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**FINAL EVALUATION OF THE INDONESIA  
MUNICIPAL FINANCE AND  
SHELTER PROGRAM**

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## **EXECUTIVE SUMMARY**

This report is the final evaluation of Indonesia's Municipal Finance and Shelter Program (MFSP). Initiated in 1988, the Project was designed to further the Government of Indonesia's (GOI) program to decentralize substantial authority and responsibility for urban development to local governments. Under the MFSP agreement (as amended), USAID was to provide \$120 million in Housing Guaranty Loan (HGL) funds for urban infrastructure improvements,<sup>1</sup> and the GOI was to implement a series of reforms called for in a pre-agreed "Policy Action Plan" and to meet certain "Investment Plan" requirements to ensure the local currency equivalent of the HGL funds received would be spent in a manner consistent with program objectives and legal requirements.

### **PURPOSE AND METHODOLOGY**

The main purpose of this evaluation is to assess the GOI's performance under the Policy Action Plan and Investment Plan requirements. However, to the extent evidence permits, the report also comments on the Project's broader impacts and draws lessons that should be of relevance to other USAID projects with similar objectives. With respect to the latter, specific recommendations are offered for the implementation the new GOI/USAID Municipal Finance for Environmental Infrastructure Project (MFEI), which both extends and expands upon the themes of MFSP.

The evaluation was conducted in August 1994 by two U.S. urban policy specialists. To obtain evidence on the policy change that has occurred, as well as Project impacts, the authors examined numerous reports and other documents, interviewed 32 program officials and knowledgeable observers, and analyzed GOI and USAID records on sectoral investments and financing.

### **MAIN FINDINGS AND CONCLUSIONS**

The MFSP should be regarded as a substantial achievement. While it has not met all of its stated targets in full, it has facilitated a truly monumental (and, we judge, permanent)

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<sup>1</sup>USAID has also provided an additional \$5 million grant for technical assistance and training to support themes in the Policy Action Plan--work which is not assessed in this evaluation.

change in governance in Indonesia—one that offers probably the only viable hope of enabling the country to meet the enormous challenge it faces in managing rapid urbanization both efficiently and equitably.

**Policy Action Plan Accomplishments through 1992.** In the first few years of MFSP, the GOI had already accomplished a great deal within the framework of the Plan. It had: (1) transformed the process by which urban infrastructure is programmed through the Integrated Urban Infrastructure Development Program (IUIDP—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 improved the management of the property tax and other local own-source revenues, and enhanced their yields; (3) set a sound policy and technical base for expanding private sector participation in urban services; (4) built the base for expanded municipal borrowing for urban infrastructure, notably through establishing the Regional Development Account (RDA); and (5) established and maintained a viable framework for interministerial coordination of central government actions affecting urban development. The Interim Evaluation of MFSP in 1992 recognized the importance of these advances, but raised concerns about several remaining threats to longer term objectives.

**Policy Action Plan Accomplishments, 1992-94.** We judge that the momentum behind MFSP policy themes has grown notably since 1992 and the GOI has since done much to address the concerns raised in the Interim Evaluation. Key achievements are noted below in relation to priority assigned them in that Evaluation:

1. **Strengthening the base for credit financing of municipal infrastructure:** the volume of lending for local government and enterprise investments was considerably expanded (including an 84 percent increase in RDA disbursements from Rp.47.9 billion in 1991/92 to Rp.88.1 billion in 1992/93); a serious examination of reforms to the structure and management of the RDA and alternative credit mechanisms to expedite the evolution of a sound market-based credit finance system has been initiated.

2. **Building performance capacity in local government:** the number of person-days of relevant skill training provided to local officials has been substantially increased (by 45 percent from 1992/93 to 1993/94); a major new training program in urban management has been initiated; the number of professional civil servants under the jurisdiction of the Ministries of Home Affairs and Public Works assigned to work for regional and local governments has more than doubled (from 54,700 in 1991/92 to 132,800 in 1993/94).

3. **Expanding local government revenues and local government discretion over the use of revenues received:** property tax (PBB) receipts increased nominally by 58 percent from 1991/92 to 1993/94; more notably, real per capita own source revenues of Tk. I and II governments (including PBB) had increased by 60 percent in the four years from 1987/88; the share of PBB receipts to be retained by local governments was expanded from 90 percent to 100 percent and a decree instructing Provinces to allocate 50 percent of motor vehicle taxes to local governments was implemented; absolute levels of central government grants

to local governments grew markedly (SDO and INPRES grants increase by 53 percent from 1991/92 to 1994/95); the proportion of central grants that local governments can freely allocate between sectors increased from 20 percent in 1990/91 to 25 percent in 1994/95; local government contract approval authority was increased from Rp.500 million to Rp.2 billion; the local (as opposed to regional) government share of all central grants increased from 45 percent in 1990/91 to 57 percent in 1994/95.

4. *Other key accomplishments:* IUIDP program coverage continued to expand (by the end of 1993, areas with coordinated investment programs completed and with financing approved accounted for 80 percent of the national urban population—up from 56 percent a year earlier—and planning work was either underway or scheduled for areas accounting for another 9 percent); the number of water authorities for which control has been transferred from the central to the local level increased from 177 in 1992 to 276 in 1994 (control has now been transferred for all but 17 of 293); a series of new regulations transferred additional authority for specific functions to local governments; a major review of Indonesia's urban policy was conducted and resulted, for the first time, in strong and explicit endorsement of MFSP Policy Action Plan themes in the nation's new development plan (Repelita VI); Repelita VI also strongly endorses building urban environmental management principles into local planning processes and several new projects and regulatory measures have been initiated in support of this goal; the GOI is preparing a new Policy Action Plan for Repelita VI which reinforces earlier themes but adds a broader scope for urban management.

**Progress Under the Investment Plan.** From the start of MFSP through March 1994, the GOI has documented investments in local environmental infrastructure totaling \$188.5 million in accord with HGL program requirements (i.e., shelter-related improvements benefitting below-median income households not supported by funding from other donors). This total is well in excess of the \$120 million required under the MFSP agreement. Also noteworthy are efforts made by GOI and USAID (implemented in 1993) to improve the targeting of program benefits to low income households: (1) by narrowing formulas for HGL eligibility; and (2) by the GOI decision to require demand-surveys as a part of all future local investment planning (which provides a knowledge base to permit more effective targeting).

**The Importance of USAID's Role through MFSP.** It cannot be argued that all GOI accomplishments identified above would not have occurred without USAID's assistance through MFSP. However, there is substantial evidence that MFSP contributed in important ways to sustaining and expediting the program and influencing priorities to heighten the impact of the overall agenda. The World Bank had earlier provided substantial loan funding linked to Policy Action Plan performance but, in the late 1980s, it withdrew from that approach and notably reduced its funding commitments for the program overall.<sup>2</sup> MFSP thus entered to fill an important void at that time. GOI officials readily acknowledge that HGL funds became vital to continuity in the investment program (and that, because of less

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<sup>2</sup>The Asