overall program (teams funded by other donors, reporting to BAPPENAS, have more central responsibility in that regard). The flexibility inherent in this approach was a potential benefit, but the risks were also high. The dangers of fragmentation and diversion to office tasks outside the project scope were far from trivial.

Operating Accomplishments. The performance of the MFPC has been effective in the face of these challenges: (1) the overall work program, as negotiated with the steering committee, has been developed (and recurrently adapted) in a strategic manner so that resources have been well-leveraged and focused on topics critical to overall program achievement, while avoiding duplication with other GOI consultant resources; (2) each individual team member has shown considerable initiative in developing work and establishing working relationships with counterpart agencies; each is highly regarded by counterparts; (3) actions of the team have consistently emphasized interagency coordination and cooperation (all key agencies have been meaningfully involved in planning the overall agenda and have been kept well informed about progress; major seminars and conferences have been designed to address crosscutting issues that demand interagency participation); (4) the team has gone out of its way to collaborate with other consulting teams working in the sector and (on an informal basis) to jointly focus efforts on Policy Action Plan priorities.

Substantive Accomplishments. The MFPC's substantive outputs have been substantial. They include:

- Preparing analyses and reports on municipal bonds, local government debt management, intergovernmental grants, PDAM finances and debt management, and current practices and future potential in private sector participation in urban services. The latter provided much of the basis for the design of the PURSE project.

- Developing and updating quantitative monitoring indicators on performance under the Policy Action Plan.

- Preparing analysis and recommendations concerning the rationalization and coordination of financial management system packages and urban information systems, and working with GOI staff to implement change.

- Preparing plans for a major interagency program of technical assistance and training for local governments in urban management and for the clarification and further development of local government guidelines for urban management.

- Helping to design and guide pilot programs to broaden the approach to local investment planning by linking infrastructure investment to urban economic development objectives and spatial planning.

- Designing and conducting five national interagency policy seminars (municipal finance, urban institutional and manpower development, private participation in urban water supply, urban land price inflation, management of local government debt).

- Designing and conducting technical workshops (program planning for BANGKOTA, monitoring indicators, regional investment modeling, new approaches to infrastructure development).

- Designing and conducting incountry staff training courses for individual counterpart agencies (70 participants to date).

- Sponsoring and arranging for overseas short courses in urban financial management, urban environmental management, infrastructure planning, and public-private partnerships (81 participants to date).

Areas for Improvement. While this component has been successful overall, the evaluation raises four concerns. First, the project has not been forceful enough in keeping the principal fiscal reforms included in the GOI's urban sector policy statement at the top of the policy agenda. The momentum for intergovernmental grant reform, for example, appears to have eroded, while no clear strategy has emerged for following up creation of the RDA with movement toward larger-scale, market-based lending to local governments. Second, although original plans did not call for MFP focus in this area, problems have emerged in the decentralized investment programming process (e.g., the lack of adequate strategic planning and priority setting, bottlenecks in project processing) that now warrant attention from the project. Third, while the MFP training program has been consistent with the original plan in its emphasis on overseas training, a higher priority should now be given to developing indigenous training capacity (this priority is now being recognized in the MFP's plans for building such capacity in urban management). Finally, the technical assistance agenda could be better focused if the TA team, government Counterpart Committee, and AID representatives met regularly to review accomplishments and set priorities for the next period. We recommend that such meetings be held quarterly, and that, prior to each meeting, the TA team distribute a summary of technical assistance products over the past quarter and a proposed work plan for the next quarter. BAPPENAS should be invited to participate as a member of the MFP Counterpart Committee. Because of its central role in relation to the Policy Action Plan, the addition of MFP technical assistance support directly to BAPPENAS should also be considered.

PROGRESS IN RELATION TO THE LOGICAL FRAMEWORK

In addition to the GOI's performance under the Policy Action Plan, the Municipal Finance Project also is to be evaluated against a series of Objectively Verifiable Indicators (OVI) of performance set forth in the Logical Framework of the Project Paper. Most of these measures overlap themes of the Policy Action Plan, but some bring out interests not covered explicitly in that Plan. An interim review of progress in relation to the Log-Frame is presented in Annex A and summarized here; more complete information on each of the topics is presented throughout the report. The results of the OVI evaluation are mixed. Many of the targets either have been achieved or, in our judgment, are well on the way to being achieved. But in roughly half the cases, we identify problems or find that the data needed to monitor progress are not available. In three cases, discussed in the Appendix, we question the appropriateness of the targets that originally were set.

■ **Project Goal: 5 measures**

- (1) Increase in total level of shelter-related urban investment.

Not met. Over the project period to date, sector investment has increased at an annual rate of 4.5 percent, which is well below the rate of inflation. Per capita real investment in the sector has declined substantially. Even in current rupiah, total sector investment in 1991/92 was less than in 1988/89.

- (2) Increase in investment benefiting below median-income families.

Unknown. There is no monitoring of the income profile of investment beneficiaries.

- (3) Increase in private-sector financing of urban services.

Almost certainly met.

- (4) Increase in local own-source revenue available for investments benefiting below median-income families.

Own-source revenues have increased strongly. How these funds are being used is unknown.

- (5) Reduction of present level of central government funding of urban infrastructure.

Not met. Central government funding has increased; its relative importance in the sector financing mix is at least as great as it was at beginning of project period. (We assume this goal is intended to relate to a reduction in the relative share of central government funding rather than a reduction in the absolute amount of such funding.)

■ **Project Purposes: 7 measures--4 achieved or making appropriate progress toward achievement (principally those concerning greater private sector role in service provision; enhanced financial management capacity of local government; and operationalization of the RDA); 3 not yet achieved and future full achievement questionable (consolidation of central grant and loan system; incentive system for local revenue generation; central government loans reflect cost of capital and risk).**

■ **Project Outputs: 11 measures of "illustrative" magnitude of outputs--6 achieved or making appropriate progress (participation of private sector; meeting investment plan targets; clarification of division of service responsibilities by level of government; standardization of financial reporting to central government; reduction in concessionary loans); 4 not achieved and future full achievement questionable (practical guidelines for acceptable levels of local borrowing; grant formulas that tie assistance to**

local management improvements; adoption of financial disclosure standards; policy to sell to private sector participation certificates in RDA portfolio (this last is not an appropriate target in our judgment); 4 not achieved but some progress (guidelines for local borrowing, appropriate cost recovery strategies for services, standardized accounting for central funds to local government, financial disclosure requirements established); 1 is not being monitored systematically (adoption of local cost recovery pricing in urban service delivery) though anecdotal evidence suggests that progress is being made.

■ *Project Inputs:* 3 measures having to do with disbursement of HG loan, provision of technical assistance, and GOI implementation of investment plan--all have been achieved.

In summary, performance in relation to the overall Log-Frame is promising at this point. However, the problems identified should be addressed. Most of them re-emphasize one of the major conclusions related to progress under the Policy Action Plan: i.e., there is an urgent need for a more forceful strategy at the central level for reforms that will give local governments greater control over the financing side of urban investment. The failure to monitor the income profile of the beneficiaries of urban investment is another deficiency. It has led to a great deal of conflicting speculation as to whether these investments are reaching the urban poor.

FUTURE PROGRAM DEVELOPMENT

Indonesia's decentralized urban development program has accomplished much, yet much remains to be done. The program's basic themes are still valid and they work as an integrated package: failure to make sufficient progress under any one of them would severely constrain the success of the others. It should be self-evident that the program is most likely to proceed effectively under the continued pressure of an interministerially supported and coordinated Policy Action Plan at the central level--one that is regularly monitored and adapted in response to changing trends and the emergence of new opportunities. The greatest threats to continued progress would be to break up the Plan and TKPP or to establish alternative mechanisms that weaken them.

Continued support from external donors for some years will be essential if the delivery system promised by this Plan is to become fully institutionalized and self-sustaining. Particularly in view of the key role AID support has played of late, and of its contribution to the urban sector policy dialogue, the probable payoff to additional AID resources is substantial. A new HGL program is warranted together with amendments to substantially expand the technical assistance and training component of the Project. To best take advantage of this opportunity, *a new HGL should be based on the GOI's perseverance with all elements of the Plan, but should give special emphasis to areas that are appropriately the focus of AID technical assistance initiatives: (1) effective programs and policies to further urban environmental quality management and the provision of urban environmental infrastructure; (2) a viable and sustainable finance and credit system*

for local government; and (3) private sector participation in urban services. These emphases are fully consistent with the priorities for the future identified in BAPPENAS' Issues and Priorities Report.

The investment program under the new HGL should be structured to reinforce priority for investments that benefit below median-income households, reduce environmental degradation, and support the transition of the RDA to a market-based system of municipal credit.

Chapter 2

**LOCAL RESPONSIBILITY AND
THE INVESTMENT PROGRAM**

This chapter reviews progress in strengthening and clarifying local government responsibility for urban infrastructure (Policy 1) and implementing a coordinated and decentralized process for programming urban infrastructure investment (Policy 2). Further data on goals, targets, and accomplishments are provided in the updated Policy Action Plan matrix in Annex 3.

STRENGTHENING AND CLARIFYING LOCAL RESPONSIBILITY

Basic legislation assigning main responsibilities in urban development to local governments was passed in the 1970s. Medium term goals in the current program under this theme were defined to extend and clarify authority consistent with these laws. Three objectives were set relating to (1) the clarification of detailed functional responsibilities between levels of government, (2) clarification of responsibilities for traffic management, and (3) defining responsibilities under the Integrated Urban Infrastructure Development Program (IUIDP). These have largely been achieved.

Specific achievements include a policy statement (PP 14 1987) that sets forth parameters assigning service functions more clearly at the local level. Also, infrastructure was inventoried in ten cities, and central and local officials reached joint agreements on more specific allocations in those cities (e.g., maps of all roads were marked to demarcate which level of government and which specific agency would be responsible for the development or upkeep of each road link). Lessons from these exercises were then used as a basis for similar classification as a part of investment programming activities elsewhere (Directorate Bina Program, 1989 and TKPP, 1989a).

The most recent accomplishments under this element relate to the re-classification of urban areas. The HGL Second Year Assessment noted that this process was a concern. Unless a city has been given Kotamadya status, it has no government primarily concerned with its own specifically urban interests, as distinct from those of its rural hinterland. In deciding whether or not to borrow from the RDA, for example, the

incentives of a Bupati that happens to have a sizeable city within his Kabupaten boundaries are very different than they would be for the Walikota of the city itself. NUDS (1985) proposed a schedule for accelerating the classification of urban areas in Indonesia, but that schedule has fallen far behind. The process is moving more quickly now, however. Two Kota Administratif have recently been upgraded to Kotamadya status (Bitung, in North Sulawesi, in 1990, and Denpasar, in Bali, in 1991) and plans are well along for similar upgrades in the near future (including five Kota Administratif that are provincial capitals).

IUIDP PROGRAM RATIONALE

Through the mid-1980s, virtually all urban infrastructure in Indonesia was planned by central government agencies in Jakarta (primarily by the Ministry of Public Works--MPW) and implemented by their field offices in the provinces. The programs of one central office (e.g., water supply) were seldom coordinated with those of another (e.g., drainage), either spatially or temporally, and local officials had little chance to influence them.

As cities and towns began to grow much more rapidly, there was recognition that this approach could not be sustained logistically, let alone respond sensitively to the varying needs of different urban areas. Many central officials came to believe that the only satisfactory long-term solution would be for local governments to assume full responsibility for providing (and largely financing) their own urban services. This approach was endorsed in the National Urban Development Strategy (NUDS, 1985). However, it was also clear that few of Indonesia's local governments then had the capacity to assume this role effectively.

The IUIDP response to this dilemma is a phased approach to decentralization in which the central government supports local capacity building at the same time that it works with existing local staff in planning and implementing investment programs (See TKPP, 1987, and, Hendropranoto Suselo, 1985 and 1988). In its idealized form, the process entails the following steps: (1) meetings are held with provincial governments to review NUDS analyses and prioritize cities for attention; (2) project teams in the selected cities (local staff with technical assistance provided from the center) review and update local master plans or develop a new "structure plan" where none is available; (3) teams then use those plans as a guide in developing a proposed local multi-year investment program (PJM) integrated across several sectors; (4) the teams are also required to prepare a complete financing plan (RIAP) that covers the enhancement of local revenues and borrowing, as well as support from the central budget and/or external donors; (5) plans (LIDAP) are also prepared for building the capacity of local government to assume ever increasing responsibility for infrastructure development, operation, and maintenance; and (6) individual city programs so defined are reviewed at the province and central levels and decisions are made about the allocation of central loan and grant funds.

To date, IUIDP has been limited to functions that traditionally had been the responsibility of MPW's Directorates General Cipta Karya (water supply, sanitation, drainage, kampung improvement) and Bina Marga (urban roads). It was reasoned that trying to cover more functions at the start might add complexity and threaten program viability. Other functions could be added later after the IUIDP had proved itself.

IUIDP PROGRAM DEVELOPMENT AND ACCOMPLISHMENTS

Program Accomplishments and Operating Problems

IUIDP has been implemented nation-wide under guidelines issued in 1987 (TKPP, 1987b). Progress is detailed in Directorate Bina Program, 1990, and cogently summarized in Budhi Tjahjati, 1990. PJMs have been prepared (or are in preparation) for urban areas in all 27 provinces.

As the program was developing through 1990, efforts were made on a continuous basis to improve it in process. One example is the fact that initial guidelines and manuals were regularly reviewed and revised based on operating experience. Another is the introduction of a new emphasis on improving the operations and maintenance (O&M) of infrastructure through the Performance Oriented Operations and Maintenance Management System (POMMS, see P.T. Perencana Aneka Sarana and DeLeuw Cather, Inc., 1990), which was designed and tested in eight cities. Also notable was Directorate Bina Marga's effort in shifting virtually all urban road planning into the IUIDP framework.

Partly because initial targets were so ambitious, there have been many problems in IUIDP implementation (see UNDP, 1989, and Tjahjati, 1990). Particularly in the early years, consultants often dominated PJM preparation without providing adequate opportunity for meaningful local involvement. Still today, many local governments have not yet internalized the process or developed the capacity to operate it effectively. It also became clear that the initial guidelines were too cumbersome and did not permit enough flexibility to adapt to varying local needs and priorities.

Nonetheless, IUIDP has generally been regarded as a major accomplishment. Its basic characteristics (integrated planning across sectors based on city-specific conditions, the linkage to financial discipline through the RIAPs and to capacity building through the LIDAPs) in and of themselves have been seen as a dramatic improvement over the approach of the past. Also, efforts continue to be made to rectify problems as they are identified: e.g., by revising IUIDP guidelines (see, for example, TKPP, 1989b).

Progress in PJM preparation and appraisal has been substantial over time and has given no signs of slowing down over the past year. At this point, the number of PJMs reaching the appraisal stage is growing markedly. As of December 1991, 80 PJMs had been completed (covering urban areas accounting for 50.6 percent of the nation's

estimated 1990 urban population) and another 96 were in preparation (covering another 20.6 percent of the urban population).

Recent Program Improvements and Institutionalization

Since 1990, there are a number of indications of the GOI's efforts to further institutionalize and improve the IUIDP process. Five are noted below:

1. The Ministry of Home Affairs (MHA) now regularly requires that local governments that have them use their PJMs and RIAPs, developed through IUIDP, as the basis for their submissions in the traditional annual budget negotiations with the central government (RAKORBANG). Interviews during the Third Year Assessment, and again in this mission, suggest that local government (Tingkat II, or Tk.II) officials are increasingly conforming to this requirement.

2. Often overlooked is the impact PJM/RIAP preparation has had on the central agencies that have traditionally planned and implemented urban infrastructure programs (principally Cipta Karya and Bina Marga). MPW instructions, in fact, now require these agencies to conform their own investment plans to PJMs where they exist. More important, perhaps, than instructions on paper, is the political power the existence of a locally developed PJM creates. In the early 1980s, when local governments had no coherent capital improvement programs of their own, they had little rationale for complaining about a central agency's implementing a project in their territories without sufficient prior negotiation. Now, when a PJM exists, there is a sound basis for appealing any central agency initiative that does not conform to it. Interviews have indicated that such appeals generally are upheld and that, accordingly, the central agencies are progressively less likely to try to initiate projects inconsistent with PJMs.

3. Efforts are continuing to improve the effectiveness of the program itself and to gain local acceptance and control. Under the leadership of the Interministerial Group (IMG) that is now responsible for day-to-day IUIDP guidance under TKPP (a) guidelines and manuals again are being revised toward these ends; (b) a major study of "strategic management for urban development" was undertaken (PADCO, 1992); and (c) the UN support project is providing special technical assistance in three cities particularly to enhance local governments' sense of "ownership" of the process.

4. The recently developed Program Financial Accounting and Management (PFAM) System, which was designed to improve the monitoring of IUIDP expenditures, is currently being installed in 9 provincial and 44 local governments.

5. Cipta Karya is experimenting with expanded versions of the IUIDP approach. It is working with local leadership on IUIDP planning exercises (in Bandung and three towns in Sumatra) that involve a wider range of infrastructure sub-sectors and explicitly incorporate a broader range of development goals (e.g., economic development). These efforts have been supported and guided under the MFPC.

THE INVESTMENT PROGRAM

Tables 2.1 and 2.2 present data on the core of the urban investment program from 1987/88, the baseline year prior to implementation of MFP, through 1991/92. The data include investment programmed by central agencies as well as funds flowing through the PJM process.²

For comparative purposes, data for 1986/87 are shown, as well. Expenditure totals are taken from the formal monitoring of the Cipta Karya sub-sectors performed by TKPP and Cipta Karya. In some cases, the figures differ slightly from the earlier estimates presented in the GOI's *Issues and Priorities Report*. Data for the fiscal year 1991-92 (ends March 31, 1992) are preliminary and subject to small revisions.

Urban sector total investment increased substantially between 1986/87 and 1987/88, due primarily to the influx of funding from the World Bank's Urban Sector Loan. Since that time (and over the lifetime of MFP), sector investment has increased at an annual compound rate of about 4.5 percent, which is well below the rate of inflation. As a result, real investment per capita has fallen significantly. Investment has fallen even farther behind the estimates of needs that underlie the sectoral program. It also has trailed budget targets. For example, the Rp. 750.7 billion actual investment total for 1990/91 compares with a budgeted total at the beginning of the year of Rp. 1,094.1 billion.

Both the World Bank (1991) and BAPPENAS (1992) recognize that investment levels are falling behind targets. Indeed, BAPPENAS estimates for 1990-91 show an even greater shortfall. Both reports judge that in the short-term institutional constraints probably have been more binding than financial constraints. The pipeline of high quality projects ready for appraisal has declined, and there are important bottlenecks, stemming from both GOI and donor practices, in disbursement and implementation. These are important issues to be addressed in the next phase of the program.

For the six years shown, the largest share of funds was spent on water supply systems (more than one-third) and local road extensions and improvements (almost one-quarter). Sizeable shares also went to flood protection, environmental sanitation and drainage, and the Kampung Improvement Program (KIP). This allocation of resources conforms to the priorities stated in Repelita V. The financing side of the investment picture is discussed in Chapter 3.

²The data on these tables include O&M expenditures, as well as capital investments for the basic needs subsectors covered under IUIDP. Similar data (isolating expenditure directly in urban areas) are not available for other subsectors such as energy, telecommunications, and port and market development.

Table 2.1
THE URBAN INVESTMENT PROGRAM, 1986/87-1991/92
 (Current Rp. in billions)

	Total	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
USE OF FUNDS							
Water Supply	1,582.2	1,88.6	250.6	260.7	198.9	332.1	351.3
Flood Prevention	451.3	28.6	103.7	119.5	105.3	41.5	52.7
Env. San & Drainage	468.5	42.1	72.0	108.4	66.9	96.0	83.1
Kampung Improvement	283.8	23.4	38.8	59.4	52.0	58.4	51.8
Roads	1,116.0	115.6	146.7	204.3	255.8	186.4	207.2
Planning	248.0	30.2	47.3	41.2	48.8	36.3	44.2
Total	4,149.7	428.5	659.1	793.5	727.7	750.7	790.3
SOURCE OF FUNDS							
National							
Cipta Karya	1,345.4	133.8	215.5	235.8	202.0	239.7	318.6
Other	917.2	53.1	183.7	215.0	206.0	136.7	122.7
Subtotal	2,262.6	186.9	399.2	450.7	408.7	376.4	441.3
Local							
Domeest. Loans	221.7	12.1	27.2	64.8	8.5	55.4	53.8
INPRES	447.0	60.5	70.5	72.0	106.8	71.9	65.4
SDO	34.2	4.8	4.2	19.7	2.0	1.2	2.3
APBD I & III	585.6	65.7	75.3	138.8	131.1	85.0	89.8
PDAM	598.6	98.5	82.8	47.6	71.3	160.8	137.7
Subtotal	1,887.2	241.6	259.9	342.8	319.6	374.3	349.0
Total	4,149.7	428.5	659.1	793.5	727.7	750.7	790.3

SOURCE: TKPP

Table 2.2
THE URBAN INVESTMENT PROGRAM, 1986/87-1991/92
 (Percent of Total)

	Total	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
USE OF FUNDS							
Water Supply	38.1	44.0	38.0	32.9	27.3	44.2	44.5
Flood Prevention	10.9	6.7	15.7	15.1	14.5	5.5	6.7
Env. San & Drainage	11.3	9.8	10.9	13.7	9.2	12.8	10.5
Kampung Improvement	6.8	5.5	5.9	7.5	7.1	7.8	6.6
Roads	26.9	27.0	22.3	25.8	35.2	24.8	26.2
Planning	6.0	7.0	7.2	5.2	6.7	4.8	5.6
Total	100.0						
SOURCE OF FUNDS							
National							
Cipta Karya	32.4	31.2	32.7	29.7	27.8	31.9	40.3
Other	22.1	12.4	27.9	27.1	28.3	18.2	15.5
Subtotal	54.5	43.6	60.9	56.8	56.1	50.1	55.8
Local							
Domest. Loans	5.3	2.8	4.1	8.2	1.2	7.4	6.8
INPRES	10.8	14.1	10.7	9.1	14.7	9.6	8.3
SDO	0.8	1.1	0.6	2.5	0.3	0.2	0.3
APBD I & III	14.1	15.3	11.4	17.5	18.0	11.3	11.4
PDAM	14.4	23.5	12.6	6.0	9.8	21.4	17.4
Subtotal	45.5	56.4	39.4	43.2	43.9	49.9	44.2
Total	100.0						

Source: TKPP

CONTRIBUTION OF THE HG LOAN

The GOI has channeled HGL resources directly into projects delivered through this sectoral program (HGL supported projects are clearly identified and advertised as such). The GOI's practice has been to allocate, as well, additional amounts from its own resources (exclusive of amounts financed by other donors) to HGL-eligible purposes.³

A report on these expenditures (Directorate Bina Program, 1992) shows that over the period of the first three tranches (through 1991/92), a total of \$72.9 million in HGL funds had been invested. Of this total, \$56.2 million went for projects being administered by DG Cipta Karya: 45 percent of this amount was for water supply projects, and another 27 percent for Kampung Improvement Program (KIP) projects, while shares of 8 percent or less each were allocated for projects in human waste and sanitation, drainage and flood control, solid waste disposal, access road improvement, and urban planning. The remaining \$16.7 million was channeled to the sector via loans through the Ministry of Finance Regional Development Account (RDA).

The GOI documented that it invested an additional \$45.7 million from its own resources on HG-eligible expenditures during the third tranche period. Thus, the first three tranches have resulted in a documented total of \$118.6 million in HG-eligible expenditures so far (\$72.6 million plus \$45.7 million). The total through the third tranche will ultimately be higher, if the GOI provides documentation on its HG-eligible own-source outlays over tranche periods one and two. These investments are consistent with the goals set for the investment program, and support approved types of infrastructure as called for in Section 5 and Annex 5 of the Project Paper (AID/Indonesia, 1988). AID staff have on several occasions undertaken field visits to confirm, on a sample basis, the existence of the listed projects and their compliance with HGL eligibility criteria.

STRENGTHENING THE INVESTMENT PROGRAM

Total investment is now falling behind, and there are questions about the quality of the project pipeline. How can it be strengthened so that it can address the needs of urban growth more effectively? To be sure, a large part of the solution will ultimately depend on completing reforms of the financial system. Potentials there will be discussed in Chapter 3. Another requirement will be a sizeable expansion of coordinated technical assistance and training in urban management. This issue will be discussed in Chapter 4. But steps can be taken within the program itself that should make a difference in the short term.

³Based on studies at the start of the program, formulas have been established for estimating the percentage of expenditures in each infrastructure category that are likely to benefit below median-income households.

Local Strategic Analysis and Priority Setting

One of the highest priorities for IUIDP now is to move local officials into a more commanding role in ongoing PJM/RIAP preparation and implementation. In the first rounds of IUIDP, many local officials worked closely with the consultant teams and controlled key decisions, but this was not true in many others (Tjahjati, 1990). Another problem is that PJMs generally suffered from a lack of analysis and strategic planning and priority setting across sectors before project lists have been compiled. Program staff admit that IUIDP guidelines have been weak in these areas. It might be possible to address both of these objectives by a new (but fairly low-cost) program to involve local leaders in strategy planning to improve the efficiency and effectiveness of their action programs.

The process might work as follows: (1) a central technical assistance/training team would work with local government staff in preparing quick studies of the development challenges faced by a city (and the relationship of the city's current PJM to those challenges); (2) the mayor would call in his top management staff along with a few key private and community leaders for a one- or two-day retreat; (3) at the retreat, local technical staff (with assistance from the central team) would present their ideas coming out of their studies; i.e., outlining alternative strategies for development open to the city and presenting rough estimates of the impacts of each (e.g., infrastructure and land development requirements, costs and potential financing, environmental impacts, impacts on job creation and economic indicators). The estimates would be presented only to stimulate the joint thinking of the local leadership team, not in the manner of hard forecasts. In this context, the local leadership team would be forced to consider basic strategic choices in a realistic manner. The initial retreat might lead to other meetings, to policy decisions and guidelines after that and, finally, to modifications to improve current PJMs. This thinking would not be limited to the current IUIDP subsectors. (This approach is quite consistent with ideas for broader "dynamic spatial programming" now being experimented with on a pilot basis under guidance from the MFPC--see Chapter 5).

Short-Term Efforts to Facilitate Pipeline Processing

While the responsibility for implementing urban infrastructure investment is shifting to local government, much of the work in handling the current pipeline still rests with DG Cipta Karya. Management analysis and process reform there might help to expedite processing. The BAPPENAS' *Issues and Priorities Report* offers ideas as to one way in which this could be approached. It identifies that the problems "reside partly in the government procedures associated with project identification, preparation, appraisal and implementation . . . and partly with the practices and demands of external agencies." The approach would be to reach agreement about a "more practical and responsive form of lending package." This might entail project identification and preparation based on the "bare bones of a PJM;" expedited procedures such as those used in the World Bank East Java/Bali project for preparation and appraisal (based on "plausible" estimates and full

sub-project preparation only for the highest priority elements); working in close collaboration with the Mayors and Sekwildas; defining institutional arrangements and funds channeling arrangements prior to loan effectiveness; appraisal procedures tailored to the scale and complexity of sub-projects (making it possible to appraise and disburse against simple sub-projects quickly); and providing better initial technical assistance and simpler procedures for procurement. The most important theme would be to allow the most urgent and simplest sub-projects to move more quickly.

Changing Roles for DG Cipta Karya

As more responsibility shifts to local governments, Cipta Karya's traditional role will diminish, yet it still contains the nation's greatest concentration of professional skills regarding physical infrastructure. One avenue for using this resource productively stems from the recent proposal, prepared collaboratively by the MFPC team and IUIDP Implementation Support Group, to develop a major program to build local government capacity in urban management. This proposal involves a coordinated interagency approach to technical assistance and training that would gradually replace present fragmented programs in these fields (see discussion in Chapter 5).

Some of the key modules that are a part of that proposal focus on urban physical development--including issues relating to land, infrastructure, environmental improvements, and related aspects of economic development. It could be that a major function for Cipta Karya in the future, perhaps the primary function, would be to serve as a center for technical assistance and training to local governments in these physical development aspects of the coordinated urban management capacity building program.

Cipta Karya should not develop this orientation in isolation. The ongoing planning and management of the overall urban management capacity building program is proposed as a collaborative effort of all key agencies in TKPP. Even those modules oriented to urban physical development should be delivered in a team environment with colleagues from BAPPENAS and MHA having joint responsibility with Cipta Karya for program delivery.

There is wide recognition that training in a lecture setting alone is not an effective approach to capacity building. This new program could employ a full range of techniques that international research has shown to have the highest payoffs. This could entail, for example:

- Acting as *facilitators* (including the provision of analytic support) to local leadership teams (city officials and private leaders) as they conduct their own strategic planning and priority setting as discussed above.
- Preparing and delivering *training courses* to all levels of local government staff, including practical exercises and field work combined with more conventional lecture approaches.

■ Providing hands-on assistance to local staff in *installing new management, analytic, and operating systems and procedures* (this could cover a wide range of systems approaches including program feasibility and impact analysis, development project cash flow management, implementation monitoring). Here, the TA teams would work with them directly to install the systems (providing related training as appropriate), remain on-site to assist them in trial runs and initial operations, and return periodically to assess performance for top managers and provide any additional help that might be needed in working out problems.

■ Providing other types of, *on the job training* that may be needed to local staff in the development process.

■ Serving as an *extension service for technical assistance*--when local leaders have special problems related to our areas of expertise, we would be prepared to send in technical assistance teams to help them in solving them. This would include consultant-type assistance in preparing studies and policy development to the extent that is requested.

■ *Assembling, preparing, and disseminating reports, journals, newsletters* and other materials on new techniques and approaches for local governments in urban physical development.

■ Preparing and conducting *conferences, seminars, and workshops* on relevant new techniques and approaches in fields relevant to Cipta Karya expertise.

ADDRESSING THE URBAN ENVIRONMENTAL CHALLENGE

Urban Environmental Trends

The *Issues and Priorities Report* prepared by BAPPENAS (1992) recognizes a new priority that has not been addressed in investment programming. Research over the past few years suggests that environmental degradation may be becoming Indonesia's most serious *urban problem*. Although it has not yet reached critical levels in most cities, air pollution is increasing rapidly, particularly with the growth of motorized vehicles. Yet more serious now is water pollution, which is accelerating with urbanization as more and more untreated wastes are discharged into rivers and streams and also contaminate ground water resources. Waterborne diseases are already one of the leading causes of serious illness and death in Indonesia's cities. Also, unguided urban expansion into environmentally sensitive areas (particularly lands subject to flooding and watersheds) is growing and can be both life threatening to the residents and permanently damaging to ecosystems.

A recent environmental profile of metropolitan Jakarta (MEIP, 1991b) paints a frightening portrait of trends in that city, but these issues are of growing importance

throughout urban Indonesia (Williams, 1987). Further insights into the nature of these problems are provided in an AID-sponsored study environmental conditions in Jakarta and Ujung Pandang (Chifos and Lubis, 1991) which finds that (1) the problems are indeed severe; (2) individuals and firms have little understanding of how their own behavior impacts these problems or what might be done about them; (3) a large share of all urban environmental issues are really problems of inadequate development and management of land and infrastructure; and (4) responsibility for dealing with environmental degradation overall remains fragmented. Furthermore, it is generally conceded that the burdens of urban environmental degradation fall most heavily on the poor (see, for example, Campbell, 1989).

In Indonesia today, there seems to be widespread awareness that urban environmental degradation is already severe. The Chifos and Lubis (1991) study indicated that households, commerce, and industry now believe environmental improvement is important and that many households (roughly 50 percent) are willing to pay for some basic improvements (better public toilets, cleaner and better-designed waste water ditches). Government leaders interviewed unflinchingly showed concern for the urban environment and an interest in policies and programs to improve it.

Past Efforts to Address Urban Environmental Degradation and Their Inadequacies.

Indonesia is, in fact, ahead of many other countries in attempting to address its environmental problems. Studies prepared in cooperation with the World Bank have examined concerns with regard to industrial pollution (World Bank, 1991e) and forests and other trends in the countryside (Davis, 1988). In 1986, the GOI established a process requiring the preparation of environmental impact assessments of public and large private sector projects (AMDAL) and a Presidential Decree in June 1990 formally established the Environmental Impact Management Agency (BAPEDAL), providing a general mandate for pollution control and oversight of the AMDAL process (Calkins, 1991, Kingsley and Ferguson, 1992).

However, these steps are not likely to be forceful enough to have a substantial effect. Much reliance to date has been placed on strengthening AMDAL, and studies indicate the much needs to be done to improve it (Fisher, 1991). But environmental specialists increasingly recognize that environmental impact assessments in and of themselves are not enough. They often come too late to affect the key public decisions that determine environmental quality: i.e., much work has gone into a project's design by the time environmental assessment is conducted, and there is much resistance to change at that point. Environmental criteria should be given prominence at the very start of the planning process, but there is presently no mechanism to ensure that will occur. Also, there are no mechanisms to involve Mayors and other local leaders in mounting broad and forceful environmental quality management programs in individual cities.

A more comprehensive approach is being taken in Jakarta where the World Bank (in conjunction with its Metropolitan Environmental Improvement Project--MEIP--and the Jabotabek Urban Development Project III) is working with GOI and local officials to sort out institutional responsibilities and deal with issues such as joint wastewater treatment, institutional strengthening, environmental improvement in Kampung (with a new emphasis on community participation), and informal-sector community-based composting and recycling enterprises. But similar activities are not underway elsewhere. The GOI has not yet developed a complete policy, let alone the institutional capacity, to deal with *urban environmental quality management (UEQM)* nationwide.

Implications for AID's Municipal Finance Project

The fundamental goal of the MFP is to improve shelter and living conditions for the urban poor, but accelerating environmental degradation will certainly prevent the achievement of that goal. Thus, the MFP is itself directly threatened unless some way is found to more effectively address environmental concerns. The project's components as presently defined do not address these issues directly, although with modifications they represent a framework well suited for doing so (as explained below). Therefore, adapting the present approach to incorporate effective UEQM should be a high priority in the design of a new HG Loan program.

Suggested Approach

The most basic understanding behind the GOI's urban Policy Action Plan is that local leaders have stronger knowledge and incentives to guide urban development effectively than central officials. Surely, that is also true of UEQM. Also, it is self evident that the solution to most urban environmental problems will depend on improved infrastructure and services, or programs closely linked to them; i.e., it is impossible to imagine effective UEQM that does not entail enhanced water supply, waste disposal and treatment, and guidance of land development (which is primarily influenced by the placement of major roads and water supply mains). Therefore, *the decentralized urban development program defined in the Policy Action Plan is not only the best, but probably the only effective, vehicle for addressing urban environmental degradation.*

Furthermore, the context offered as local leaders consider tradeoffs in infrastructure design should have a profound effect in stimulating their interest in other programs needed for UEQM. For example, the best time to gain their support for demand management programs to reduce wasteful use of water may be during PJM preparation, just when they have been confronted with estimates of the full costs of infrastructure to collect and treat all of the wastewater implied by present trends in usage (see Kingsley and Ferguson, 1992). This context should also stimulate their thinking about community involvement in environmental management, as well as roles for the government and private entities in sustainable urban service delivery.

An ideal place to give prominence to UEQM should be in the type of urban strategy formulation and priority setting process associated with IUIDP described in the section above; i.e., a local leadership team (including private sector leaders) seriously reviewing strategic options and making basic policy decisions based on analysis of the implications of alternatives.

Several things (that could be supported in a new HGL program) will be needed to further UEQM effectively: (1) the addition of clear UEQM objectives to the policy action plan; (2) efforts to begin to measure and monitor environmental problems in cities (e.g., the extent and spatial spread of ground-water pollution--it makes the most sense to start with selected and simple measures first and then improve monitoring capacity over time); (3) national level work to develop analytic techniques that can show local decision makers in a straightforward manner the implications of alternative strategies (there are bases for such techniques--see, for example, Abt Associates and Sobotka Inc., 1990, and Shin et al, 1992--but effort is needed in making their outputs easier for local leaders to understand); (4) the mounting of this type of local strategic planning process in the context of the overall decentralized urban development program; and (5) supportive research, policy development, and technical assistance and training at the national and provincial levels. We believe these approaches should be given priority in the next stages of the existing MFP project and in the design for a new HGL.

Urban Disaster PMP

The main arguments supporting this approach for UEQM also are highly relevant for disaster prevention, mitigation, and preparedness (PMP) in urban areas. In particular (1) while supportive roles should be played by national and provincial governments, if it is to be effective, the main thrust of PMP activity should be designed and implemented by local leadership; and (2) early local strategic planning, linked to UEQM, is likely to do much more to relieve the pain and damage associated with disasters in urban areas, and at much lower cost, than anything done after the fact. An example is the Bhopal disaster in India. The problem there was fundamentally a land-use problem--squatter settlements would not have sprung up around the plant if local government had done more (provided trunk infrastructure, etc.) to open up sufficient land for low-cost residential development in other locations. The same can be said for the emergence of kampungs in flood prone areas in Indonesia.

UEQM Program Themes

The following themes should be supported as a part of environmental management in the suggested program.

■ *Responding effectively to service demands that can be met by local governments, and helping to structure a tariff policy that recovers costs from beneficiaries to the extent feasible but recognizes income and demand limitations.* Households now pay for safe water, access to communal toilets, and garbage collection, and are willing to pay

more for some types of environmental infrastructure. But it is the essence of markets that households not be forced to pay for services they don't want to buy. The decision as to which local environmental services should be delivered through markets, subject to consumer choice, and which should be delivered collectively through the public sector, and how these latter should be paid for, will be critical to establishing a self-sustaining system of environmental management. Greater exploration of demand, the cost of different options for environmental infrastructure, and the external (community-wide) benefits associated with each is needed before pricing decisions can be made.

■ *Appropriate technologies.* Water-borne sewage systems and piped water to individual households are clearly beyond the financial reach of many of the households that the HGL seeks to serve. However, alternative technologies of the type supported by KIP offer lower costs and promise much greater coverage. Further exploration of these options must play an important role in any strategy to improve the urban environment.

■ *Building popular support for and awareness of the benefits of environmental quality.* More than most countries, Indonesia has a rich network of local organizations and heritage of community self-help, even in urban areas. This organizational network provides a foundation that can be built on for environmental infrastructure that reaches low-income people. It also provides the framework for collective choice at the community level in prioritizing environmental projects.

■ *Private sector participation.* Where markets are judged to be the appropriate institutional vehicle for delivering services, priority should be given to private providers. Already, private sector providers are active in such key areas as septic tank cleaning and sludge removal and solid waste collection. Community preparation for the use of private markets in environmental services provides a natural link between a new HGL and the PURSE project.

■ *Measurement and monitoring.* Better data collection and better analysis of the impact of environmental conditions on human health and economic growth are necessary conditions for better-informed environmental choices. Involvement of the kampungs in environmental quality monitoring is one way to give them a greater sense of control over environmental conditions and investment choices.

Chapter 3

FINANCING URBAN DEVELOPMENT

The core of the Municipal Finance Project is designed to implement policy reforms in the financing of local governments and local capital investment. The Project Paper identifies the project purpose as to assist the GOI in:

"further developing its municipal finance system by *expanding* and *enhancing the management* of (local) financial resources, which will enable Indonesian municipalities to (a) assume an increasing share of the financial responsibility for urban shelter-related infrastructure and services; (b) create conditions favorable to private sector involvement in urban investment finance and service provision..."

THE POLICY FRAMEWORK

Expressed somewhat differently, the Project has the policy objective of helping to establish a self-sustaining system of local and intergovernmental finance capable of meeting the country's urban investment and urban service needs. It is built around four pillars of reform articulated by the GOI in its urban sector policy:

- Strengthening local governments' own-source revenues.
- Rationalizing the intergovernmental grant system, so that local authorities have access to more predictable and transparent central-government transfers, and can exercise greater control over the funds they receive.
- Establishing a workable local government credit system, which can serve as a mechanism of transition to local authority borrowing from the private capital market.
- Strengthening the private sector's role as investor in local infrastructure facilities and provider of local services.

In part, the Project Paper viewed the fiscal re-structuring implied by this agenda as dictated by central government's budgetary reality. With the subsidence of the oil boom, central government resources were not expected to grow fast enough to permit continued rapid expansion of the real value of central grants and central government capital construction in the urban sector. A diversification of revenue sources therefore was necessary if growth in urban sector investments was to be sustained. At the same time, decentralization and increased involvement of the private sector were judged to be desirable in themselves. Both steps were expected to increase the productivity of investment and help ensure that capital planning and service provision would become more responsive to local demand.

THE POLICY ACTION PLAN FOR LOCAL FINANCE

The general objectives of the Project have been translated into specific elements of the Policy Action Plan, as negotiated and agreed with the GOI. Policy objective 3 under the Plan calls for strengthening local government resource mobilization and financial management. It contains four sub-objectives: (a) improving the performance and yield of the property tax, local taxes, and local service charges; (b) improving cost recovery and management of local enterprises; (c) improving local government financial management capabilities; and (d) encouraging private-sector participation in the provision of local public services. Policy objective 4 calls for increased municipal borrowing and improvements to the system of central-local government transfer payments. It contains the sub-elements: (a) creating a consolidated loan fund for local governments, (b) modifying grant allocation criteria so that the grant structure more directly supports sector policy objectives, and (c) utilizing the system of central-local grant funds to address poverty alleviation.

POLICY ACTION PLAN: ACCOMPLISHMENTS

As reviewed below, substantial progress has been made in implementing the municipal finance elements of the Policy Action Plan. Progress is most pronounced in strengthening the technical capacity of central government and local authorities to collect taxes that accrue to the local level, and in setting up institutional mechanisms that have the potential for revamping central-local fiscal relations. Despite the many accomplishments, however, the overall financing picture of local governments has not changed to the degree contemplated in the Project Paper. Most achievements to date have potentially important impact. They must now be increased in scale to have practical effect. Further, experience in implementing the first four years of the Project shows that it is necessary to modify some of the Project Paper's assumptions about binding constraints standing in the way of local resource mobilization and expanded use of credit.

Improving Property Tax and Local Tax Performance

The PBB (Pajak Bumi dan Bangunan) or Land and Property Tax has received the most attention in efforts to increase local revenue yields, and holds the greatest potential for future revenue growth. The PBB is a central government tax implemented with local government cooperation as the billing agent. Approximately 65 percent of revenues collected are returned to local governments on the basis of origin. The rest of PBB receipts are shared with provincial governments (15 percent) or retained by central authorities.

The PBB tax base has been rationalized and administration of the tax modernized in recent years. In 1986, the PBB base was broadened by reducing exemptions and the base was changed from rental to capital value. In an economy growing as rapidly as Indonesia's, a property tax based on the capital value of land and improvements is a highly buoyant tax--i.e., as long as assessments are kept current, the value of the tax base, and therefore tax receipts, will tend to rise faster than income levels. Valuation procedures for the PBB have been simplified and updated. Improved parcels with more than 150 square meters of building area are now valued at replacement cost (distinguished by category of building) minus depreciation. During the period 1989-91 approximately 200,000 top value properties in Jakarta, Surabaya, Medan, Bandung, and Denpasar were revalued using the new methodology. A further 70,000 top-value properties in other areas were to have been revalued in 1991-92.

Land values used for property tax purposes are estimated on the basis of unit values negotiated between PBB and local authorities. At present, unit land values are differentiated on a street-by-street basis; however, starting this year, a simplified system of land-value gradients covering an entire urban area is to be introduced. The PBB relies upon owner registration of property and self-description of parcel characteristics. A new property declaration sheet has been pilot tested in Tangerang, and now is ready for system-wide application. Sample follow-ups have found that owner declaration rates are very high, since registration of property on the fiscal cadastre and payment of property taxes convey a measure of de facto legal title. The incentives for providing a full property description, however, are not strong.

A new Payment Points system has been introduced that uses banks as the collection point for payment of property taxes. A pilot test of the new payment system in Tangerang raised collections from Rp. 4.2 billion to 8.2 billion. In 1991/92 the Payment Points system was extended to 83 TK II governments. In 1992/93 it will be extended to 100 more of the approximately 300 TK II governments. Property tax officials ascribe the greatest part of PBB revenue gains to changes in the collection system.

All of these changes combined to substantially increase property tax yields. Total property tax collections, including taxes on mining and oil property, more than tripled between 1985/86 and 1989/90, rising from Rps. 143 billion to Rps. 531 billion. They are projected to increase by another 80 percent, to Rps. 947 billion, in 1992/93. Urban

and rural property tax collections account for roughly half of total property tax receipts, and also rose sharply. Property tax yields are almost certain to continue to grow rapidly as the recently introduced reforms are universalized. For example, officials estimate that property tax receipts in Jakarta would increase by a factor of five times if all properties were assessed in relation to market value and all revenues due were collected.

Nonetheless, the potential for the property tax remains largely untapped. Total revenue collections are very modest--less than \$1 per capita for urban and rural property in 1991/92. Overall, the property tax accounts for about 7 percent of local government revenues (though a much larger share of revenues subject to local control). If the property tax is to become a quantitatively important part of the total local financing picture, emphasis will have to shift from purely technical improvements in tax administration to building a political consensus that the tax should be imposed at higher rates. At present, the effective rate of taxation is only 0.1 percent--or a nominal tax rate of 0.5 percent applied to assessments that are supposed to be set at 20 percent of market value. By all technical criteria, the property tax should be used to produce more revenue. It is a progressive tax in the Indonesian context, a buoyant tax, and one that is now well administered. Repelita V does, in fact, call for raising the rate of assessment for property tax purposes. Merely raising assessments from 20 percent to 40 percent of market value would double revenue collection and add substantially to local government revenues, while keeping effective tax rates at 0.2 percent, a very modest level by international standards.

Ironically, some of the strongest resistance to increased property taxes comes from local authorities who are more sensitive to the burdens of higher effective tax rates than to the additional revenues that would be generated for local government. This is a sign that an important practical constraint on local revenue generation is taxpayer willingness to pay--i.e., taxpayer demand for services that are provided through the local public sector.

As decentralization takes hold in Indonesia, the Government may want to consider introducing a measure of local discretion in setting local property tax rates. A system of local tax choice would acknowledge that resistance to higher tax rates exists in some places, while in others there are unsatisfied demands for greater local public spending. Rather than mandate uniform property tax rates throughout the country, it would encourage local governments to begin deciding for themselves, in consultation with citizen groups and the private sector, how much money should be raised to pay for public services. Property tax rates could be limited to a range of choice prescribed by central government. Discretion in selecting rates could be restricted to the largest cities where the financing needs, taxable base, and administrative competence all are greatest.

Local Taxes

Improvements to municipal collection of own-source revenues have been led by introduction of the MAPATDA system (Manual Administrasi Pendapatan Daerah). MAPATDA streamlines the recording of taxes due and taxes paid; helps with management of revenue collection; identifies the local revenue sources in a particular city that have the greatest potential for payoff from collection efforts; and reorganizes Local Government Revenue Offices to improve billing, collection, and monitoring of local taxes and charges. In 1991 installation of the MAPATDA system in all TK II governments was completed. Local revenue collection climbed steeply after adoption of MAPATDA. For example, in nine TK II governments sampled in North Sumatra, own-source revenue increases ranged from 19 to 96 percent. The increased yields, however, are from an extremely low base.

Preliminary draft legislation has been prepared that would give local authorities access to a new motor fuel tax. This would be a highly buoyant revenue source, especially in the larger, rapidly growing cities, and would provide a basis for greater local fiscal autonomy. The draft legislation also would allow local governments some choice in deciding which miscellaneous local taxes they want to impose. At present, there are more than 100 individual local taxes and fees, whose revenue generation varies greatly by region. Many of them do not raise enough revenue to cover the costs of administration. Simplification of the revenue system is desirable, as is local choice in deciding which miscellaneous taxes should be used.

The proposed Local Taxes and Charges bill has been tied to a controversial grant reform bill. The two pieces of draft legislation have been awaiting Cabinet approval for some time. In principle, however, the two bills are independent of each other. The proposed legislation on Local Taxes and Charges would take an important step toward fiscal decentralization, whether or not it is accompanied by new legislation regarding the intergovernmental grant system.

Improving Local Service Cost Recovery and Preparation for Private Sector Participation in Service Provision

Indonesian local authorities provide a broad array of economic services for which fees are charged. Most of these services are provided through local public enterprises, a share of whose profits are then distributed back to the general-purpose local government. On a cash basis, local public enterprises in the aggregate generate a profit. Typically, however, their capital has been paid for by government, with the result that service fees are far below true cost-recovery levels. The Policy Action Plan recognizes that conversion of these services to a cost-recovery basis is one key strategy for improving the local revenue picture and paving the way for private sector entry into service provision. Alternatively, where the public sector is ill-suited to service provision, it may make more sense for public authorities simply to withdraw from service provision, so that private providers can take over.

The most important service for which fees are charged is water supply. Repelita V assigns priority in urban sector investment to water system expansion, and also assigns priority to financial and institutional re-structuring of water authorities. GOI policy calls for local water providers to improve their finances to the break-even point, at which time they are to be converted to independent public water companies (PDAMs). For most water enterprises, progression to the break-even point has required or will require real tariff increases. To date, 177 local water enterprises have been converted to PDAM status. Approximately 150 remain to be converted. GOI policy calls for converting all water enterprises to a self-financing basis by the end of the current Repelita.

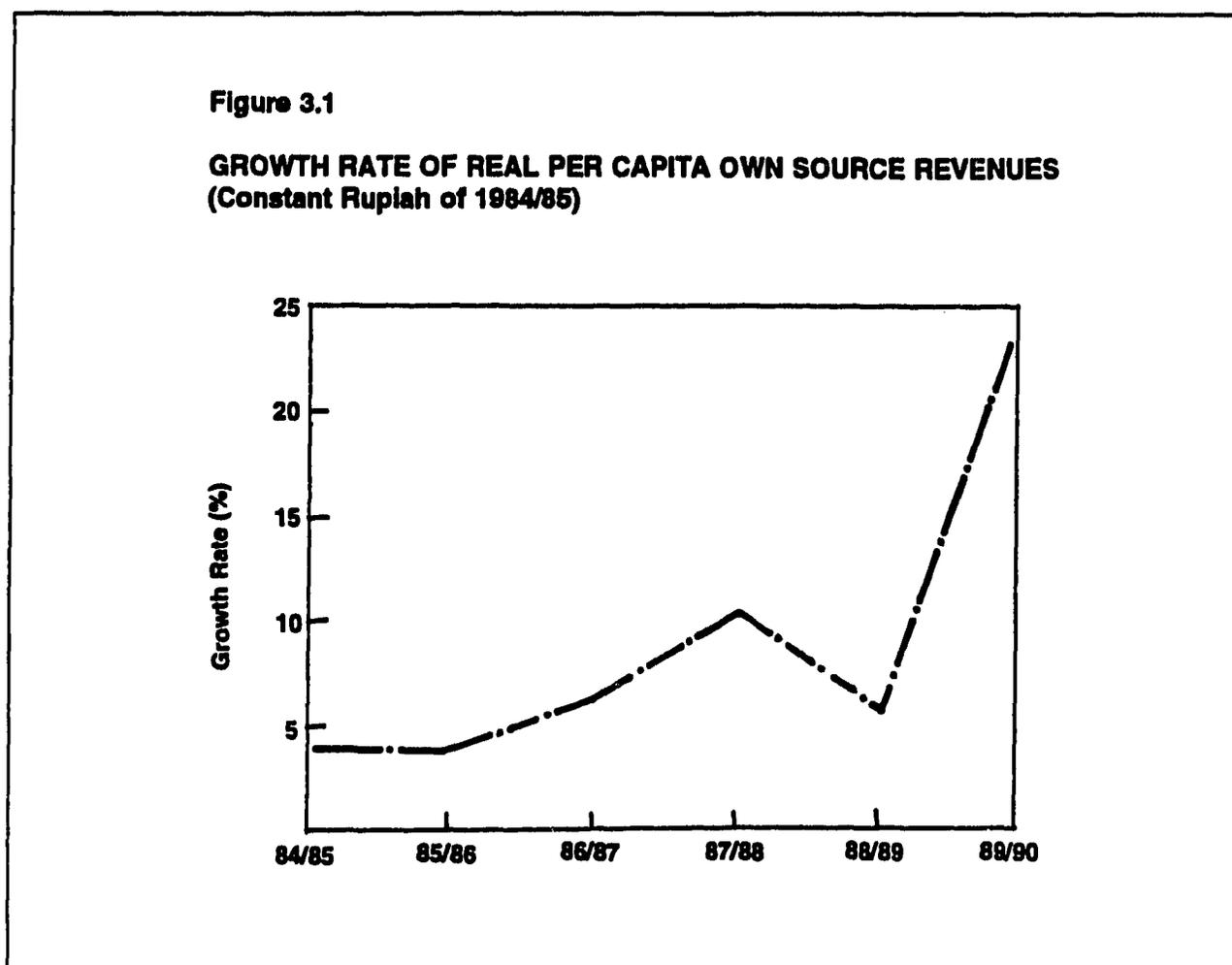
Once they become PDAMs, water enterprises are supposed to finance their capital needs through borrowing rather than central government grants. The need to pay back loans adds urgency to the PDAMs' cost-recovery efforts, and places additional pressure on tariff rates.

The effect of these policies on water-enterprise revenues can be glimpsed from a study of 14 PDAMs that have substantial borrowing (McCullough, 1992). Real revenues for these PDAMs rose at an average annual rate of 2.6 percent between 1984/85 and 1990/91. The rate of increase is likely to accelerate in the future as more of the loans move out of their grace period and require interest payments. As the burdens of debt payment have become more apparent, there has had to be some reconsideration of the role of credit in the public finance mix. For example, although formal policy calls for financing PDAM capital investment solely through loans, most investment continues to involve a mix of loans, grants, and direct government construction. In the World Bank's East Java and Bali project, just under half of the planned water sector investment is to be financed by the central government (World Bank, 1991). It is likely, too, that some delay will be encountered in converting the remaining water enterprises to PDAM status. The systems that remain to be converted have the weakest financial condition. Some of them will have difficulty reaching the break-even point, and others will be very hard pressed to finance expansion out of borrowing.

Outside of the water sector, not a great deal is known about the finances of municipal enterprises (BUMDs). In the aggregate, transfer of enterprise profits accounts for a very small proportion of Dati II revenues--less than 3 percent of own-source revenues and less than 0.5 percent of total revenues in 1989/90. The potential for rationalizing the municipal enterprise sector, however, may be substantial. An inventory of BUMDs now underway at the Ministry of Finance has identified more than 1,500 different regional and local BUMDs, performing functions that range from provision of credit to ice production and from the operation of pharmacies to markets management. Once the inventory of BUMDs has been completed, analysis will turn to the BUMDs' financial condition and the rationale for public ownership, with the intention of preparing guidelines to be used for deciding whether to restructure, privatize, or liquidate different BUMDs.

Total Own-Source Revenues

As is illustrated by Figure 3.1, local own-source revenues in the aggregate showed dramatic gains between 1984/85 and 1989/90. The growth rate of real per capita own-source revenues (including the property tax) averaged just under 9 percent per year, easily exceeding the Policy Action Plan's objective of some increase in real per capita revenues. Moreover, the growth rate accelerated at the end of the period. Data for later years are not yet available, but preliminary information indicates that there has been continued rapid growth in own-source revenues.



Private Sector Participation in Services

Private sector participation in urban service delivery and infrastructure investment offers several potential advantages in a country like Indonesia. It can relieve pressure on

government capital budgets by mobilizing private capital resources to invest in urban facilities that have revenue-generating potential. It can increase the efficiency of local service delivery by orienting service provision toward market demand and by exposing it to cost competition on the supply side. Finally, it offers a complementary model of decentralization in which consumer control over services delivered through the marketplace reinforces community control over public spending through local government.

A great deal of progress has been registered over the project period in changing attitudes toward private participation in "public" services. Some of this change is reflected in the legal framework. For example, Presidential Decree Number 21 of 1989 expanded the number of functional areas in which private participation is legally encouraged; in particular, water supply was removed from the restricted list.

A large number of local experiments are now underway in virtually all aspects of private participation in urban service provision (Walker, 1992). In the water supply sector, a joint venture project to supply water to the tourist areas of Bali at Nusa Dua was signed in May, 1991, and is now underway. Two Indonesian firms will invest \$15 million, and the PDAM will contribute about \$9 million. Negotiations continue on the large (\$125 million) bulk water supply Build-Operate-Transfer project at Umbulan Springs, East Java. The Salim Group of Singapore and Singapore's Public Utilities Board have signed an agreement in principle with the government to joint venture a \$480 million water supply project in Bintan Islands, with Riau Province and the local PDAM as partners. The workshop sponsored by MFP on private sector participation in urban water supply (WASH, 1991) identified a number of additional private-sector investment opportunities in mid-size water supply projects, but also pointed out that regulatory issues regarding water tariffs would have to be worked out before the private sector became involved in routine investments in water supply and distribution systems in cities.

In solid waste collection, a variety of models for formal-sector and informal-sector private participation are being tested. In Jakarta, 14 different private firms won competitively awarded collection contracts from the city in 1989. They now add 115 trucks and 2,000 employees to the city's solid waste management capacity. One of the firms, SOR, recently established a sister organization, SOT, that signed a 10-year contract with the Governor of Jakarta to build a 1,000 ton capacity transfer station to sort recyclable wastes, convert organic waste into compost, and serve as an intermediate dumping point before non-recyclable wastes are transferred to final disposal sites. In the larger Indonesian cities, individual scavengers are licensed by local government. Various options are being explored for collectivizing this work.

Septic tank de-sludging is another urban service currently being privatized in some cities. Padang, for example, now leases its two de-sludging trucks to a private company that provides services directly to households and charges Rp. 15,000 per house serviced (Kugler, 1991).

Municipalities also are becoming co-investors with private companies in local development projects. Surabaya's Proyek Supatman scheme actively solicits private-sector matching funds for infrastructure projects that benefit the private sector, and has raised substantial funds in this way. Most large cities have mechanisms for obtaining private land donations for street widening or new road projects. These take advantage of the landowner's interest in enhancing the value of his remaining land, as well as community pressure to support development projects. Most large cities also are in some stage of negotiation regarding for-profit joint venture projects. For example, in Padang negotiations are underway with the PDAM for a joint venture to produce Aqua bottled water, with Pemda TK I and Tk II for a joint-venture beachfront tourist development, and with local authorities for joint venture development of an industrial estate.

No reliable baseline exists against which to measure the number of private ventures in urban services. However, it is virtually certain that the number is rapidly accelerating. One of the initial activities of the PURSE project will be to conduct an inventory of private-sector ventures of this type in 10 cities that can be used for systematically measuring future progress in private participation in urban services. MFP activities--including the high-level workshop held in Bali in May 1991 and a number of follow-up reports--have contributed importantly to arousing interest in private delivery or financing of urban services and have helped define the practical steps that government can take to convert this interest into actual projects. The promising nature of MFP's initial work led to approval of a separate project, PURSE, aimed exclusively at accelerating private-sector involvement. It should be noted, however, that recent privatization steps need continued institutional support. For example, Jakarta's public-sector waster management opposes private-sector contracting. Only the insistence of the provincial Governor has sustained the private sector role.

Management Information Systems

The HGL Second Year Assessment noted concern about the development of management information systems to support municipal control over the development process. Today, no device is more important to enhancing local government capacity than a computer-based financial management and accounting system (covering all sources of revenue, and capital, as well as routine expenditures). Such systems can form the core for broader planning and management control of municipal activities. In the overall program, several systems that appeared to be at least partly overlapping were in process of development. At the local level, MAPATDA has been developed and widely implemented as a revenue-tracking and collection system (see above). PAFPACK seeks to introduce a comprehensive, program budgeting approach to local financial management. PFAM is being implemented to handle financial monitoring under IUIDP. POMMS is a budgeting and management system that focuses on infrastructure operations and maintenance. SPMKD is another overall budgeting and accounting approach for use by local governments.

Besides these financial management packages that have been introduced in different parts of the country, there has been a considerable amount of systems work done to support the PBB program (local property tax administration, being administered by central government). At the national level, SIKDD is being developed for the Ministry of Home Affairs to track local finances, as well as a number of other variables on local conditions.

The previous assessment suggested that it would be valuable to carry out a comprehensive comparative review of these systems and to develop a strategy for incorporating the best features of each into a simplified and consistent set of automated financial monitoring and management packages. Without this rationalization, local governments could be drowned in a sea of overlapping, but inconsistently constructed, management systems.

An important step was taken in this direction in late 1990. The Municipal Finance Project (see further discussion in Chapter 5) prepared a series of papers describing the various systems that were anticipated or underway, and held a major interagency seminar to review them. The seminar (Municipal Finance Project, 1990a) assessed the strengths and weaknesses of each system, identified areas of overlap, and developed principles for a more focused and coordinated approach. Our interviews with GOI officials indicate that this seminar was highly regarded and that participants recognized the need for coordination.

Steps are being taken to follow up on the recommendations of the seminar. First, a Central Technical Unit is being established in PUOD (with MFPC assistance) that will coordinate efforts to develop financial management packages. Emphasis is being placed on useful and practical final packages for local-level users, combining the best features of the packages thus far developed. Second, the MOF and MHA are now collaborating on a system for collecting local financial data that will be used in national level monitoring and analysis (also with MFPC assistance).

SUPPORT FOR MUNICIPAL BORROWING: CREATION OF A CONSOLIDATED LOAN FUND

One of the principal policy objectives of MFP has been to strengthen the role of credit in municipal finance. Central government and local governments share an interest in increasing the volume of local government borrowing. For central government, greater use of credit (instead of grants or central government provision of infrastructure) lowers the budgetary cost of capital investment. For local governments, a reliable credit system makes municipalities less dependent upon central government funding, and increases the amount of infrastructure investment they can undertake. A non-political system of municipal credit also supports decentralization. It permits creditworthy municipalities to finance their own investment priorities.

The HGL program has supported formal establishment of a consolidated loan fund, the Regional Development Account, that would increase the volume of municipal credit and serve as a transition vehicle to eventual borrowing from the domestic private credit market. It has also supported other credit initiatives, such as efforts by Surabaya authorities to familiarize themselves with the United States municipal bond market, with the possibility that the city will issue municipal bonds directly at a future date.

Procedures for operating the Regional Development Account were established by decree of the Minister of Finance on Sept. 30, 1991. On January 31, 1992 an operations manual was promulgated. Subsequently, the interest rate was established for loans made during 1992. The lending rate was fixed at 11.5 percent. Although this rate is well below the commercial rate for short to intermediate-term loans, at 24-25 percent, it establishes a positive real interest rate which reflects the recent inflation rate (9.5 percent) plus estimated administrative costs (2 percent). Formalization of the RDA fully satisfies the sub-objective of creating a consolidated municipal loan fund, as specified in the Policy Action Plan.

Functioning of the RDA

In its present structure, the RDA is a funding facility for loans to local authorities, operated as a special account at Bank Indonesia. The account can receive funds for on-lending from the Government of Indonesia, foreign loans or grants, and payment of interest and principal on past borrowings.

Loans can be made to either general-purpose Level I and Level II governments (PEMDAs) or the corresponding regional enterprises (BUMDs). However, loans must be used to finance income-producing activities, and cannot exceed 75 percent of project cost. The RDA account, though not formalized by ministerial decree until 1991, actually was created earlier and made (highly subsidized loans prior to 1991). In addition, it has been assigned responsibility for administering a number of outstanding loans that were made under international donors' sub-lending agreements. As of March 31, 1992, loans for water sector development accounted for 82.6 percent of its portfolio. Bus terminals, solid waste projects, and estates were the next largest sectoral users of funds.

New RDA loans can be made for a maximum loan period of 20 years with a maximum grace period of 5 years. In the past, the RDA has not required either principal or interest payments during the grace period. However, the new Operations Manual states that the grace period is to be limited to principal payments (see discussion below, however). Because most of the loans that RDA administers (and all of the loans that it originated) still are in their grace period, there is limited experience with repayment.

The procedures for loan application are spelled out in the Operations Manual. They require preparation of a Project Feasibility Study, which includes estimates of the economic benefits of a project, technical specification of the work to be undertaken, clarification of administrative responsibility for the project, and a financial analysis that

includes a projected Internal Rate of Return and a monthly financial plan for the use of funds.

Although the RDA has been officially created and an Operations Manual prepared, many of the key issues regarding its form of operation remain to be clarified. This is especially true because, from the date of promulgation of the Operations Manual in January 1992, no loan application have been processed that follow the new procedures.

Loan Appraisal. The Operations Manual states that loan applications will be appraised by (a) the Director General of Monetary Affairs of the Ministry of Finance, (b) the Director General of the Budget, and (c) BAPPENAS. How this appraisal process will work in practice has yet to be determined. Officials at RDA report that they believe the principal project appraisal responsibility will rest with the Directorate of Investment Funds (DDI), whose staff has received training in project appraisal from the Harvard Institute for International Development. However, BAPPENAS expressed a desire to review projects for their conformance with national or regional investment priorities, and to exert greater control over project design. There also is disagreement between DDI and BAPPENAS over the loan application process. DDI officials informed us that they intended to substitute a lengthier loan application form for the one now in use. BAPPENAS officials stated that they viewed the present form as too cumbersome and requiring irrelevant information; they want to simplify application procedures. The amount and type of review that projects receive will go far to determine whether the RDA can function as a quick-disbursing loan facility and the extent to which it supports principles of decentralization.

Interest Rate. The Operations Manual states that a uniform interest rate will be used for all loans made during a year, and that the interest rate will be announced by the Ministry of Finance in January, taking into account the average inflation rate over the past three years and administrative costs needed to support the RDA loan facility. The 11.5 percent rate announced for loans made in 1992 represents a positive real rate of interest plus a 2 percent margin for administrative costs. A number of local governments, supported by some officials at BAPPENAS, have protested application of a uniform interest rate of this magnitude. They argue that the interest rate on loans should be adjusted to reflect local governments' ability to pay.

Loan Repayment. A great deal of ambiguity concerning loan repayment runs throughout the RDA Operations Manual and RDA practices. The Operations Manual first specifies that loans must be repaid on schedule, then qualifies this with the statement, "It is understood, however, that during the loan period, either the Borrower or the guarantor may sometimes encounter financial difficulty, so that they may be unable to fulfill their obligations. In such cases, the Borrower can request the Minister of Finance to reschedule loan payments." Similarly, after stating that the grace period applies to principal payments only, the Operations Manual notes that "In cases where the Borrower is unable to pay interest during the grace period, the interest occurring during the grace period will be accumulated with compound interest and will be capitalized." There are

statements to the effect that if loan rescheduling occurs, the interest rate will be increased, and penalties will be imposed for late payments. However, no specific schedule of interest-rate adjustments or penalties is provided. On balance, the Operations Manual conveys the impression that not all borrowers are expected to make all loan payments.

This ambiguity carries over to the actual repayment record on outstanding loans. According to the RDA's records, the arrearage rate on loans it administers is 29.0 percent on principal (measured as ratio of principal payments past due to total principal due to have been paid, excluding local authority payments of monies not owed) and 24.3 percent on interest (additional interest has not been charged on late payments). Records on loan payments are not in good shape. Often, RDA records regarding principal amounts outstanding differ from local government records. RDA does not systematically notify municipalities of loan payments due in the next year, so that they can be budgeted in advance, and does not routinely notify borrowers as payments come due.

In sum, RDA's loan repayment record is not good enough to sustain a permanent parastatal loan authority or to encourage private sector entry into municipal lending. RDA authorities point out that most of the loans it administers were "forced" upon local authorities by central governments, and that the repayment record for voluntary loans should be better. Nonetheless, the poor collections record prevents the RDA's currently functioning, from being a market-oriented source of financing.

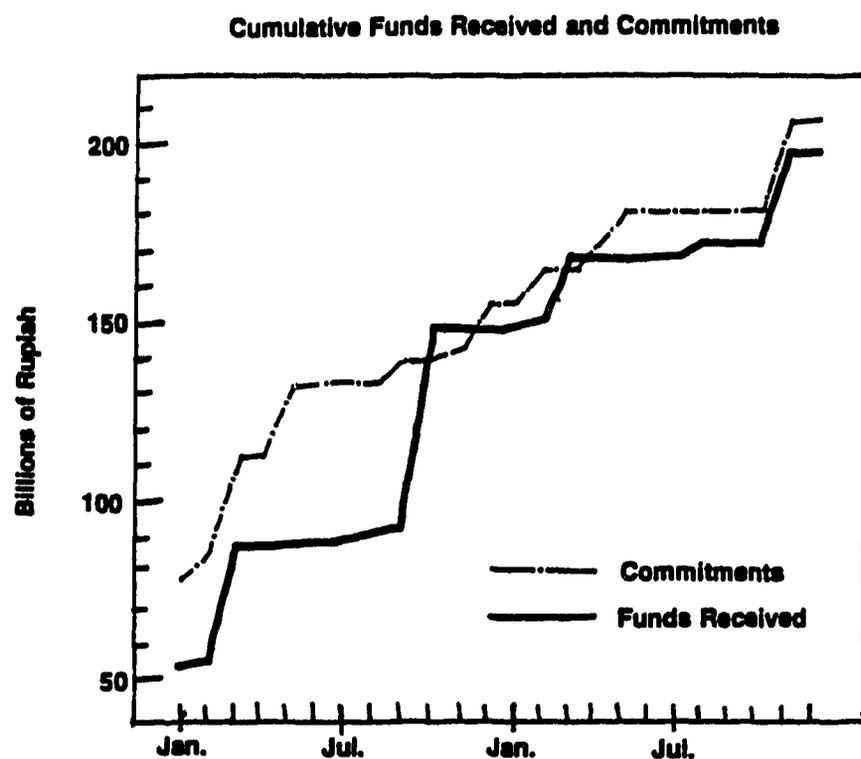
Funding. Although the Operations Manual states that interest and principal payments on past loans can be used to replenish the RDA account, up to now such payments have gone into a general state account. (The evaluation team was given conflicting information as to whether any loan repayments are now being retained in RDA). BAPPENAS' position has been that, since most of the funds initially were provided by external donors subject to international agreements, interest and principal payments should be repaid to the state for new allocation decisions. No plan has been agreed upon for longer-term capitalization of the RDA, nor has there been a stable policy of government capitalization. As Figure 3.2 illustrates, RDA funds have moved ahead in fits and starts. Loan commitments have moved in close parallel as funds became available.

General. This summary should make clear that a number of uncertainties remain as to how the RDA will operate. These uncertainties can be resolved only by observing the RDA in practice. Unfortunately, since the RDA in its present form has made no loans, and has received no loan applications that conform to the procedures spelled out in the operations manual, prospective borrowers can only speculate on its *modus operandi*.

Despite the uncertainties, the RDA probably represents the best based in Indonesia on which to build a municipal credit system. The Presidential Decree and Operations Manual defining RDA procedures provide a good institutional base for municipal lending, if they can be implemented and firmly established as precedents. The

Figure 3.2

RDA FUNDS POSITION, 1990-91



interest rate of 11.5 percent is a positive real rate, much higher than the rate at which local government loans were made in the past. It is appropriate for AID to continue to strengthen the RDA as a reliable source of municipal credit financing, which supports decentralized investment decision-making

There is no reason for RDA to have a monopoly on municipal lending, however, AID should continue to support other initiative that can lead to a market-oriented credit system, and should be ready to shift its capital support to the institutions that can make the most progress in this direction.

In the short to intermediate term there are other impediments to a municipal bond market. First, current laws do not permit issuance of municipal bonds. In addition, the central government has a longstanding policy of not issuing bonds or otherwise borrowing from domestic financial sources. Until this policy is changed, it is almost impossible to imagine the central government allowing municipalities to issue bonds. The same fear of irresponsible borrowing that has led the government to avoid central government domestic debt would apply, *a fortiori*, to municipal borrowing from the private market. In addition, the private sector has demonstrated no desire to take on the risks of municipal lending. Even loans to the best quality private sector borrowers typically do not extend beyond six years; the 20-year loans commonly found in municipal lending embody a large amount of inflation risk that lenders are unwilling to accept. Moreover, there are no organizations in Indonesia equipped to assess municipal credit risk for private sector lenders. As the RDA's repayment record indicates, municipal credit risk currently is high.

In practical terms, the most promising path to eventual establishment of a private-sector municipal credit market is to establish municipal creditworthiness through an efficiently operating RDA that gradually moves toward market terms of lending. In other countries (like Colombia and Zimbabwe), it has proved possible to "graduate" larger cities with good repayment records under a publicly-operated municipal credit system to the private market.

A second alternative to the RDA that has been discussed in Indonesia is use of the Provincial Development Banks as municipal lenders. These are public-sector banks, partially owned by the municipalities, which is likely to make them more predisposed to municipal lending. The Provincial Development Banks, however, are politically oriented institutions. Although it was not possible to examine in detail loan repayment rates for the Provincial Development Banks, it is well known that they have been saddled with repayment problems, which could be more severe in the case of loans to municipal governments, who are equity owners of the banks. The Ministry of Home Affairs, which supervises the Provincial Development Banks, indicated that it would favor a more highly subsidized interest rate than is now available through the RDA.

There is no reason for the Project to oppose development of the Provincial Development Banks as municipal lenders, if they adhere to the lending principles outlined below. Indeed, a market-oriented lending system could spread faster if pursued by both RDA and the Provincial Development Banks. If the Provincial Development Banks are willing to lend at near-market terms and to implement replacement controls, AID should be open to provide them with capital support under any successor to HGL-001. At this point, however, a good deal of institutional development has gone into the RDA, which it would be unwise to abandon. It would be a substantial reversal to the principle of market-based municipal lending if the Provincial Development Banks were to enter the field with highly subsidized interest rates that undercut the RDA. Moreover, this would jeopardize the financial status of the Provincial Development Banks, which

(unless they received direct central government funding for the purpose) would have to tap their precarious financial reserves to pay for their interest-rate subsidy.

In summary, it is the conclusion of this evaluation that the Project should give priority to strengthening the RDA, but should do so within the context of a multi-year plan for the institution, which will allow it to help municipalities establish eventual access to the private credit market.

The Longer-Term Role for Credit.

Establishment of the RDA just begins the job of building a long-term role for credit in the urban sector. Credit presently finances only a small proportion of urban sector investment--estimated at about 15-20 percent in recent years. The greater part of this lending has been done through sub-loan agreements under international donor programs outside of the RDA. The RDA has yet to establish itself as a plausible vehicle for lending on the scale that will be required to substantially augment the use of credit in the urban sector.

The BAPPENAS (1992) *Progress and Issues Report* points out that a longer-term approach to credit is needed, which will assure that local government lending is integrated with the rest of Indonesia's market-based financial system. Only the mobilization of voluntary domestic savings for investment in infrastructure can assure, over the long run, that urban investment needs will be met. As the *Progress and Issues Report* notes, the true importance of the RDA is as a transition institution that can help municipalities eventually tap into private sector savings via the private credit market.

If the RDA is to serve as an efficient transition vehicle to private credit markets, it needs to build on several key principles:

■ *There must be adequate and stable capitalization of the RDA.* Over the past two years, RDA made new loan commitments averaging about Rp. 60 billion per year, accounting for some 7 percent of investment in the Cipta Karya urban subsectors. For the last five months, however, the RDA has not made new loan commitments, primarily because it has no funds to lend. It has actively discouraged loan applications until it receives further capitalization.

The \$20 million in additional HG funding targeted to the RDA will be helpful in reactivating the RDA's lending program, but it will not solve the principal capitalization problem. To achieve its broader goals, the RDA needs regular capitalization from domestic sources and, as originally contemplated, needs to become the standard vehicle for on-lending at least a part of all donor funds for the urban sector. Its long-term funding position also would be solidified by having loan repayments go into the RDA rather than a general state account.

There are various alternatives for strengthening domestic capitalization of the RDA. One route is to have a regular budget allocation over the next several years, until the RDA builds up a large enough portfolio to capitalize itself primarily through loan repayments. Another route is to transfer to RDA administration the outstanding SLAs from past donor funding. Payments on these outstanding loans, if retained by the RDA, would give it a stable capitalization from which to make new loans for several years, making the RDA a true revolving fund (Bastin 1990). From RDA's perspective, this alternative has the advantage of making capitalization more automatic and less dependent on annual budget decisions. However, the assignment of outstanding SLA loans and payments to RDA apparently would require a cabinet decision.

A long-term plan for capitalization of the RDA would be a logical element to include in a modified Policy Action Plan. The plan could include a timetable for gradually reaching beyond government and donor funds to raise part of RDA's capital on the private capital market.

■ *Loan applications should be encouraged.* The RDA currently is managed so as to discourage loan applications in excess of financing capacity. If the RDA is to become an instrument for expanding the use of credit, "excess" applications should be encouraged. Completed loan applications are the best measure of the demand for credit. The HIID advisors to the Ministry of Finance estimated that potential demand for RDA loans is in the vicinity of Rp. 600 billion, based on their survey of local governments and local public enterprises. However, demand estimates are inevitably uncertain until they are translated into loan applications, particularly in view of some municipalities' resistance to the RDA interest rate. A backlog of loan applications for good projects is the best possible indication that the scale of credit operations should be expanded, and is the best guarantee that any new program of credit support can be quickly disbursed for worthwhile purposes. It therefore strengthens the case for external donors to channel part of their funding through the RDA. Finally, demonstration of the fact that there is excess demand for RDA loans at the current RDA interest rate is the best argument for gradually raising the interest rate to market levels.

■ *RDA's appraisal practices should be clarified as soon as possible.* The ambiguity surrounding RDA's loan appraisal process needs to be removed before the RDA can be considered a transparent or stable source of loan funding. This is a further reason for accelerating consideration of one or more pilot loans through the RDA, so that the appraisal process can be tested in practice, and any difficulties in the new procedures can be pinpointed and worked out before the new HG financing is received.

■ *Loan repayment must be taken seriously.* If the RDA is to facilitate transition to private credit market financing, it is imperative that it establish a rigorous record of timely debt repayment. The principal reason that government-operated municipal credit institutions in most other countries have failed, frequently becoming barriers to private lending rather than facilitators of it, is that they do not require prompt and universal repayment of loans. Once municipalities become accustomed to making

late payments, skipping payments, or appealing to central government for re-negotiation of loan terms, lending to them acquires a political risk that is virtually impossible to overcome. Perhaps the most important steps that the RDA can take in preparing for private-market lending to municipalities are to appraise loan applications rigorously so as to ensure that projects have the capacity for repayment, then demand that local authorities make all debt payments as due. One step in this direction is to make crystal clear that the RDA, under no conditions, will accept loan applications from enterprises that are not current in all of their past payment obligations. Such a statement could be introduced prominently into a new version of the Manual of Operations. Another step is to introduce automatic covenants into loan agreements, which require that borrowing enterprises maintain a minimum margin of net-revenues-before-debt-servicing over repayment obligations (perhaps 30 percent) and that service prices be raised to restore the margin whenever it falls below the required level. Such covenants are a frequent feature of revenue bonds in developed countries, and have been included in modified form in the East Java-Bali project.

■ *The RDA should develop a long-term plan for identifying and reducing local government credit risk.* As a transition institution, part of the RDA's role is to identify (through its lending experience) the credit risks involved in municipal loans and gradually reduce these so that it becomes feasible for the private sector to lend to local authorities. Each of the RDA's lending practices should be re-examined in this light: will it help identify and reduce municipal credit risk? For example, the practice of providing a 5-year grace period, during which neither principal nor interest payments are required, has been found in other countries to obscure costs of debt-servicing and encourage local authorities to borrow beyond their capacity. An analysis of the RDA's loan repayment experience could examine the record of initial payments after expiration of the grace period, as these begin to come due, to determine whether similar risks are being created through RDA loans. Perhaps of greater urgency, the RDA should have a systematic program of advising local authorities in advance when initial loan payments will come due, and ensuring that local authorities budget for these payments.

Experience in other countries also provides lessons about techniques that have successfully reduced municipal credit risk. For example, liens on central government transfers proved to be extremely effective in reducing municipal default rates. These arrangements automatically give lenders first claim on central government transfer payments in the event a municipality does not make loan repayments on time. In Indonesia, the most suitable device probably would be a lien on central government PBB transfers. In the event of loan arrears, the RDA or a private lender would have prior legal claim on a municipality's PBB payments from the central government. Liens on central government transfers are used as loan security in such diverse countries as Colombia, Morocco, and the state of Rio Grande do Sul, Brazil, where they have essentially eliminated credit risk for the lender, as well as in many states of the United States where lenders to high-risk central city school systems can have their loans protected by prior claim on school aid payments by the state. In the United States, several distressed central city school systems, which were formerly shut out of the credit market completely,

have attained AA or AAA credit ratings once loans were guaranteed by liens on state government transfers. The use of PBB revenues as a lien would have the further advantage in Indonesia of automatically establishing a maximum prudent level of indebtedness, since lenders would not be protected in cases where annual debt payment obligations exceeded annual property tax entitlements.

■ *The RDA should conduct its operations in an environment of full disclosure and transparency.* As this evaluation team discovered, it is very difficult to obtain information on the terms of outstanding RDA loans, the extent to which loan terms have been renegotiated, the extent of arrears/defaults in RDA's loan portfolio, or collection procedures. If the RDA is to smooth the way for private sector lending, it is critical to identify the true extent of credit risk. The terms of all loans should be a matter of public record, as should borrowers' repayment histories. Information of this kind is necessary to permit assessments of credit risk and to monitor improvements in risk reduction. Uncertainty about credit risk has been found in other countries to be the principal deterrent to private-sector lending to municipalities. Publicly disseminated information on payment histories also would be a sign that the RDA takes repayment seriously; it may in itself discourage payment delays by local governments.

■ *A consistent interest-rate policy needs to be articulated.* As noted above, it is uncertain whether BAPPENAS will accept the RDA's currently announced interest rates. Future interest-rate policy is even less certain. There is no mention in the decree establishing the RDA, or in the Operations Manual, of gradually moving RDA interest rates toward market rates. Without such a policy, of course, unsubsidized entry of private lenders into municipal credit markets will be impossible. There will be no demand for private lending, as long as municipal authorities can borrow from a public credit institution at lower rates.

Movement toward market rates of interest for municipal loans does not imply an end to central-government subsidy of urban infrastructure investment. Under the Indonesian municipal finance framework, it is impossible for more than a handful of investments nation-wide to be financed entirely by credit, given limitations on local taxes and charges. Market-rate loans, therefore, will need to be blended explicitly with grants in a single financing package, applying agreed-upon criteria to determine the appropriate share of grant financing in the mix. Agreement on the principles for establishing the grant/loan mix in different types of investment was one of the policy targets in the Project Paper. However, no such agreement has been reached, except in principle, for financing under the East Java-Bali project.

■ *Any protections against municipal credit risk should be equally available to private and public lenders.* It is likely to be many years before a private, commercial lender seeks to make a municipal loan. Nonetheless, the same conditions available to a public lender, such as grant-financing of part of the investment package or liens on central-government transfer payments, should be available to private lenders. One of the paradoxes of municipal credit operations in other countries has been that protection

against credit risk has been available only to the public credit institution, not to private banks or other commercial lenders.

■ *Commercial banks could be integrated into the municipal lending system, first by serving as collection points for loan repayments and eventually initiating municipal loans that are repurchased by the RDA.* Commercial banks are now used as the collection point for PBB payments and, in many localities, as the collection point for payment of PDAM water bills. If the long-run goal is to introduce commercial banks to municipal lending, it would seem logical to have them collect municipal loan payments, as well. This would expose both municipal officials and commercial bank officers to current lending practices, and perhaps hasten experimentation with strictly commercial loans. It also is likely to improve the payment record, as has happened with property tax and water payments when commercial banks become the payment point.

For water bills and property tax bills the banks are "passive" collectors; that is, they receive payment but do not send out bills or pursue delinquent accounts. In the case of RDA loans, the commercial banks appropriately could be used as active collection agents, who are paid a fee for loan collection. This would help put RDA loans on a more commercial basis.

In the intermediate term, if the objective is to integrate the RDA with the private credit market, commercial banks could be used to initiate municipal loans on terms acceptable to the RDA. The RDA would gradually become a secondary purchaser of municipal loans made by banks, rather than a direct lender. This strategy probably holds the greatest promise for practical entry of the private sector into municipal lending. At the outset, RDA could re-purchase from banks loans made at its standard, below-market terms. Over time, however, it could re-discount loans at rates closer to market rates.

The Choice of Sectoral Credit Policy

Using a publicly sponsored municipal credit institution (MCI) to open the way to private-sector municipal lending is not easy. Most attempts around the world have failed. Typically, the MCI becomes a dead-end institution which makes loans at below-market interest rates, renegotiate loans or fails to collect loan payments whenever municipalities face fiscal pressure, and becomes dependent for its survival on capturing low-cost or "free" capital from government or external donors. This approach permanently separates municipal credit markets from the rest of the private capital market, giving local authorities access only to government-provided funds rather than to voluntary private savings.

Segmentation of the municipal credit market in this way would be an especially severe loss for local governments in Indonesia. The nation has made, and continues to make, such strong progress in financial market reforms that local governments in the long run can only benefit from integration with the private capital market. As the

Progress and Issues Report points out, voluntary private savings are the most reliable long-run source of financing for the cities' capital investment needs. The short-run appeal of subsidized interest rates and a flexible loan repayment policy is undeniable. Over the longer term, however, as the GOI urban sector policy emphasizes, local authorities will benefit more from a policy that uses central government grants to deliver subsidies and allows the municipal credit market to operate on private market principles.

REFORM OF CENTRAL GOVERNMENT GRANT POLICY AND CENTRAL-LOCAL FISCAL RELATIONS

The Project Paper established ambitious goals for grant reform and central-government direct financing of urban investment. Reliance on total central-government financing was to decline over the project period. In the central-government financing mix, there was to be a shift away from direct infrastructure investment by central government (DIPS) toward sectoral and unrestricted block grants (INPRES) that give local authorities more control over investment choices. The allocation formulas for central-government grants were to be made more transparent and revamped to target grant assistance more effectively on low-income households, low-income areas, and projects with large externalities.

The sectoral credit strategy and the sectoral grant strategy were intended to complement each other. The increased use of credit for cost-recovery projects was supposed to free up grant funds for a higher degree of targeting on the poor.

In the Policy Action Plan, these ambitious overall goals were reduced to the sub-objective of "improving grant allocation criteria."

Some progress has been made on the original, broad objectives, but very little on the narrower objective incorporated in the Policy Action Plan. The central/local mix of urban sector investment financing has fluctuated substantially from year to year, largely in response to the availability of external funds (See Tables 2.1 and 2.2). Overall, however, the share of central government financing has not declined. In 1991/92, the central government share of investment (excluding INPRES and loans, which are treated as part of the local share) was 55.8 percent. This compares with a central share of 43.6 percent in 1986/87 and 60.6 percent in 1987/88, when the influx of funds under the World Bank Urban Sector Loan was at its peak.

The importance of INPRES block grants relative to DIPS likewise fluctuated a great deal, but in the last two years declined substantially. In 1991/92 INPRES grants financed only 8.3 percent of sector investment, the lowest level in the last six years, and down from 14.1 percent in 1986/87. The Project Paper objective of increasing the INPRES share plainly has not been achieved. (It should be pointed out that the MFPC Indicators report is misleading on this point. Because it monitors *budgeted sources of funds*, it shows an increase in the INPRES share. Actual funding, however, deviates

greatly from budget. As a result, monitoring should be conducted in terms of actual expenditures and actual revenues, rather than budgeted expenditures and budgeted revenues.)

Cipta Karya direct spending rose substantially as a share of the urban investment program over the project period. It reached 40.3 percent in 1991/92, up from 31.2 percent in 1986/87, and a low of 27.8 percent in 1989/90. This trend reverses the direction of change that the Project Paper and Policy Action Plan sought.

Ironically, despite external donors' policy support for decentralization and grant flexibility, they continue to channel their funds primarily through direct central-government spending. As a result, when external funding (and therefore total urban investment) rises, the DIP share of the total also tends to rise.

Only isolated changes in grant formulas have been made during the project period. Nor have analyses been undertaken that establish a priority agenda for future formula change. The INPRES for roads was changed to a distribution formula that emphasized land area and population, resulting in a higher share for several of the less developed regions. An INPRES Perkotaan, or urban-sector block grant, has been incorporated in the 1992/93 budget on a pilot basis. As presently designed, this grant provides support for technical assistance activities in the preparation of local investment plans. It is budgeted for 1992/93 at Rp. 38 billion, which though small as a share of total central funding, would account for more than one-third of sectoral INPRES funds. Details of the INPRES Perkotaan have not been released as of this date (and reportedly still are under design), but it will affect the distribution or incentives for capital financing directly.

On the surface, reluctance to tackle either the relative importance of central government financing in the urban investment mix or the structure of central government funding appears to represent a backing away from the principle of decentralization emphasized in the original urban sector policy agenda. Reduction in central-government direct provision of capital facilities is key to almost all of the other sectoral financing reforms. Until central government financing is reduced, it is unrealistic to expect that substantial local government demand for own-source revenues will emerge, or that local authorities will be eager to expand their use of credit. Any rational local government will use "free" government funds to the extent they are available before falling back on alternative sources of financing that imply direct local costs. In other words, local government is not likely to become an enthusiastic constituency for the bundle of financing reforms urged in the Project Paper and urban sector agenda until they are convinced that the traditional policy of central-government financing no longer is available to them.

In practice, however, the most important steps taken toward decentralization are likely to involve greater local participation in defining local investment bundles and in deciding the investment financing mix. Under the IUIDP process, DIPs are no longer investment allocations decided solely at the central level. Rather, they represent a

negotiated outcome between local, provincial, and central government as to how the jointly defined investment plan (PDAM) ought to be financed. Under the World Bank's East Java--Bali project, this process has been taken one step further. The central government is supposed to guarantee that central resources will be provided to finance all of the jointly negotiated local investment plan, after budgeting jointly agreed levels of local and provincial financing. Under this system, Cipta Karya direct spending through DIPs ceases to be a purely "central" activity. Instead, it is more demand driven by local perceptions of investment priorities.

HGL Investment Plan

In view of this reality, some of the measures originally proposed in the Project to measure success in decentralization have to be revised. The fact that a large part of the HGL Investment Plan has been financed through DIPs, and that the HGL program has contributed to increasing the share of central government financing in the urban infrastructure sector, does not necessarily imply that the goal of decentralization has been frustrated, as long as local governments now have more control over how DIPs are expended. Our interviews with both local government and central government officials lead us to conclude that local authorities now have a substantially greater voice in allocation of central government investment funds in the urban sector. One type of interim adjustment that is appropriate in monitoring policy change under the HGL is to devise a means of systematically measuring local participation, through the PDAM process and intergovernmental budget negotiations, in determining DIP allocations. Less emphasis should be placed on the *source of revenues* as the measure of decentralization and more on the level of government that *makes decisions about the uses of funds*.

Nonetheless, the investment plan remains an important instrument for achieving the Project's objectives. Expenditures under the HGL investment plan should directly reinforce the program's policy priorities. In particular, the Project should direct a higher proportion of funding through the RDA, should use the investment plan to encourage more spending on environmental infrastructure, and should look for ways to reinforce decentralized control of investment decisions in the rest of the investment package. This will allow AID-financed investment to more directly support the GOI's policy program for the sector.

POVERTY ALLEVIATION

One specific aspect of intergovernmental financing reform emphasized in the Project Paper was greater targeting of central-government sectoral resources on the poor. The GOI has continued to fund the Kampung Improvement Program (KIP), which has gained a worldwide reputation for urban sector poverty alleviation. However, no significant modification of grant formulas or other changes have been undertaken to reinforce this objective.

More fundamentally, there is a dearth of information regarding the degree of poverty targeting in current sector programs. The only information now available deals with geographic allocation of central government funds. These data indicate a high degree of targeting of central government resources on the largest urban areas, especially Jakarta. Not only is the per capita volume of investment highest in these areas, but the share of central government financing is high. Such an allocation of central government resources is likely to be at odds with targeting on the poor.

Technical assistance under MFP should give more priority to removing the ignorance now surrounding the incidence by income group of investment projects in the urban sector, including the activities specifically financed by the Housing Guaranty Loan. One straightforward, but nonetheless critical, series of analyses could sample beneficiaries of different types of projects to determine their income profile. A sample could be constructed to compare projects by sector (e.g., water distribution vs. roads), financing source (e.g., loan-financed vs. central government direct investment) and geographical location (e.g., large vs. small urban areas). Existing data (MFP, 1991) imply that direct central government investment (DIPs) is much more highly skewed toward large, wealthy urban areas than INPRES grants, which on balance tend to favor poorer regions. For example, DKI Jakarta receives more than one-third of the DIPs allocation, but less than 2 percent of the INPRES allocation. This implies that a reduction of DIPs in favor of INPRES could have the additional benefit of more effective regional targeting on poverty alleviation.

Poverty targeting becomes an especially important issue with respect to the RDA and expanded use of credit for infrastructure finance. There are potential conflicts of principle contained in the Project Paper and Policy Action Plan. On one hand, greater use of credit and cost-recovery service pricing are urged; on the other, greater targeting of investments on the poor is urged. As long as the poverty population lacks the financial capacity to pay cost recovery prices for services, these two objectives may be in conflict with each other. It would be valuable to determine whether such a trade-off exists in practice by tracking a sample of RDA projects to clarify how RDA loans were blended with other sources of financing to put together an overall financing package, what the income profile of project beneficiaries was, and what pricing strategies have been used to deliver services to local users. Household sampling to determine the importance of public service purchases in low-income households' budgets would provide information needed to make a realistic decision about how vigorously to press forward with cost recovery pricing for this segment of the urban population.

RECONSIDERING THE MUNICIPAL FINANCE AGENDA AND SECTORAL PRIORITIES

There is a paradox in assessing achievements under the municipal finance component of the MFP. Most of the objectives spelled out in the Policy Action Plan have been achieved. Since this represents the policy agenda to be used in monitoring project

progress, as agreed between AID and GOI, one must conclude that there has been a high degree of success in project implementation.

At the same time, only moderate progress has been made toward the broader project purposes identified in the original Project Paper. Despite specific project accomplishments, overall investment in the urban sector declined significantly in real terms over the project period. The sectoral investment financing mix today is more dependent upon central government funding than in 1988. It is unclear whether targeting of sectoral investment to the poor has improved, because there is no monitoring of the incidence of beneficiaries.

This situation implies that Policy Action Plan's objectives should be reconsidered to see whether they adequately capture the original project purposes. Further, the Project Paper itself was built upon several key assumptions regarding constraints that had to be removed before the municipal finance reforms outlined could be achieved. After four years of experience in project implementation, it is appropriate to re-consider whether the initial identification of constraints was accurate.

Mobilizing Local Resources.

The Project Paper implies that effective constraints on local resource mobilization are of two kinds. First, local governments lack technical capacity to administer local revenue sources efficiently and collect the revenues due them. Second, central government laws allocate to the local level only a few significant revenue sources and, for the most important one, the PBB, mandate a very low rate of taxation. The project design attacks the first constraint through technical assistance in financial management to municipalities and technical assistance in tax administration to the PBB system. The second constraint was to be attacked through central government laws that enhanced local government revenues.

Omitted in this analysis is consideration of citizen-taxpayer demand for public services, or willingness to pay for publicly provided capital facilities. Demand seems to be a more important constraint than had been foreseen. The study of PDAM financing suggested a substantial price elasticity of demand for piped water consumption. Many local authorities have resisted higher local property assessments for PBB purposes.

Demand limitations have several important implications for the design of project implementation strategy. At the most basic level, sectoral investment "needs" estimates may overstate the amount of public investment that citizens are willing to pay for from their own resources, given their income constraints. If the sector actually succeeds in shifting to a substantially greater use of credit and cost-recovery pricing, it can be expected that desired sectoral investment levels will fall. That is, investments that seemed to represent basic "needs" when paid for by central government are likely to be reconsidered as optional expenditures when paid for directly by users or local authorities. Up to some point, falling short of sectoral investment targets need not be regarded as a

problem, if in fact it is the consequence of shifting to more demand-driven investment decision-making.

For the design of credit strategy, demand elasticity provides a warning sign. Revenues that local authorities can generate, and therefore the level of indebtedness that they can support, are likely to be overestimated by projections that assume revenues will rise in direct proportion to tariff rates. In fact, revenues generally climb less rapidly as demand falls and revenue collection difficulties mount. One cause of municipal credit difficulties around the world has been overestimation of the revenue responsiveness to tariff increases. Analysis of the actual experience of highly indebted PDAMs therefore becomes critical to making mid-course corrections in credit policy toward the water sector.

Finally, the importance of local demand factors suggests that decentralization policy should give more importance to creating institutions that can effectively capture and express local demand. In the property tax field, this principle would lead to allowing local authorities some discretion in setting local tax rates, based upon local differences in the desire to provide services through the public sector. In the design of local investment packages, it suggests that authorities should be more aggressive in conducting user-demand surveys and using these to shape investment priorities. Investment planning that merely translates central-government priorities into a local investment plan does not capture the essence of demand-driven decentralization.

Long-Term Strategy for Credit Development.

In credit policy, the Project Paper and Policy Action Plan place almost exclusive emphasis on creation of the RDA. It is taken for granted that establishment of the RDA, at least if it makes loans at a reasonable, positive interest rate, will pave the way for expansion of credit financing and entry of the private sector into municipal lending. The experience of the rest of the developing world suggests that this is an overly sanguine view. As argued in this chapter, the RDA can become an effective vehicle for credit expansion only if there is a long-term plan for its capitalization. It can serve as an effective vehicle for transition to a private credit market only if it adopts rigorous operating principles designed, above all, to identify and reduce the risks in municipal lending.

Creation of the RDA is a good start toward a municipal credit policy. However, the most important work lies ahead.

Keeping the Finance Picture in Perspective.

One lesson that emerges from project implementation experience to date is that project monitoring cannot focus exclusively on the specific targets incorporated in a Policy Action Plan. At regular intervals, AID project directors and the Government Steering Committee need to take stock of whether achievement of specific action plan items are actually moving the sector in the direction that the overall project desires. Project implementation experience sometimes reveals unanticipated constraints that justify the Project in modifying Policy Action Plan priorities.

CONTRIBUTIONS OF POLICY DIALOGUE, TECHNICAL ASSISTANCE, AND THE INVESTMENT PLAN

The project design contemplates achieving its overall purpose through a combination of policy dialogue, technical assistance, and physical investment financed by the HG. These instruments have been used consistently in a manner that greatly enhances specific achievements under the Policy Action Plan, but also are jointly responsible for lesser progress that has been registered toward the overall finance agenda, as spelled out in the Project Paper.

Policy dialogue under MFP was largely responsible for creation of the RDA, in the face of a good deal of bureaucratic resistance. For this accomplishment, AID and the Project deserve accolades. The areas identified in this chapter as ones where hoped-for progress was not made coincide with areas that the policy dialogue did not emphasize: design of an overall sectoral credit strategy, reduced reliance on central-government funding and especially central government direct construction for infrastructure investment, and development of demand-driven mechanisms for making local tax and expenditure decisions. These goals should be given more importance in future policy dialogue.

Technical assistance in the municipal finance area is directly responsible for many of the project's accomplishments. The seminar held on financial management packages, and subsequent synthesis of alternative financial management systems into a comprehensible core package that can be implemented locally, is a signal achievement. Analysis now being completed on PDAM finances promises to open the door to critical policy discussion, ranging from the use of credit to finance the water supply expansion program to the need for greater demand responsiveness in local investment decisions. Using the specific financial experience of PDAMs as the entry point into this debate is likely to be far more effective than general papers less concretely anchored to new information.

Nonetheless, the technical assistance team's performance contributed to what sometimes appears to be premature focus on specific issues of secondary importance that divert attention from key objectives of the Project. For example, the Technical Assistance

Work Plan for the Project called for completion during the first two years of Special Studies and analyses on such topics as Rationalization of the Overall Grant/Loan System, Tariff Policies and Affordability Criteria for Urban Services, Income Targeting of Urban Service Investments, and Debt-Carrying Capacity of Local Governments. If these special studies had been carried out, they could have helped the overall Project identify and keep focused on the most critical issues in municipal finance. (Note that a study of loan management and debt administration is now underway at PUOD. It is intended to serve, *inter alia*, to (1) track the debt of local governments, (2) track debt service payments, (3) flag fiscal problems arising from debt, and (4) review the draft law on the Debt Coverage ratio that will replace the formerly used Debt Service Ratio.)

The Investment Plan has exceeded its objectives of getting funds disbursed rapidly to important sectoral projects, while inducing substantial counterpart investment from domestic resources. As noted, however, like the World Bank and ADB programs, most AID financing has been channelled through central DIP allocations. In order to support the project's objective of expanding local control of the investment process, it would make sense in the future to add a further requirement: namely, that only projects that have been explicitly approved by local government as being consistent with their own priorities (either as a part of their PJM or independently so certified) be considered as eligible under the HG investment program.

Chapter 4

LOCAL CAPACITY BUILDING AND PROGRAM COORDINATION

STRENGTHENING LOCAL GOVERNMENT CAPACITY

Consistent with Policy 5, the Plan's objectives have included (1) carrying out a comprehensive study of the urban institutional and manpower development needs of local governments; and then (2) developing a program to strengthen local government capacity based on the results of the study.

UIMDS and the Lack of Follow-Up

The study (Urban Institutional and Manpower Development Study-UIMDS) was completed at the end of 1988 (P.T. Hasfarm Dian Konsultan and DHV Consulting Engineers, 1988). One of its major contributions was a new Human Resource Data Base (HRDB) containing the results of a 30,000 respondent manpower survey. The report's findings and recommendations covered most relevant topics (urban planning, local financial management, urban service delivery, personnel management, training, administrative status of urban areas, internal organizational structures, and training) and examined appropriate roles for central, provincial, and local authorities in each. The report recognized that considerable time will be required to address all of these issues adequately, but it pointed out many other areas in which progress could be made incrementally without waiting for major legal changes. Across all topics, short-term actions could entail organizational tightening to eliminate functional redundancy, streamlining presently cumbersome procedures, and introducing computer-based management systems.

The study's recommendation on training warrant a particularly high priority. Observations during earlier HGL assessments confirmed that, while training has been provided under several elements of the Policy Action Plan, the results of these efforts were not well documented individually, and there had never been a comparative evaluation of their performance.

UIMDS was much discussed after it was completed, and was generally well received, although through mid-1991, steps had not been taken to form a definite plan of action to deal with its recommendations. One reason for inaction may have been general knowledge that the World Bank was preparing a major "Local Government

Institutional and Manpower Development Project." In 1991, however, after meetings in which the GOI and the World Bank were unable to agree on the structure of this Project, plans for it were dropped by both institutions. The HGL Third Year Assessment recommended that "The development of some comprehensive program to address these issues, specifically related to urban governments, should be among the program's highest priorities over the coming year."

The Consolidated Urban Management Program

Collaborative effort by advisory teams of the Municipal Finance Project Contract and the IUIDP Implementation Support Project has begun to address this issue (Municipal Finance Project, 1992d). They prepared an inventory of all training programs currently available for local officials and used that as a basis for discussions with all subagencies participating in IMG. Agency counterparts recognized that present training options are highly fragmented with substantial gaps, as well as overlaps. There was general agreement that the absolute level of technical assistance and training for local governments needed to be substantially increased, that a coordinated approach will be required, and that it should focus on building capacity in *urban management*.

The design calls for something in between large scale restructuring (that would require markedly greater centralized coordination) and an incremental approach that would only modestly adjust existing programs. It emphasizes targeted strengthening of parts of the current system along with selected program coordination. Suggested principles state that the system should address both structural and content deficiencies; should target all relevant actors (central, as well as local) while being focused on management of urban local government services consistent with the national policy of decentralization; should be "demand driven" and responsive to job needs of local managers; should be paid for in large part by local governments; should merge concepts of technical assistance and training; and should be consciously experimental.

The design for a new training program in urban management calls for "Tier 1 courses," which would offer materials on *strategic management* for Tk. II top management teams (assessing conditions and potentials of their cities, setting priorities, allocating resources, organizing and motivating staff, and monitoring results). "Tier 2 courses" would be aimed at lower level professional staff and focus more on "how to do it." There would be both Tier 1 and Tier 2 courses in four substantive areas: (1) financial management, (2) infrastructure capital investment planning; (3) service delivery management; and (4) spatial planning and land management.

Civil Service Reform

There is another issue that deserves attention, even though it has not been addressed explicitly in the Policy Action Plan. Regardless of the effectiveness of technical assistance and training in urban management, capacity will not be built unless local governments can recruit and retain competent staff. UIMDS recognized that present civil

service regulations provide strong incentives for would-be public servants to seek employment at the central, rather than the local, level while providing disincentives for talented young managers to seek careers in the public service in general (see also King, 1988). Ultimately those biases must be eliminated if the program is to succeed.

Fortunately, a major reform of the civil service system is now underway (World Bank, 1991c). This reform was motivated by the GOI's general recognition of the need to transform public functions to an emphasis on guiding and facilitating private sector development in the economic sphere, rather than the need for improved local government management per se, but it should be fully consistent with the goals of the overall TKPP program. The process (under the Ministry for the Utilization of the State Aparatus--MEMPAN) is beginning with a broad "job analysis" initiative intended to streamline organizational structures and improve management and technical skills.

In the past, government employees holding "structural" positions, mainly with administrative duties, benefitted most from the present complex supplementary payments systems in the compensation package. The intent is to use job analysis to create a new system of "functional" positions and career paths, which would have clearly defined compensation schedules tied to performance and rely more on competitive procedures for promotions (in contrast to the semi-automatic promotion process that currently exists). The current system offers substantially greater promotion opportunities to central agency employees than to staffs at the Tk. I and II levels. The new system, with numerical credits given uniformly under the functional paths based on work contribution and professionalism, will eliminate that bias. It would seem important for the next update of the Policy Action Plan to relate more explicitly to MEMPAN in expediting implementation of these reforms as they affect Tk. I and II governments.

SECTOR PLANNING AND COORDINATION

The program's last policy (Policy 6) addresses the need to strengthen coordination and consultation in the urban development sector. The most basic step under this policy was formal establishment of TKPP in 1987 and the subsequent decree extending its responsibility for an indefinite period. The forming and initial performance of TKPP won world-wide recognition (see, for example, Wegelin, 1990), but there was concern during 1990 that it was losing some of its initial forcefulness.

The Institutional Base for Coordination

Several steps were taken in 1990 and 1991 to strengthen TKPP institutionally. Most important, TKPP chairmanship was vested clearly with Deputy V (responsible for spatial development) in the National Planning Agency (BAPPENAS)--the most logical place for it. Second, the IUIDP Management Group (IMG), established to support of TKPP in IUIDP implementation, was strengthened through clarification of responsibilities and the establishment of regular meeting schedules. This group is made up of representatives

at the Director level and handles day-to-day coordination of the investment program in response to guidance from TKPP, which operates at the Director General level.

Also, after some delays in 1989/90, technical assistance teams funded under the UNCHS administered IUIDP Implementation Support Project and AID's Municipal Finance Project Contract (MFPC) were mobilized in September 1990. Discussions of their activities throughout this report indicate that they have made important contributions to the work of both TKPP and IMG. These two consultant teams have been in regular communication and have collaborated in a number of areas. Their most important joint effort has been the initial planning for a coordinated capacity building program in urban management discussed above.

Interviews during this evaluation indicate that pace of interagency participation in program management under TKPP and IMG may have slowed somewhat over the past year. This may be inevitable in an election year--the period just may be prior to the formal planning process for a new Repelita. However, there is recognition of the need to reinvigorate the process, and steps are being taken toward this end. For example, in late June, IMG members participated in a five-day retreat to redefine missions, operating modes, and priorities.

Program Review and Planning

In February 1991, the TKPP Chairman submitted to AID an overall examination of the program, reviewing performance under the Policy Action Plan and highlighting issues to be addressed (TKPP, 1991). A more comprehensive *Issues and Priorities Report* (Bidang Regional dan Daerah, BAPPENAS, 1992) was submitted in March 1992. This report contains a thorough and frank review of both progress and problems, and lays out ideas for future work in urban policy in some detail. This report, and the 1991 submission, confirm the GOI's ongoing commitment to the program and serious consideration of means of improving it.

The future work program suggested in the *Issues and Priorities Report* supports continuity in all of the current themes of the Policy Action Plan, presenting ideas about goals for the next stage in each. The report endorses decentralization as the primary goal. It gives substantial coverage to means of strengthening planning and coordination mechanisms at the central level. It is not as thorough in its treatment of key issues in the municipal finance agenda discussed in Chapter 3 or in suggesting how demand driven mechanisms might be built to facilitate local leadership in devising Indonesia's urban future, but it touches on these issues as well. It is refreshing in its recognition of current bottlenecks in the investment program (as discussed in Chapter 2) and offers promising approaches for addressing them. Its views about substantive emphases that need to be added are very much consistent with those in this evaluation, particularly those related to urban environmental quality management, private sector participation, and building local capacity in urban management.

Monitoring Sector Performance

Prior to mid-1990, serious inadequacies existed in the systems to monitor progress of the overall program. There had been reports on individual elements, some of which were of high quality but there was no recurrent, comprehensive, factually based reporting on the progress of the program as a whole. Prior HGL Assessments argued that an elaborate new monitoring system was not required--the need was for a simple quarterly report that would be easy for top decision makers to understand.

Important contributions were made to this objective during 1990/91. First, the Municipal Finance Project (1991h) developed a set of statistical indicators on many of the key variables needed to track changes in the intergovernmental finance system, directly related to Policy Action Plan targets. All are presented in chart form, making it possible to see immediately whether conditions are improving or not. Second, Directorate Bina Program improved its reporting systems on IUIDP progress, with tables showing changes in status for each urban area affected (information on related activities such as MAPATDA and training programs are also included). Information on overall program expenditures and financing also was improved (the basis for the analysis in Chapter 2).

However, the Bina Program report is no longer being submitted on a regular basis. We believe that this report should be reinstated and other items recommended in prior HGL assessments should be added. Most important, new information from these sources should be integrated into one report and used recurrently as the basis for discussions of progress in TKPP/IMG meetings.

Some suggestions for additions are as follows: At the TKPP level there appears to be a need to improve reporting on the progress of working groups in developing work plans, draft legislation, etc. Tables should be appended indicating the dates on which meetings were held, who attended, and explicit citations of any documents produced (with a one-paragraph abstract of their content, where possible). Additional factual information also would be helpful for programs now being implemented: a table on PBB implementation that would show for each city the total number of parcels, total valued to date, recent and expected future collection rates and Rp. yields; some indicators of the extent of involvement of local government officials in PJM/RIAP preparation and implementation; more data on characteristics of PJMs by city--e.g., total and per capita investment levels by subsector, data on program composition, and some simple performance ratios; and regularly updated tables showing the number of employees who have received training under each component program in each city.

In one area, more fundamental steps will be needed if monitoring and reporting are to be improved. The Project emphasizes more effective targeting on the urban poor--targeting of GOI policies regarding infrastructure provision, targeting of tariff subsidies and central-level grants, and targeting of the HGL investment program. At present, negotiated agreements between GOI and AID are used to define the proportion of each category of investment that can be formally attributed to below median-income

households. However, the actual income incidence of the current urban investment pattern and current sector subsidies, as well as the direction of change over time, is not known. The initial Work Plan for the MFPC called for special studies on income targeting of urban investments and affordability criteria to be applied to tariff design of urban services. To date, these studies have not been carried out. They remain a priority, and should be structured so that they permit measurement of the effectiveness of the Project in reaching the urban poor. Field surveys, conducted on a sample basis to determine income characteristics of beneficiaries of different types of urban investment projects, burdens of urban service tariffs in relation to household income, and priorities of poor households for urban service improvement, would be appropriate.

Urban Spatial Strategy

The *Issues and Priorities* Report recommends efforts to update the nation's urban and regional development strategy. In this regard, it is worth reiterating concerns raised in prior HGL assessments about the implications of such strategies to local investment programming.

To avoid an overly ambitious charter at the start, IUIDP purposefully was limited to a basic set of functions (water supply, drainage, sanitation, urban roads and a few other related activities). This is an important set (including all that together really set the spatial pattern *within an urban area*), but there are others that have to be considered in local capital budgeting. The PJM/RIAP process has proved to be a basically sound approach for planning local investments, and there is little doubt that local officials should expand its scope to cover, for example, budgeting for school and health center development. But what about building new electric power plants, telecommunication facilities, and major roads; i.e., *strategic infrastructure*? These are investments in which the provincial and central governments retain a stronger interest since they play a more powerful role in setting the *interurban* pattern of opportunities for economic expansion.

There seems to be general agreement at this point that IUIDP should be broadened and linked to the work of the recently appointed committee for Spatial Planning. However, very careful analysis is needed to determine how this should be accomplished (analysis that covers the practical administrative implications, as well as the economic development aspects). Perhaps there should be two linked, but relatively independent, processes: one that covers matters fully under the discretion of localities and another that involves more negotiation between local and higher level governments concerning strategic infrastructure. As previously recommended, a concept paper addressing these issues should be developed and discussed over the coming year before definite decisions are made to change IUIDP.

Chapter 5

**THE TECHNICAL ASSISTANCE
AND TRAINING COMPONENT**

The Project's grant-funded technical assistance and training component incorporates two subcomponents (1) the Municipal Finance Project Contract (MFPC), a \$3.9 million contract awarded to the Research Triangle Institute on the basis of a competitive procurement, and (2) a \$1.1 million fund for short-term consultancies, training, and administrative support administered directly by AID/Indonesia.

MFPC STRUCTURE AND WORKING RELATIONSHIPS

The basic design of the MFPC created a challenging assignment for the consultant team. Four long-term consultants were assigned to separate offices, each working in one of the key agencies involved in Policy Action Plan implementation. Their original terms of reference gave clear mission statements, but flexibility was retained so that product priorities and schedules could be adapted in consultation with counterparts. They reported to an interagency steering committee chaired by an official of the Ministry of Finance. They were not charged with major coordination responsibility related to the overall program (teams funded by other donors, reporting to BAPPENAS, have more central responsibility in that regard). Flexibility inherent in this approach was a potential benefit, but risks were also high. Dangers of fragmentation and diversion to office activities outside the project scope were far from trivial.

To address these limitations, the team relied on several approaches: (1) negotiating work topics that were both important in relation to the overall Policy Action Plan and not being addressed by other consultant or government teams; (2) conducting new research and providing concept papers on these topics (that were generally widely circulated and discussed) to stimulate understanding and interest; (3) using these topics as the basis for major national seminars involving participants from all relevant agencies; and (4) following up with appropriate agencies to promote action on seminar results. Seminars and follow up work were generally done in cooperation with other donors and technical assistance teams.

The advisors were placed in four of the most important agencies involved in the implementation of the Policy Action Plan:

- *Board of the Analysis of State Finance, Credit, and Balance of Payments, Ministry of Finance*

Chairman of MFPC Steering Committee: Dono Iskandar,

- *Center of Regional Finance Analysis (PAKD), Ministry of Finance.*

Counterpart: Dr. Susiyati B. Hirawan; Head
Advisor (and Team Leader): James McCullough

- *Directorate of Local Government Finance, Directorate General of Regional Autonomy (PUOD), Ministry of Home Affairs*

Counterpart: Birong S. Tambunan SE, Director
Advisor: Steven Pereira

- *Directorate of Urban Development (BANKGKOTA), Directorate General of Regional Development (BANGDA), Ministry of Home Affairs*

Counterpart: Soedarsono Soekardi, Director
Advisor: William Kugler

- *Directorate General of Human Settlements (Cipta Karya), Ministry of Public Works*

Counterpart: Ir. Bambang Rachmadi, Director General
Advisor: John Taylor

The elements of the MFPC work program related to themes of the Policy Action Plan but, consistent with the Project Paper, emphasized municipal finance objectives:

1. **Expand Financial Resources**
 - 1.1 Rationalize Intergovernmental Fiscal Relations
 - 1.2 Enhance Private Sector Participation
 - 1.3 Enhance Local Resource Mobilization
2. **Enhance Management of Existing Resources**
 - 2.1 Institutional Structure to Support Technical Assistance and Training
 - 2.2 Implement Finance and Management Packages

- 2.3 Improve Urban Management Information Systems
- 2.4 Improve Local Service Delivery Enterprises
- 3. Enhance Dynamic Urban Planning Approaches
 - 3.1 Integrate Economic Growth Potential in Infrastructure Packages
 - 3.2 Rationalize GOI Planning Regulations and Training
- 4. General
 - 4.1 GOI Staff Training
 - 4.2 Information Exchange

The paragraphs below describe major accomplishments and issues in each of these elements. Major written outputs are listed (under Municipal Finance Project) in Annex A and additional documentation on training is provided in Annex D. (It should be noted that each advisor accomplished more than a review strictly related to formal work program tasks would indicate. Counterparts told us that all advisors made extra efforts to help them in the general strengthening of their agencies and in dealing with some of their day-to-day emergencies.)

MFPC AGENDA TO EXPAND FINANCIAL RESOURCES

Rationalizing Intergovernmental Urban Fiscal Relations (1.1) and Enhancing Local Resource Mobilization (1.3)

Original tasks under these sub-elements related to provision of policy advice and analysis on overall municipal finance and management issues (including both loan and grant components); development of a model to analyze alternative grant/loan allocation approaches; development of methods for assessing the debt-carrying capacity of local governments, developing urban service tariff guidelines (non-water) and assisting in implementing revenue enhancement systems. Major outputs include:

1. The preparation of policy papers on the potential for municipal bonds in Indonesia (1991e), analysis of issues related to the design of a new grant for urban development (Inpres Perkotaan)(1990b), and local government debt management (1992c).
2. Developing and conducting an interagency seminar on local government debt management (Batu-Malang, East Java--131 participants--1992c).
3. The design, initial data collection, updating, and dissemination of a series of monitoring indicators on GOI performance on objectives (mostly financial) under the Policy Action Plan (1991h). Four workshops were held on these indicators, involving 170

participants. This work has been widely disseminated and is viewed as a particularly valuable contribution by the agencies involved in the program.

4. A study of the finances and debt management position of 14 of the most heavily indebted local water companies, or PDAMs (1992d). This was conducted primarily to fulfil requirements under Task 2.4 (see below), but it should be used to support overall understanding and reorientation of cost recovery pricing policy and credit use. It is the first study of its kind and shows promise of serving as a basis for important financial management improvement for PDAMs.

5. Considerable progress was made in furthering the implementation of revenue enhancement systems (discussed under another work program element below).

All of these contributions are important and, in some cases, they are extremely valuable. Some of the most important elements of municipal finance reform have not received follow-up, however. These include a strategy for future development of the RDA that will help establish market-based municipal lending on the scale needed to finance future urban investment; assessment of options for reforming grant allocation formulas and strategies for rationalizing the overall grant and loan system; analysis of tariff structure of urban services and affordability criteria that ought to be incorporated into the tariff structure; and preparation of guidelines to determine the practical debt-carrying capacity of local authorities. Each of these topics was included in the original Detailed Work Plan of the MFPC. Many of the original tasks related to these topics were, however, dropped from the second year work program. As discussed in Chapter 3, many issues at this level remain unresolved and still are among the most critical barriers to overall program achievement. It is not expected that the work of any consultant team could, or should, force resolution on such issues. Nonetheless, in our view, a continuing stream of policy analysis (proposing ways to look at these issues in a fresh light or adding new data to give specificity to the policy debate) could have made contributions to opening doors that still appear to be closed.

Enhance Private Sector Participation (1.2)

In this element, the team was asked to undertake a variety of research and development tasks that would support furthering the participation of the private sector (formal and informal) in the provision of urban services. The work program included reviews of previous studies, undertaking new research, conducting seminars, developing ideas for guidelines and training programs, and considering options for demonstrations.

Objectives of this agenda have been largely achieved. A series of working papers focusing on private sector involvement in urban water supply were prepared in collaboration with the WASH project. Short field trips yielded information about existing private sector participation in various urban services in Surabaya and Padang. The most important event was a three-day workshop around findings of the WASH study in Bali in May 1991 (70 participants)(1992d). Workshop sessions dealt with methods such as

Build-Own-Transfer, by which private firms have participated in water supply in other countries, but also considered institutional, financial, and legal/regulatory constraints in Indonesia and the means of addressing them. After the workshop, advisors followed up with meetings on these topics in individual ministries (the most active was in the Ministry of Public Works). These efforts formed the basis for the design of the PURSE project discussed in Chapter 3 (AID/Indonesia, 1991).

Since then, MFPC advisors in BANGDA and Cipta Karya have continued a program of policy research as a bridging activity until the PURSE project itself begins. This work should do much to facilitate start-up when the new PURSE advisors arrive. It is planned that NFPA advisors will continue to work on private participation in smaller scale projects even after PURSE is initiated.

MFPC AGENDA TO ENHANCE THE MANAGEMENT OF EXISTING RESOURCES

Institutional Structure and Local Capacity (2.1)

Here, the work program called for a series of activities to help address the central challenge of Policy 5 of the Policy Action Plan--building local government capacity. The initiating event was another major interagency seminar, in this case to follow up the UIMDS study (see discussion in Chapter 4). The seminar, held in Megamendung in March 1991 (70 participants--1992c), reviewed the findings of UIMDS and included several substantive workshops to discuss both present conditions and ideas about what could be done to follow up on study recommendations. Further discussions were again held in individual counterpart agencies to consider courses of action in more detail, and meetings were held with several key counterparts and with the IUIDP Implementation Support Group. These efforts led to current proposals to develop a coordinated program for capacity building in urban management (1992d), discussed fully in Chapter 4. As noted there, this proposal holds much promise as a way to come to grips with one of the areas in the Policy Action Plan where progress lagged in relation to both needs and original expectations.

Another accomplishment in this area is the design of a project to compile and review all regulations and guidelines now applicable to local officials in urban management, and then to develop ideas for revisions in accord with modern management concepts. At present, the guidelines are known to have many gaps and overlaps. A comprehensive review of this sort is very much needed. Planned activity also includes development of a system for issuing and recurrently updating comprehensive sets of regulations and guidelines that affect local governments.

Financial Packages and Information Systems (2.2 and 2.3)

This element also yielded important forward movement under the Policy Action Plan. The approach and its outcomes are discussed fully in Chapter 3. Briefly, the

problem was that a number of systems had been developed (or proposed) to address management information needs at both the local and central levels and there was considerable overlap between these approaches. Again, an interagency seminar was conducted to facilitate understanding of the issues and possible courses of action (in Cipanas in December 1990 with 97 participants--1990a). Follow-up activities to coordinate further systems design and implementation are now underway.

Improve Local Service Delivery Enterprises (2.4)

The first requirement under this Task was the study of the finances and debt management position of heavily indebted local water companies (PDAMs), noted above, which is now nearing completion. Work is also underway on using this study as a basis for establishing an orderly set of regular financial monitoring indicators for PDAMs. The final Task under this work program is a study of the regulatory and financial performance of other (non-water) local public enterprises (BUMDs). This work has been designed and an inventorying of BUMDs is now underway in the Ministry of Finance.

MFPC AGENDA TO ENHANCE DYNAMIC URBAN PLANNING

The objective of this element of the program has been to "integrate economic growth potential into infrastructure investment planning" (3.1). It was noted earlier that IUIDP was purposefully limited to only a subset of all infrastructure investment categories focused on "basic needs," to avoid the risks of an overambitious charter at the start. It has been generally recognized, however, that the concept should be broadened over time. Ideas have been developed within DG Cipta Karya for an approach called "dynamic urban planning," which would involve local leadership in planning for urban change in a manner that links more broadly defined infrastructure programming to local economic and land development opportunities, as well as basic environmental needs (Hendropranoto Suselo, 1989). MFPC work in this element was to support this concept, but also to perform a number of other "general support" tasks related to IUIDP and urban planning.

The focus of this element is being addressed by two MFPC-guided pilot efforts to implement the dynamic urban planning concept--in East Bandung and North Sumatra. In the East Bandung project, for example, a consulting team is performing analyses and taking other steps to facilitate the thinking of local leaders about new land development options. They are attempting to think through the impacts different schemes would have on economic activity, and in turn what that would mean for infrastructure and urban service needs (for the economic activity itself and the new residential population it might bring into the area). Alternative ways to finance the development are being considered in light of the local government's fiscal position. Environmental impacts are also being examined. An unusual, and promising, feature of the project is that private developers and community leaders are participating with the local government leadership team in reviewing both the analysis and the policy and action alternatives.

Other work under this element included consideration of a model that might be employed at the Provincial level to set investment priorities, the provision of comments and advice on the nation's proposed new Spatial Planning Law, and considerable general assistance in IUIDP implementation.

All of these are valuable activities. The concern of this evaluation is that MFPC resources may not be adequately focused on today's highest priority problems. Chapter 2 identified important problems in the development and implementation of the investment program. For the time being, at least, DG Cipta Karya has a critical role to play in overcoming many of these difficulties. Ideas suggested in Chapter 2 warrant priority: the notion of central interagency teams working with local leadership in more effective strategic planning and priority setting (very much akin to concepts in dynamic urban planning), management analysis and procedural adjustments in appraisal and implementation processing, the possibility of internal changes that would facilitate Cipta Karya's role (working with other agencies) as a provider of technical assistance and training to local governments. It would seem that the next stages of planning for the MFPC should address these needs more clearly and centrally.

TRAINING AND INFORMATION EXCHANGE

In this area, the evaluation entailed examining relevant documentation, discussions with providers and their counterparts, and separate interviews with a sample of the trainees (14 individuals). Our findings are that contributions of both MFPC- and AID-programmed training under this component have been impressive.

1. The four MFPC national policy seminars noted above were important training events in and of themselves (total of 369 participants).

2. The MFPC also designed and conducted three special technical workshops: (a) on the missions and operating processes of BANGKOTA in MHA (47 Participants); (b) on the indicator report that was prepared and the concept of using regular updates to monitor program progress (separate workshops in MOF, BANGDA, MPW, and BAPPENAS--170 participants); and (c) on regional investment modeling (for BAPPENAS and for MOF--78 participants).

3. The MFPC's development of special in-country training courses for central agency staff (in BANGKOTA in MHA with 39 participants, and PAKD in MOF with 31 participants) warrants special attention. The PAKD course, now in process, includes 20 separate lectures given by MFPC advisors and other specialists on topics ranging from financial analysis to computer networking and IUIDP planning. The BANGKOTA course emphasized a similar array of technical subjects relevant to day-to-day workloads in the agency but also included supplementary training in English.

4. AID-programmed overseas training and study tours have involved 76 Indonesian officials to date, normally in courses offered in the United States and specially designed for staff from developing countries. A total of 42 attended the Research Triangle Institute course in urban financial management and local government finance, 4 attended Harvard University courses on urban development, 3 attended an ICMA course in local government management, 7 attended a VCU urban management program, and 1 attended a special TSS course on urban development and shelter management. Several participated in RHUDO/Asia seminars: 4 at the seminar on market towns in Nepal, 3 at the land policy seminar at Chiang Mai, Thailand, and 8 at the urban management seminar in Bangalore. In addition, 1 was supported on a study tour related to municipal bonds in the United States, and 3 have been supported in longer-term training in urban development related fields (at Harvard, the University of Southern California, and the University of North Carolina).

It is difficult to find much fault with these programs as delivered. Our overall conclusions concerning the training component are:

1. It was based on an explicit training strategy (expressed in the Project Paper and appropriately translated into the MFP work program) and proceeded in accord with that strategy.

2. The range of course offerings was well focused on the key policy themes of the overall program and, thereby, furthered the program's basic objectives (self-evident from the nature of the courses identified above).

3. Individual course offerings appear to have been well designed to achieve substantive objectives expected of them (based on review of a sample of course descriptions).

4. Based on our interviews with a sample of participants, it is our opinion that they have benefitted appropriately from the courses they attended. Although there were variations in enthusiasm, comments by the sample of participants interviewed were almost totally positive. They were able to clearly explain the purposes and content of the training experiences in which they participated, and many articulated ways in which those experiences had improved their job performance when they returned; a few claimed major changes in outlook and effectiveness because of them.⁴

⁴The only criticism of note was that some of the presentations in the United States demanded English language skills beyond the capabilities of some of the participants. Generally, it was felt that course instructors spoke carefully enough to be understood, but problems were encountered on field visits, for example, with local officials.

5. Participants appear to have been well selected. They were government officials at the right level, and with the right career orientations, to benefit from the materials presented.

In the view of this evaluation, however, training strategy should be modified for the future. A very large share of all resources to date were devoted to overseas courses. Those courses have been valuable for those who attended them, and it is reasonable for the Project to continue to offer such opportunities in the future. The question is one of proportions. It seems clear that over the longer term, indigenous training (such as has been proposed for the urban management capacity building program noted above) would be more cost effective and offers the only hope of beginning to address the training needs of Indonesian local governments at scale. This point was also made with respect to the Indonesia program by a recent review of RHUDO training strategies in the Asia region (Nolan, 1992). We judge that a larger share of the total budget should be devoted to the development and appropriate implementation of indigenous training opportunities in the future. Shifting the proportions in that direction should be a priority objective through the remaining years of the Project period.

A second, comparatively minor, criticism is that the MFPC could have done more with the original work program Task of developing an "Urban Information Exchange." To be sure, they have taken important steps in this direction with the accomplishments cited above. Nonetheless, the original work program talked of developing a more regular "working paper" series and a semi-annual journal on relevant issues. We believe these topics should be reestablished and given emphasis in the remainder of the Project.

COORDINATION OF SHORT-TERM AND LONG-TERM TECHNICAL ASSISTANCE

The technical assistance design for the Project separated short-term assistance from the long-term assistance provided under the MFPC. This arrangement led to unnecessary administrative delays in coordinating the two types of technical assistance. Often, when the GOI, AID, and the MFPC team identify a topic for intensive policy analysis or training assistance, it will be appropriate to add specialized short-term assistance to the skills of long-term personnel working under the MFPC. At present, this can be done only by having AID compete a specialized contract, design a specialized work order under a continuing IQC, or find ways to break an activity into a series of smaller activities that can be handled administratively as purchase orders. A great deal of administrative time and effort goes into any of these approaches. The MFPC team pointed out that it frequently encountered delays in obtaining short-term technical assistance help.

In the future, it would be advisable to more explicitly link short-term and long-term technical assistance. One way to do this is to include a budget for short-term technical assistance within the institutional contract of the MFPC if the latter contract is amended. AID should retain discretionary control over a substantial part of the short-

term technical assistance budget, in order to ensure that there continues to be competition among potential suppliers of such assistance. However, building a budget for short-term assistance into the institutional contract for long-term assistance would (a) reduce the administrative burdens involved in obtaining such assistance, and (b) allow the long-term contractor greater discretion in identifying how short-term assistance can be used most effectively to complement the work of long-term advisors. AID could require that short-term assistance beyond some threshold level, or for activities not specifically identified in the initial contract, receive written authorization from AID in advance.

COORDINATION AND CONSENSUS

Compared to most projects of this kind, the MFPC has been unusual in the attention it paid to communication and interagency collaboration. In one respect, however, performance in this area could be improved. Joint meetings with advisors, agency counterparts, and AID representatives (to review plans and progress and to adjust activities as needed to focus on priorities) have been infrequent. It is recommended that such meetings be held at least on a quarterly basis during the remainder of the Project and that agendas and supporting materials be circulated ahead of time. Also, since BAPPENAS plays such a key role in virtually all issues touched on by this Project, it would seem useful for key BAPPENAS officials responsible for the IMG to be added to the membership of the counterpart committee. It would also make sense for this component to add BAPPENAS to the list of key agencies to which it provides technical assistance resources directly (possibly in the form of a full-time advisor).

OVERALL PERFORMANCE

This evaluation indicates that the MFPC has been innovative and effective in responding to the challenges it faced: (1) the overall work program, as negotiated with the steering committee, was developed (and recurrently adapted) in a strategic manner so that resources have been well leveraged and focused on topics critical to overall program achievement (addressing important gaps while avoiding duplication with other GOI consultant resources); (2) each individual team member has shown considerable initiative in developing and conducting work and in establishing working relationships such that the services of each are highly valued by their counterpart agencies; (3) actions of the team have consistently emphasized interagency coordination and cooperation (all key agencies have been meaningfully involved in planning and have been kept well informed about progress of the overall agenda; major seminars and conferences have been purposefully designed to address crosscutting issues demanding interagency participation); (4) the team has gone out of its way to collaborate with other consulting teams working in the sector and (on an informal basis) help focus joint efforts on Policy Action Plan priorities.

While this component has been successful overall, this evaluation raises four concerns. First, the project has not been forceful enough in keeping the principal fiscal reforms included in the GOI's urban sector policy statement at the top of the policy agenda. The momentum for intergovernmental grant reform, for example, appears to have eroded, while no clear strategy has emerged for following up creation of the RDA with movement toward larger-scale, market-based lending to local governments. Second, although original plans did not call for MFP focus in this area, problems have emerged in the decentralized investment programming process (e.g., the lack of adequate strategic planning and priority setting, bottlenecks in project processing) that now warrant attention from the project. Third, while the MFP training program has been consistent with the original plan in its emphasis on overseas training, a higher priority should be given now to developing indigenous training capacity (this priority is now being recognized in the MFP's plans for building such capacity in urban management). Finally, the technical assistance agenda could be better focused if the TA team, government Counterpart Committee, and AID representatives met regularly to review accomplishments and set priorities for the next period. We recommend that such meetings be held quarterly, and that, prior to each meeting, the TA team distribute a summary of technical assistance products over the past quarter and a proposed work plan for the next quarter. BAPPENAS should be clearly invited to participate as a member of the MFP Counterpart Committee. Because of its central role in relation to the Policy Action Plan, the addition of MFP technical assistance support directly to BAPPENAS should also be considered.

Annex A

ACHIEVEMENTS UNDER THE LOGICAL FRAMEWORK

The following paragraphs present the text of each element of the Logical Framework of the Municipal Finance Project as developed in the Project Paper (AID/Indonesia, 1988). Currently available information on status with respect to each Objectively Variable Indicator (OVI) is presented in italics.

PROJECT GOAL (The broader objective to which project contributes):

To improve the shelter conditions of Indonesians with below median-incomes by facilitating the delivery of affordable, local, shelter-related infrastructure.

Measures of Goal Achievement:

■ An increase in the total level of investment in shelter-related urban services and infrastructure.

Between 1987/88 and 1991/92, investment in the Cipta Karya subsectors increased at an annual rate of 4.5 percent, well below the rate of inflation. On a real per capita basis, investment levels fell substantially.

■ An increase in the level of shelter-related urban investments benefiting below median-income families.

There has been no monitoring of the income profile of the beneficiaries of urban investment; therefore, it is not known whether this objective has been achieved. This evaluation recommends a household sample to determine the extent to which investments under the project benefit below median-income families.

■ An increase in the level of private sector financing of shelter-related urban services/infrastructure.

There is no systematic monitoring of levels of private sector financing; therefore, it is not known with certainty whether this objective has been achieved. However, all of the public officials interviewed reported that there has been a substantial increase in private sector involvement. Case studies of Padang and Surabaya confirm a large increase in private sector involvement in urban services in those cities.

■ An increase in municipal local own-source revenue available for shelter-related urban investments, benefitting families below the median income.

Municipal own-source revenue has grown rapidly in real, per-capita terms (see Chapter 3). The income distribution of the beneficiaries of investment financed from local revenues is not known.

■ A reduction in the present level of central government funding of shelter-related urban services/infrastructure.

As per data presented in Chapters 2 and 3, central government funding for the program has increased since 1987/88, so this measure has not been achieved. (We assume this goal is intended to relate to a reduction in the relative share of central government funding rather than a reduction in the absolute amount of such funding.)

PROJECT PURPOSES:

To provide assistance to the GOI in further developing its municipal finance system by *expanding and enhancing the management* of its financial resources, which will enable Indonesian municipalities to (a) assume an increasing share of the financial responsibility for urban shelter-related infrastructure and services; (b) create conditions favorable to private sector involvement in urban investment finance and service provision; and (c) create a framework for partnership between the public and private sectors.

Measures of Achievement:

■ Municipalities are able to utilize private sector financing for shelter-related urban infrastructure.

Municipalities are legally able to utilize private sector financing for these purposes, and they have done so in several cases (see Annex C, Goal 3). A Presidential Decree removed water supply from the list of activities where private sector participation was prohibited.

- The private sector is willing to participate, individually or in partnership with the public sector, in the financing of urban-shelter-related infrastructure services.

Several actual cases demonstrate that private willingness exists if the circumstances are appropriate (see Annex C, Goal 3). The PURSE project will attempt to create circumstances that will expand this interest.

- The central government's system of grants and loans is consolidated.

This measure has not yet been achieved. See discussion in Chapter 3.

- A uniform incentive system for improving revenue generation and expenditure control by local governments is developed.

This measure has not yet been achieved. The grant system has not been modified to create incentives for local financial controls.

- A central government lending mechanism is operationalized.

This measure has been achieved with the establishment and issuing of operating guidelines for the Regional Development Account. However, no loans have been made under the new guidelines. See discussion in Chapter 3.

- Central government loans funds to municipalities on terms reflecting the cost of capital, risk and servicing.

Under both the RDA and GOI agreements related to the East Java/Bali Project, loan terms have moved considerably toward this objective and away from the highly concessional approach of the recent past. However, interest rates are still well below the cost of capital adjusted for risk and servicing costs. The RDA interest rate of 11.5 percent compares with commercial rates (for less risky loans) of about 24-25 percent.

- The financial management capacity of local governments is enhanced.

Although much room for improvement remains, this measure has been achieved with the broadscale implementation of the MAPATDA system and other initiatives. See discussion in Chapter 3.

OUTPUTS:

- Provision of shelter-related urban infrastructure, valued at the equivalent of \$100 million benefiting below-median income families.

- 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 resources mobilization.

- Strengthened capacity of the local government finance system to mobilize and manage resources.

- Establish the foundation for increased private sector participation in the provision and financing of urban infrastructure and services.

Illustrative Magnitude of Outputs:

- For Repelita V, an additional policy is included in the Statement of Policies for Urban Development in Indonesia that encourages private participation in the financing of urban investments.

With strong support by AID in policy dialogues, this objective was added to the Policy Action Plan (Annex C, Goal 3).

- The rupiah equivalent of \$100 million is spent by the GOI to provide shelter-related urban infrastructure for the urban poor.

This measure was achieved in full after completion of the first three tranches (\$118 million in HG eligible investments thus far documented). See discussion in Chapter 2.

- Guidelines are developed for local government acceptable levels of borrowing and acceptable sources of loans.

Appropriate guidelines have been developed under the East Java/Bali Project, but similar ones have not yet been published for RDA lending. The MFPC is making progress toward better understanding of the issues associated with local government indebtedness through its analysis of PDAM finances and dialogues with central and local officials.

- Cost recovery strategies for appropriate urban services are developed that reflect the cost of urban services to private sector beneficiaries.

The MFPC and others have undertaken analysis to contribute to this objective and MHA directives have supported it. Case studies in Padang and Surabaya confirm a significant increase in tariff rates toward cost recovery levels, which are believed to be representative of experience elsewhere. Data are not available, however, on nationwide changes in tariff policy.

■ Formal guidelines are established specifying which urban services will be the responsibility of the local, provincial and central levels.

This measure has been achieved (Annex C, Goal 1).

■ Central government issues guidelines for private sector participation in the construction, operation, management and maintenance of urban, shelter-related infrastructure.

While some preliminary materials have been prepared along these lines, formal guidelines have not yet been issued. The imminent PURSE project should address this issue and thus it appears promising that this measure will be achieved during the Project period.

■ Accounting of all central government funds flowing to municipalities is standardized.

This measure has not been fully achieved as yet, but the MFPC is working with both the Ministry of Finance (PAKD) and the Ministry of Home Affairs (PUOD) to synchronize their information systems in a manner that will address this need satisfactorily.

■ Financial management performance indicators are developed that tie the amounts of central government financing a municipality receives to its financial management performances.

Progress has been made by the MFPC in developing and regularly updating relevant indicators (Municipal Finance Project, 1991), but these are not being used by the GOI in determining grant allocations. At this time, it is by no means certain the GOI is willing to take that step.

■ Financial disclosure requirements for municipalities are established.

There are clear rules for Tk.II reporting of financial outcomes to the Provincial level and all PDAM financial records are subject to audit. These financial records, however, are not regularly made public and, in that sense, the spirit of this objective has been frustrated.

■ Central government develops a policy enabling it to sell participation certificates in its RDA loan portfolio to the private sector.

This measure has not been achieved and, planning for it is not underway. RDA rules would currently preclude the sale of participation certificates to private buyers. In the opinion of the evaluation team, this is only one possible strategy for opening

the RDA and municipal borrowers to the private credit market, and is an unrealistic target in the short run.

■ Central government will have reduced or eliminated loans at concessionary terms to local governments, substituting grants where poverty levels require concessions.

A good deal of progress has been made in reducing concessionary terms in loan rates. There is still disagreement within government, however, as to what municipal lending policy should be. An appropriate mechanism for linking grant and loan allocations is being applied in the East Java/Bali project, but there has been no agreement to adopt a similar approach as a matter of national policy.

INPUTS: Implementation Target (Type and Quantity)

■ HG LOAN. \$100 million authorization over the 6 years life of project (FY88 - FY94).

The full amount of the loan has been disbursed well ahead of schedule.

■ TECHNICAL ASSISTANCE AND TRAINING GRANT. Long-term technical advisors are hired and in place. Short-term consultant services are provided as needed to support and the project. Mission Urban Advisor is under contract.

This measure has been achieved in full.

■ GOI INVESTMENT. \$1.8 million in TA and training and \$100 million in rupiah equivalent expenditures from April 1, 1989 through March 31, 1994.

As documented in Chapter 2, the GOI investment program is well ahead of expectations in this regard so far, and it can be expected that, with the application of the fourth tranche underway at present, this measure will soon be achieved in full.

Annex B

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Annex C

POLICY ACTION PLAN UPDATE

POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April-June, 1992
Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description ** (target)	Monitoring indicators
1.	Strengthen Local government responsibility for urban infrastructure development, operation and maintenance. Define and classify urban infrastructure and assign functional and financial responsibilities for planning implementation, operation and maintenance to 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)	• assign working group and provide TOR	Completed (11/87)	Working group assigned and agreed TOR
				- formulate urban service inventory and classification policies and work-plan to address all Kotamadyas	Completed (12/87)	Functional classification
				Complete surveys and classification in 10 cities	Completed (10/88)	Agreed classification maps and inventories
				Continue rolling program of classification in remaining cities (Kotamadyas and urbanized Kabupaten)	Being implemented (90-92)	Agreed classification maps and inventories
						Blang (1990), Denpasar (1992) & other Kotaps, (including 5 provincial capitals) upgraded to Kotamadya
				• MPW & MHA Joint Decree (14/1987) assigned responsibility for water, wastewater & solidwaste to local government	Completed (/87)	
		1.02 Define institutional responsibilities for traffic management in urban areas (1987-90)	Study and assign responsibilities for traffic management and policy coordination (by TK, DGBK, DGLT, and DGPUOD)	- Define issues and workplan for resolution	Completed (10/87)	Agreed workplan
				- Assign working group	Completed (01/89)	Working group assigned
				- Assign phased responsibility to selected Level II cities	Being Completed ** (/90)	Decree assigning local government responsibility for traffic management & authority for vehicle tax.
				- Transport & traffic planning & budgeting included in PJM guidelines/road classification system coordinated with budgeting		

POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April - June, 1992
Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description ** (target)	Monitoring indicators
		1.03	Develop program responsibilities for local governments in Integrated Urban Infrastructure program (IUIIP)	Application of IUIIP 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"> Issue directives of MPW agencies to apply IUIIP processes in urban infrastructure planning Issue directives to Level I and II local governments to adopt IUIIP process approved by TK 	<p>Completed (08/87) Directives issued</p> <p>Completed (08/87) Directives issued</p>
2.	Integrated expenditures 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 IUIIP planning	Develop & implement guidelines for non Cipta Karya subsectors within MPW as well as Cipta Karya sub-sectors and issue updated guidelines for all sub-sectors 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 Issue periodic updates of IUIIP guidelines Manuals issued for RIAP & LIDAP development IUIIP pilot project incorporates linkage to economic potential in IUIIP process for E. Bandung, Kabupaten Karawang (W. Java) and 2 Kodya in Sumatra. Further improve, pilot test and replicate PAFPACK Program Financial Accounting and Management System (PFAM) designed to improve monitoring of IUIIP expenditures PFAM tested in East Java/Bali UDP and Sulawesi/Trian Jaya UDP. 	<p>Completed (12/89) Projections issued</p> <p>Ongoing ** (08/90) Revised PJM guidelines completed. Being issued by MOTIA</p> <p>Being implemented (01-92) 90 PJMs completed by early 1991, covering 40% of total urban population, 116 PJMs in progress. 81% of urban population will be covered by PJMs now complete/in progress.</p> <p>Ongoing (02-03) RIAPs & LIDAPs prepared for 11 level I & 55 level II governments under IIRD E. Java & Bali UDP, ADB Sumatra & W. Java SCUOP, and elsewhere.</p> <p>E. Bandung being implemented (3/92) E. Bandung & Sumatra IUIIPs completed</p> <p>Ongoing (88-) Pilot tested in Surabaya (88-88). Pilot test expanded to 9 TK II gov'ts (89-90) and 27 TK II gov'ts (90-92).</p> <p>Design Completed (/91)</p> <p>Being implemented System implemented in 9 Tk I and 44 Tk II local governments.</p>

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POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April-June, 1992
Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (NB. crucial steps indicated by*)	Description **(target)	Monitoring indicators
3.	Strengthen Local Government resource mobilization and financial management	3.01 Fully Implement PBB tax law (1988-90)	Improve revenue performance of Property Tax (PBB) through technical and management improvement programs.	<ul style="list-style-type: none"> • Appoint Valuation Advisors to develop a Valuation Methodology for top value properties and supervise the valuation process on Jakarta, Surabaya, Medan, Bandung and Denpasar. - Extend top properties valuation methodology to 30 other cities - Appoint Tax Administration Advisors to assist PBB in improving Property Tax Administration and policy issues. - Decision to Replicate Implementation 	<ul style="list-style-type: none"> Completed (89-91) Completed (91-92) Completed (89-92) On-going (92-93) 	<ul style="list-style-type: none"> Valuation advisors appointed to assist PBB in individually valuing high value properties, develop a computer assisted valuation model (CAV) and train valuers. A total of 200 000 properties valued. A prototype CAV was developed. Twenty PBB officials were sent for overseas training and many PBB officials underwent in-country training. Valuation advisors were appointed to supervise implementation. A total of 70 000 additional properties valued in 30 other cities. Tax Administration advisors appointed to assist PBB in designing a collection-led implementation strategy for tax reform. This collection-led strategy involved developing and supervising the implementation of the Payment Point System (SISTEP) and the Collection Monitoring System (SISLAP). The SISTEP system was successfully implemented in Kabupaten Tangerang in 1989 and subsequently replicated to 83 regional governments by 1991/92. As part of the SISTEP system, strict enforcement has been stressed. Total Property Tax Collection for the rural and urban sectors has improved from US\$ 117 million in 1988/89 to US\$ 164 million in 1991/92. One hundred more cities will be incorporated to SSMOP operation during 07/93.

POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April-June, 1992
Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description **(target)	Monitoring indicators
				<ul style="list-style-type: none"> Develop a comprehensive Property Information Management System (SISMOP) to integrate the property administration functions of property data collection, valuation, assessment, collection (e.g., SISTER), enforcement and taxpayer service (appeals and objections). 	On-going (91-93)	SISMOP pilot project established in Kabupaten Bekasi, East Jakarta and South Jakarta. The pilot project has tested improved procedures for assigning tax object identification numbers (NOP), collecting property information and the development of computer-based SISMOP components. The property information collected will be used to evaluate and finalize the property valuation methodology for Indonesia by mid-1992.
		3.02 Improve revenue performance of local taxes and service charges (1987 onwards)	<p>Improve the structure of local taxes and charges (by DGKDN and DGPUOD)</p> <p>Implementation of local tax office procedure improvements (by DGPUOD)</p>	<ul style="list-style-type: none"> Draft legislation "Law on Local Government Taxes & Charges" and "Central-Local Fiscal Relationships" prepared by MOF under review by cabinet. Evaluate pilot tax office improvement (MAPATDA) in Urban IV (Loan 1972-IND) cities MAPATDA manual system of local tax administration improvements expanded to all TK II gov'ts Computerization of MAPATDA Manual System tested in 20 TK II gov'ts 	<p>Pending Review (/92)</p> <p>Completed (90-91)</p> <p>Completed (90-91)</p> <p>Being Implemented (/92)</p>	<p>Evaluation report</p> <p>Increase in Own Source Revenue (OSRs) reported by MFP Monitoring indicators</p>
	(b) Improve management and supervision systems of local enterprises capabilities	3.03 Improve cost recovery and management of all regional enterprises (1987 onwards)	Improve user charge/cost recovery performance of PDAMs in Java (by DGCK and DGPUOD)	<ul style="list-style-type: none"> Analyse cost recovery performance of all water enterprises subject to SKB 4/84-37/KPTS/84 and identify problem PDAMs Implement, commencing in Java and Sumatra, the adoption of: <ul style="list-style-type: none"> (i) water tariff structure and appropriate tariff level to cover O&M costs, depreciation of debt service (whichever is larger) and 	<p>Completed (09/87)</p> <p>Completed (09/89)</p>	<p>Improvement action plan recommendations</p> <p>No of water enterprises complying (w/ PDAMs)</p>

POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April-June, 1992
Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description ** (target)	Monitoring indicators
				(g) BKKP (Audit Agency) Accounting Guidelines for PDAMs established for tracking operational costs, debt service, depreciation allowance, etc.	Completed (/91)	No. of PDAMs adhering to BKKP accounting guidelines
				- MFP conducted analysis debt management	Being Completed (06/92)	
		Assign water enterprises monitoring and development functions to PMDUs throughout Indonesia (by DGCK and DGPUOD)		* Assign functions and provide budgets and staff to Central and West Java PMDUs	Completed (01/88)	Directives issued and units operational in Java
				- Appoint consultants to (i) assist PMDUs and (ii) assist water enterprises	Completed (07/88)	Contract signed
				- Pilot test & fully implement system of Provincial Monitoring Development Units (PMDUs).	Being Implemented (92-)	No of provinces with PMDUs established as a result of extension of pilot system: PMDUs have been established in all provinces except Irian Jaya, Timor Timur & DKI Jakarta
				- Water Enterprise Management Information System (WEMIS) at DGCK for financial & technical data on SPAMs & PDAMs, supported by PMDUs.	Installation Completed, Not all SPAMs & PDAMs reporting data yet.	PDAMs to report financial as well as technical data thru WEMIS.
				- PDAM Financial Monitoring System by PUOD under MFP amendment.	Proposed (92-93)	
				- Management TA/training to PDAMs under MFP amendment.	Proposed (92-93)	
		Review optional water enterprises organizational arrangements for all provinces based on efficiency criteria by TKPP		- Formulation of TOR	Completed (12/87)	Agreed TOR
				- Appointment of consultants	Completed (01/88)	Contract extension signed Java provinces structure defined, implementation timetable agreed
				- Complete review of recommendations for initial implementation in Java	Completed (01/88)	

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Actions, Keysteps, targets, updated April-June, 1992
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No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (NB crucial steps indicated by*)	Description ** (target)	Monitoring indicators
				<ul style="list-style-type: none"> - BPAMs upgraded to PDAMs status as a result of GOI technical assistance & training - Formulate TOR for BUMD inventory & regulatory guidelines study - Complete BUMD study and plan for rationalization under MFP amendment. 	<ul style="list-style-type: none"> Being Implemented Being Implemented (04/92) Proposed (82-83) 	<ul style="list-style-type: none"> No of BPAM-PDAM conversions (By 1992 131 BPAMs & 177 PDAMs) Agreed TOR by PUOD Study results approved by GOI
	(c) Improve local government financial management capabilities	3.04 Improve financial management capacity in all TK. I & TK. II gov'ts	<p>Initial design/pilot tests of financial management & MIS packages under IBRD Urban IV, V & USL1 (SPMKD, POMMS, PAFPACK, SIKDO, MAPATDA).</p> <p>Develop framework resolving conflicts & filling gaps between various financial mgmt & mgmt info systems designed/piloted under IBRD Urban IV, V & USL1.</p> <p>Expand Performance Oriented Maintenance Management System (POMMS)</p> <p>Develop a consolidated, coordinated and controlled system of Urban Management guidelines for use by Tk. II governments</p>	<ul style="list-style-type: none"> - Prepare written guidelines based on MOF-MHA seminar to review pilot experience with financial & mgmt info systems. - Establish Central Technical Unit (CTU) in PUOD to revise & integrate financial mgmt systems based on Seminar Technical Report - Overview of existing laws/regulations/guidelines by TKPP and Draft Strategic Plan for Urban Management in Indonesia. - Initial Phase of UMG Development (detailed inventory, analysis, action/plan & TOR development) being contracted under MFP. - Full UMG Implementation under MFP Amendment. 	<ul style="list-style-type: none"> Completed (84-89) Completed (12/90) To be Implemented (82-83) Completed (89-90) Being Implemented (82-) Completed (01/92) Completed (02/92) To be Determined 	<ul style="list-style-type: none"> MFP Seminar Technical Report PUOD strategy/ action plan. Tendering package issued/ Contract Award/Systems redesign & installation. E. Java & Bali UDP funding. MFP supervisory support.

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POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April-June, 1992
Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description ** (target)	Monitoring indicators
(d)	Encourage private sector resources mobilization and private sector participation in the provision and delivery of urban infrastructure services	3.05 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
				- Private Sector Participation Identification Study (First E. Java Water Supply Project - IBRD Loan 2275-IND)	Completed (12/89)	
				- 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 prepare its recommendations		
				- "Financing & Commercializing the Private Provision of Public Services" study describing elements of needed policy framework, evaluation criteria & negotiating parameters common to all subsectors of public-private partnerships.	Completed (03/91)	
				- WASH study of private sector participation (PSP) in urban water supply & draft admin guidelines for PDAMs.	Completed (05/91)	
				- WASH seminar held to disseminate study findings on next steps for GOI	Completed (05/91)	
- PURSE project designed & approved to mobilize TA to undertake policy studies, develop guidelines, & test findings thru pilot projects.	Being Implemented (91-97)					

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Actions, Keysteps, targets, updated April-June, 1992
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No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (NB crucial steps indicated by*)	Description **(target)	Monitoring Indicators
				<ul style="list-style-type: none"> - Preliminary surveys in Padang & Surabaya & TOR prepared by MFP for detailed survey of PSP in Urban Service at the local gov't level (study to be financed by PURSE). - BOO/BOT Seminar overview of PSP & power, telecom, & toll road subsectors. 	<p>Completed (02/92)</p> <p>Completed (02/92)</p>	
			<p>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)</p> <p>Introduce pilot projects in selected local authorities, with initial emphasis on the water supply and solid waste subsectors (by MHA)</p>	<p>Provide model agreements between local authorities and the private sector concerning a variety of forms of private sectors participation</p> <ul style="list-style-type: none"> - Umbulan Springs, Pasuruan, E. Java bulk water supply for PDAMs of Surabaya, Gresik, Sidoarjo & Pasuruan BOT-type contract signed Bromo Consortium \$125 million 15-yrs 1990. - Lhok Seumawe, Aceh Utara water supply, transmission, & distribution to industrial (80%) & non-industrial (20%) users. American, Dutch, & local investors & 70 million 30-yrs 1990. - Nusa Dua, Bali Water supply & distributions for hotel development approx \$15 m (private)/\$9 m (public) 15 - yrs(1991) - Bintan Islands water supply Singaporean company Saim group \$480 m under negotiations, Singapore Public Utilities Board and Riau province PDAM. 		<p>Model agreements provided</p>

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				<ul style="list-style-type: none"> - Semarang \$125 million water treatment & distribution system under negotiations. - Solid waste collection & transport service contracts by private firms serve 10% Jakarta's 261 sub-districts in 1988. In Surabaya private firms transport 10% of the city's solid waste from temporary collection to final disposal sites. - For electric power generation, the GOI is reviewing BOO-type proposals from 2 consortia for Paton 5&6 and 7&8 power plants, each pair 1200 MW \$1.7-2 billion. - In telecommunications, the GOI seeks to establish revenue sharing agreements (build-transfer type contracts) with domestic firms for 490,000 of the country's 1.4 million lines. As of Sept. 1991, 53,000 lines put into operations under revenue sharing agreements. Broad deregulation under review. 		
		3.06 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)	<ul style="list-style-type: none"> - Tk. II Loan Administration Study by PUOD on debt service, depreciation, demand analysis, & methods for increasing tariffs to attract private investment - Pilot test Tk. II Loan Administration Monitoring System & provide training to 5 PDAMs. 	<p>Completed (91-92)</p> <p>Being implemented (92-93)</p>	

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4.	<p>Improve financing systems and mechanism for urban infrastructure and incentives for local resources mobilization</p> <p>(a) create a consolidated loan fund for local governments</p>	4.01	Provide a viable system of loan finance for local governments (1987 onwards)	Strengthen Central-local Government borrowing scheme (by DGMOM)	<ul style="list-style-type: none"> • Assign consultants to review policies for the Regional Development Account (RDA) • RDA Decree signed by MOF formalizing credit facility • RDA Borrowers Manual Prepared • Decree signed setting RDA interest rate for 1992 - Workshop on Local Gov't Debt Mgn't held in Malang by MFP/MOF to review RDA procedures. - MOF/HMD Local Gov't Project Appraisal course established. - SPABP mechanism established to allow donor funds to be channelled directly to local gov'ts thru INPRES grants with linkages to approved IJDP PJM's. 	<p>Completed (03/89)</p> <p>Completed (09/91)</p> <p>Completed (01/92)</p> <p>Completed (02/92)</p> <p>Completed (02/92)</p> <p>Completed (/91)</p> <p>Completed (/91)</p>	<p>Consultants assigned</p> <p>Copies disseminates to Provincial & selected Kotamadyas</p>
		4.02	Improve allocation mechanisms of grant finance (1987-89)	Improve allocation criteria and guide-lines for Central - Local grant system (by TR)	<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 - Experimental Inpres Perkotaan established for FY 1992/93 for Rp. 38 billion, as part of Inpres Da II. 	<p>Completed (06/87)</p> <p>Being Implemented ** (/90)</p> <p>Pending Review (/92)</p> <p>Completed (/92)</p>	<p>Working group assigned</p> <p>Working group report with specific improvement proposals</p> <p>Draft legislation "Law on Local Government Taxes & Changes" and "Central-Local Fiscal Relationships" prepared by MOF under review by Cabinet.</p>

POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April-June, 1992
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No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description ** (target)	Monitoring Indicators
4.03		Improve information base for policy development and operational decisions on local government finance	Improve system of Tk. I & II reporting to MOF & MHA (PUOD) for APBD Local annual budget/actuals.	<ul style="list-style-type: none"> - SKDD financial & demographic system pilot tested in Semarang under Urban V. - SKDD pilot system upgraded by SKD financial reporting & monitoring system at PUOD and local gov'ts with support from MFP. 	<ul style="list-style-type: none"> Completed (/90) Being implemented (92-93) 	
			Improve information base for mobilization of local resources.	<ul style="list-style-type: none"> - Land Information Management System (LIMS), supporting land registration & property tax collection pilot tested in Semarang. 		Next steps for adaptation of LIMS elsewhere to be determined.
			Improve information base required by Central Gov't to prepare policies & programs and monitor local gov't performance.	<ul style="list-style-type: none"> • Regional finance information & analysis system (PAKDBASE) installed and tested at MOF/PAKD. Integrated with SRD by MOF/MFP. 	Being implemented (92-)	
				<ul style="list-style-type: none"> - Urban Policy Action Plan Monitoring Indicators System designed & installed by MFP 	Being implemented (91-92)	Monitoring Indicator System fully institutionalized.
				<ul style="list-style-type: none"> - MFP Municipal Finance Seminar assessed strengths & weaknesses of various MS, including National Urban Development Strategy (NUDS) database & Urban Information System (UIS). 	Completed (12/90)	Action on MFP Seminar recommendations
	(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"> 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

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No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (NB. crucial steps indicated by*)	Description ** (target)	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 their grant/loan implications	10/90	Package agreed
				Agree on channels for delivering poverty alleviation packages including guidance requirements monitoring and evaluation	03/91	Channels for delivery agreed (See Inpres Perkotaan under 4.02)
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 - BAKN)	- Urban Institutional and Manpower Development Study (UIMDS) needs assessment.	Completed (/88)	
	(a) evaluate Local Government needs, with particular emphasis on urban managers and coordinate long-term training programs			- UIMDS Seminar by MFP to communicate findings & recommendations.	Completed (03/91)	
				- UNDP consultancy support for institutional development in MENPAN, LAN and BAKN.	Being implemented (/92)	
				- "A Training & Technical Assistance Delivery System for Urban Management: A" Preliminary Note in Strategy by MFP/IUIDP-INS.		
	(b) raise staff capabilities of local revenue administration, planning and programming, and operations and maintenance	5.02 Strengthen management and staffing capabilities in MPW DGs and Provincial Dinas PU, to provide guidance to local governments (1987-1990)	Review coordination arrangements between MPW DGs in IUIDP process	Issues directives to DGs	Being implemented ** (10/90)	Directives issued
				MPW staff "deconcentration" and "secondment" to support TK II.	Completed (/90)	
				- Manual for IUIDP preparation distributed for use in East Java/Bali	Completed (04/92) UDP	
				- Manual for IUIDP appraisal	Being implemented (/92)	
				- Workshops to explain manual guidelines	Being implemented (/92)	

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Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description ** (target)	Monitoring Indicators
			Identify staff skills and training experiences required to provide adequate management, technical and financial advice to Local Govts. (by MPW, MHA and MENPAN)	<ul style="list-style-type: none"> - Carry out internal review of DGOK with assistance of management consultants - *A Training & Technical Assistance Delivery System for Urban Management: A* Preliminary Note in Strategy by MFP/IJNDP-INS. 	<ul style="list-style-type: none"> - Being implemented ** (/90) - Completed (02/92) 	Assessment finalized
	(c) provide guidance to all govt. units in coordination of urban development	6.03 Remedy conflicts and inconsistencies among existing laws and regulations on urban management	Develop a consolidated, coordinated and controlled system of Urban Management guidelines for use by Tk. II governments.	<ul style="list-style-type: none"> - Cursory inventory of existing laws/regulations/guidelines by TKPP and Draft Strategic Plan for Urban Management in Indonesia. - Initial Phase of UMG Development (detailed inventory, analysis, action/plan & TOR development) being contracted under MFP - Full UMG implementation under MFP Amendment 	<ul style="list-style-type: none"> - Completed (01/92) - Completed (02/92) - To Be implemented 	
			New guidelines provided by new legislation.	<ul style="list-style-type: none"> - Draft Spatial Planning Law provides plan preparation guidelines and protected area controls - Housing and Settlements Law regulates public housing and settlements 	<ul style="list-style-type: none"> - Under Review - Enacted (02/92) 	Submitted House of Representatives (08/91). Expected to be enacted mid-1992.
8.	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 (1987 onwards)	Establishment of an Interagency Coordination Team for Urban Development (TKPP and an executive secretariate)	<ul style="list-style-type: none"> * Ministerial Decree (SK) establishing structure and resources of TK issued * TKPP purposes and membership redefined as a policy making body. IMG established to manage technical implementation of IJNDP projects. 	<ul style="list-style-type: none"> - Completed (04/87) - Completed (/90) 	Decree issued Extension date on April 1, 1989
	(a) establish an interagency coordination team and an executive secretariate					
	(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 (1987-1988)	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)	<ul style="list-style-type: none"> - Assign standing working groups interalia for planning and programming, program implementation, financial resources and training, and institutional development 	<ul style="list-style-type: none"> - Completed (/87) 	Assignments made

POLICY ACTION PLAN HGL

Actions, Keysteps, targets, updated April-June, 1992
Previously amended May 3, 1990

No.	Policy Area/Objectives	Medium-term goals	Action Proposed	Key steps during project period (04/87-04/92) (N.B. crucial steps indicated by*)	Description ** (target)	Monitoring Indicators
				- 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

Annex D

STATEMENT OF WORK
MUNICIPAL FINANCE PROJECT
INTERIM EVALUATION

I. TITLE

Municipal Finance Project Interim Evaluation

Evaluation of the Municipal Finance Project, Indonesia; Project No. 497-HG-001, funded with \$100 million Housing Guaranty loan resources and \$5 million grant for technical assistance and training (497-0365). Period of implementation FY 88 - FY 94.

II. PURPOSE

The purpose of this evaluation is to provide the Government of Indonesia (GOI) and USAID/Indonesia with an assessment of the progress of the Municipal Finance Project since 1988, with particular emphasis placed on activities since September 1991 (the date of the most recent program Assessment). It will provide the basis for decisions about modifications and extensions to the existing program, and about design implications for a possible new \$125 million HG loan program.

The base line for the evaluation of progress made under the Policy Action Plan (PAP) is the information contained in the August 1988 Project Paper for the Municipal Finance Project, the August 1989 Policy Action Plan Review, the May 1990 Policy Action Plan Update, the Second and Third Year Assessments of August 1990 and September 1991 respectively, and the March 1992 report by BAPPENAS entitled "Progress and Issues in Indonesia's Urban Development and Priorities for Policy Analysis, Strategy Formulation and Programming" (subsequently referred to as the "Issues and Priorities" report). A copy of the Executive Summary from the two most recent Assessments is appended.

The evaluation will focus on the two major approaches to assistance undertaken by the program: sector assistance, through provision of HG resources; and technical assistance and training. The evaluation will provide separate assessments of the two approaches, and recommendations for future activities of both.

III. BACKGROUND

A major challenge facing Indonesia, as the rate of urbanization continues to increase, is to improve the delivery of its urban service investments, especially for the benefit of low income families. An important means of meeting this challenge is to develop more efficient and equitable systems of municipal finance. Indonesia's rapid urbanization and the magnitude of its many associated problems, coupled with the limited pool of central resources, requires the GOI to continue to develop a more decentralized system of financial planning, with local governments taking greater control over investment decisions. Within this system, local governments will be able to assume more responsibility to mobilize their own resources. In response to these GOI initiatives, A.I.D. and the GOI have designed an urban program, the Municipal Finance Project (MFP).

The program addresses four major problems facing the municipal finance system: (1) near-term shortfalls in the GOI development budget; (2) the need to expand sources of revenue; (3) the need for performance incentives; and (4) the need for a clear policy towards servicing low income populations. The MFP emphasizes local resource mobilization, infrastructure affordability and cost recovery, public-private partnerships in urban service provision, and targeting of shelter-related services to low income communities.

In August 1988, USAID/Indonesia approved the Project Paper (PP) for the MFP. This PP presented A.I.D.'s urban policy agenda, which was the basis for approving \$100 million of HG resources and \$5 million of DA resources in support of A.I.D.'s urban programs in Indonesia. In approving the PP, USAID/Indonesia authorized the first \$25 million of HG resources for the MFP for FY'88.

In July 1989, August 1990 and September 1991, USAID and RHUDO/Asia undertook assessments of PAP progress, detailing and assessing actions the GOI had made in reforming the municipal finance system since approval of the Project. The assessments of 1990 and 1991 summarized program accomplishments since the prior assessment, and recommended priorities for improvement in subsequent periods. The present Evaluation will include a similar summary of accomplishments. Based on these assessments, RHUDO/Asia recommended that USAID/Indonesia authorize the second, third and fourth tranches of HG resources for the MFP.

In March 1992, the GOI submitted to A.I.D. its "Issues and Priorities" report. This report summarizes progress in

urban development and in the formulation and implementation of urban policy during the prior year, and identifies the actions proposed by the GOI for the next two fiscal years to develop urban policy and strategy, and to accelerate program implementation. It is also being used as a basis for updating the GOI's urban strategy for incorporation in Repelita VI. The was submitted in response to the request from A.I.D. to the GOI for information required for decisions on the disbursement of the fourth and final tranche of the \$100 million in HG resources.

The DA grant has provided support for technical assistance and training. There have been a variety of technical assistance activities funded by the Project, including provision of the services of four full-time technical advisors to the Ministries of Finance, Home Affairs and Public Works, and several studies.

Other studies, funded from several different sources, have also been designed to support the GOI's Policy Action Plan. It is, however, not intended that impact of these studies be explicitly included within the scope of the present evaluation.

There have also been a variety of training activities funded from the project: support for individual participation in training courses in the U.S. and regionally, sponsorship of study tours, and the authorship of in-country seminars and training programs, as well as on-the-job training by resident advisors. Their principal purpose has been to develop the technical capacity of the staff in the sector's public and private policy and implementing organizations.

USAID/Indonesia now wishes to evaluate the progress which the GOI has made related to municipal finance policy since September 1991, and the degree to which the MFP has assisted GOI to formulate policies and implementation strategies, and to develop technical expertise, since the commencement of the project. USAID also wishes to place the MFP in the context of assistance and support being given the GOI by other External Support Agencies (ESAs) such as the World Bank, Asian Development Bank and UN agencies, in the urban sector, and to understand the degrees of complementarity, and of overlap or omission, if any.

This evaluation is designed to assist USAID/Indonesia to provide the basis for recommendations concerning possible amendments and changes to the MFP, and to assess the design implications for a possible new \$125 million HG loan.

In doing so, the evaluation will necessarily need to (a) determine the extent to which policies developed under MFP

to date are sustainable, and (b) reassess the relevance of the original project objectives to the GOI's newly-restated urban policy.

IV. STATEMENT OF EVALUATION ACTIVITIES

This evaluation seeks answers to the specific questions listed below. The evaluation team will seek to provide empirical findings to answer these questions, and the team's report will provide conclusions based on the findings and recommendations based on an assessment of the results of the evaluation exercise.

a. To what extent has the GOI achieved its stated objectives with respect to targets stated in the PAP for:

1. strengthening and clarifying local government responsibility for urban infrastructure;
2. implementing a coordinated and decentralized process for programming urban infrastructure investment;
3. enhancing local government resource mobilization, financial management and involvement of the private sector in infrastructure and service delivery;
4. establishing effective mechanisms to support municipal borrowing and improving the system for allocating intergovernmental grants;
5. strengthening the institutional capacity of local governments; and
6. improving intergovernmental coordination and consultation in urban development.

What has been accomplished in these target areas, particularly during the previous year? What has been the role of A.I.D. vis-a-vis other ESAs in supporting the GOI's urban policy agenda? Are the accomplishments sustainable? What are the recommended priority actions for accelerating change?

b. To what extent have the measures of goal achievement and the objectively verifiable indicators of project purpose and output, as stated in the Log Frame of the PP, already been reached?

c. In the light of the "Issues and Priorities" report and other policy statements by the GOI, are the aims and objectives of the Project, as summarized in the PP, still consistent with the principal priorities of the GOI? Are they still realizable within the remainder of the Project implementation period?

d. To what extent have expenditures made under the annual Investment Plans satisfied the objectives and forecasts described in the PP, Section 5? How has the share of the Investment Plans implemented directly by local governments, and implemented by central government in accordance with local government plans, changed over time? How could the local government share be increased in the future?

e. Has GOI progress on the policy objectives been commensurate with investment of the HG resources? Is there continuing justification for a program of this type and magnitude?

f. To what extent has the Regional Development Account (RDA) been operationalized in accordance with the expectations of the PP? What are alternative paths for future development of local government credit mechanisms?

g. How have the principal project-funded technical assistance activities contributed to the Program's policy objectives? How do they relate to technical assistance activities funded from other sources? What changes or additions to the MFP would be necessary better to achieve the objectives specified in the "Priorities and Issues" report?

h. What project-funded training activities have been undertaken in the course of the project? The team should summarily describe the events that have been sponsored, and should quantify and characterize the individual training that has been funded. How far does the existing MFP address the training and technical assistance needs of local governments? How directly are they related to the policy objectives of the Project?

V. STATEMENT OF SPECIFIC EVALUATION TASKS

In addressing the questions and issues summarized above, the team will perform the following tasks:

Task 1: Preparatory Work

Before departure for Indonesia, team members shall familiarize themselves with previous and current literature about the project. The Mission will ensure that this literature is available to the team. It includes:

- a. the Project Paper for the MFP;
- b. previous program assessments;
- c. the recently completed evaluation of the training program of RHUDO/Asia;
- d. reports of studies completed under the MFP program;
- e. the "Issues and Priorities" report;
- f. the list of training and technical assistance activities undertaken in association with the program; and
- g. the project completion report for the World Bank's Urban Sector Loan to Indonesia.

The team members will meet with representatives of the World Bank in Washington, DC, to determine the Bank's views on implementation of urban projects in Indonesia. They will attend a briefing arranged by the PRE/H Backstop Officer for Indonesia.

The team members will also finalize a plan of work for the field work in Indonesia. This may include the preparation of evaluation instruments and criteria, interview forms and suggested benchmarks. These will be discussed with and approved by the Mission before they are applied. The team may also choose to send the Mission a list of questions on data requirements in order that collection of the information may be started in advance of the team's arrival.

Task 2: Prepare an Assessment of Policy Action to Date

The team will identify policy action accomplishments from September 1991 to the present, based on monitoring indicators in the PP, the updated Policy Action Plan and the "Issues and Priorities" report. This review will cover actions taken, policies adopted and changes initiated, and will identify issues which still need to be addressed. The team will also summarize progress made in the preceding period, i.e. between program commencement and September 1991: since this has already been reported in some detail in annual assessment reports, the information need be re-presented only in summary fashion.

In order to obtain the most current information to undertake this assessment, the team will meet with and interview key GOI officials responsible for PAP implementation, including senior representatives of BAPPENAS and the Ministries of Home Affairs, Public Works, Finance. Other meetings will be held with the Secretary of TKKP, the MSFP GOI Project Manager, full time members of the MFP technical assistance team,

resident representatives of the World Bank in Jakarta, representatives of other ESAs as available, and the USAID/Indonesia Urban Policy Division Chief. In addition to the documents listed in Task 1, the team will review the routine reports of the MFP Technical Assistance team, the quarterly reports written by TKKP on PAP implementation relating to the World Bank's first Urban Sector Loan, other reports written in support of PAP implementation, and Progress Reports of the Implementation Support Project for the Integrated Urban Infrastructure Development Program (IUIDP).

In evaluating the overall achievements of the policy-based sector assistance, the team should use the means of verification identified in the PP so far as readily available data permit. Their findings should be summarized in matrix form, comparing the targets in the Log Frame with actual outcomes.

Task 3: Evaluate the Effectiveness of the Training Activities

The team will evaluate the effectiveness of the training activities in relation to the program's overall policy objectives, and the newly-stated objectives of GOI as contained in the "Issues and Priorities" report.

("Training" is understood to include participation in formal training courses, the sponsorship of workshops, conferences and seminars, on-the-job training, institutional development of training institutions, and supporting informational materials.)

The evaluation will be done through interviews with both providers of training, a sample of participants and putative indirect beneficiaries of training activities, and will include a review of the MFP/IUIDP "framework report" on training and technical assistance.

The team will also comment on the effectiveness of the management of the training program, and the integration of training activities into the overall framework of the program.

Task 4: Evaluate the Effectiveness of the Technical Assistance Activities

The team will evaluate the effectiveness of the technical assistance products in relation to the program's overall policy objectives, and the newly-stated objectives of GOI as contained in the "Issues

and Priorities" report. This will be done through interviews with members of the GOI Steering Committee for the MFP, clients of technical assistance activities, and other potential users of reports and studies.

Task 5: Review the Status of RDA Implementation

The team will summarize the current status of RDA implementation and should review the options for its further development to provide a sustainable basis for long term credit for local governments. The team will examine documentary evidence of the start-up of the RDA and written policy statements of the Ministry of Finance, and will interview relevant officials and advisors in the Ministry of Finance in order to summarily describe and evaluate the procedures that have been followed and the options for future development as proposed by GOI representatives from time to time.

Task 6: Identify Emerging Opportunities and Obstacles to Implementation

From the preceding tasks, the team will assess the probability for sustained impact of this project, and will recommend whether a continuation of this type of project is justifiable. The team will identify emerging opportunities which could be incorporated in any subsequent amendment of or extension to the MFP, including the Policy Action Plan. The team will also identify any obstacles to PAP implementation, and propose new approaches to overcoming these obstacles, including new approaches for provision of technical assistance and training. The issues discussed in the September 1991 program assessment should be updated. The update should include a review of 1991-92 performance, plans for the future, opportunities to strengthen the program, and relevant critical policy issues impacting the urban development strategy for Repelita VI.

VI. EVALUATION TEAM

The evaluation team should consist of two people, at least one of whom must be thoroughly familiar with urban issues in Indonesia.

The team leader should be an Urban Policy Analyst with at least twenty years experience in urban policy analysis, urban economics and municipal finance, as well as previous

experience in policy evaluation. The team leader must have had previous experience of work in the urban sector in Indonesia.

The other member of the team should be a senior urban management specialist.

At least one team member should have prior experience of conducting evaluations of technical assistance and training programs, and one should have a knowledge of alternative techniques for credit mobilization for infrastructure finance.

VII. LEVEL OF EFFORT

The team will provide a total level of effort of 54 person-days, to be spent as follows:

U.S. (initial briefing, final report)	10 person-days
Indonesia	36 person-days
Travel time	8 person-days

A 6-day work week is authorized.

VIII. SCHEDULE

The evaluation will begin in Washington, DC, on or about June 1, 1992, and in Jakarta on June 12, 1992. The team will be required to meet with Mission evaluation and Urban Program personnel for a full briefing at the start of the field assignment, and, in the second week of field work, to discuss their preliminary findings and conclusions with the Mission. The team will also be required to give final exit briefings for the Mission and GOI representatives. On return to Washington, DC, the team will provide a briefing on their findings to PRE/H.

The USAID/Indonesia Urban Policy Division Chief will assist the team by providing the literature specified in Task 1 above, and in organizing meetings in Jakarta and obtaining the necessary statistical information.

IX. REPORTS AND DELIVERABLES

The team will prepare, in the field, a draft final report which responds to the questions in Article IV above, and which corresponds to A.I.D.'s required format for evaluation reports.

This draft report will be submitted to USAID/Indonesia prior to the team's departure from Indonesia. USAID/Indonesia will provide the team with comments from A.I.D. (USAID/Indonesia and PRE/H) and GOI representatives within four weeks of the team's departure. The team will provide a final report within the subsequent two weeks, i.e. on or about August 14, 1992.

The final report will be provided to USAID/Indonesia as a diskette written in Word Perfect 5.1, plus fifteen printed and bound copies. A further five copies of the printed report will be provided to PRE/H, with copies to CDIE in accordance with normal AID/W requirements.

The team will also be responsible for the drafting of Sections H and J of the standard A.I.D. Evaluation Summary. A copy of this form, and of the instructions for completing it, are attached for reference.

X. FUNDING

The source of funds for this evaluation will be grant funds under the evaluation line item of the USAID/Ministry of Finance Municipal Finance Project (497-0365). The total preliminary budget is US \$55,000 as shown in Attachment 2.

Annex E

**INTERVIEWS CONDUCTED FOR
THE INTERIM MFP
EVALUATION**

The research team conducted the following interviews between June 15 and July 7:

- Ahadis, Hatta; Chief, Sub-Directorate for Human Settlement, Directorate of Urban Development, Directorate General of Regional Development, Ministry of Home Affairs
- BANGDA Staff under training
- Bastin, Johan Dr.; Harvard Advisory Group, Harvard Institute for International Development
- Dice, Steven; World Bank, Project Director, East Java and Bali Urban Development Project
- Happe, Nancy; Price Waterhouse, Advisor to Ministry of Finance
- Herbert, John; IUIDP Chief Technical Advisor
- Hirawan, Susiyati; Head of Center for Regional Finance Analysis, Ministry of Finance
- Iskandar, Dono; Chairman, Board of the Analysis of State Finance, Credit, and Balance of Payments
- Khanna, Anupam, Division Chief, Infrastructure Operations, East Asia and Pacific Islands, World Bank
- Kugler, William; Research Triangle Institute Urban Development Specialist, Directorate General of Regional Development, Ministry of Home Affairs
- McCullough, James; Research Triangle Institute Chief of Party, Ministry of Finance

- Ministry of Finance Staff under training, including: Arlen Pakpahan and Busrori, Messrs. Ketut and Sutomo
- Montes, Marco; PBB Project coordination, Harvard Institute for International Development Property Tax Project
- Munandar, Gita; IUIDP Implementation Support, BAPPENAS
- Murjanto, Djoko; Director for Program Development, Directorate General of Human Settlement (Cipta Karya)
- Prawiradinata, Salmun; Head, Credit Analysis, Center for Regional Finance Analysis, Ministry of Finance
- PUOD Staff under training, including: Mulia Bachtiar, Hilda Saroinsong, Rasken Sebayang, and Yevons Gurusinga
- Rachmadi, Bambang; Director General of Human Settlement (Cipta Karya)
- Royat, Sujana; Director, Centre for Urban and Regional Infrastructure, Ministry of Public Works
- Soegjoko Ph.D., Mrs. Budhy Tjahjati S.; Head, Bureau of Socio-Economic Planning, BAPPENAS
- Soegjoko, Dr. Sugjanto; Deputy V, BAPPENAS
- Soekardi, Soedarsono; Director for Urban Development, Directorate General of Regional Development, Ministry of Home Affairs
- Supangkat, Harry; Director for Investment Fund, Ministry of Finance
- Suselo, Hendropranoto; Assistant to the Minister of Public Works in Integrated and Urban Spatial Planning
- Tambunan, Birong; Director of Regional Finance, Directorate General of Public Administration and Regional Autonomy, Ministry of Home Affairs
- Taylor, John; Research Triangle Institute Urban Development Specialist, Directorate General of Cipta Karya
- AID/DIR and PED/UPD Staff
- Whitehead, Stuart; The World Bank

- **Wijanarko, Agus; Head of Subdirectorate, Planning and Program, Cipta Karya, Ministry of Public Works**
- **Zaris, Ruslan; MFP Coordinator, Cipta Karya, Ministry of Public Works**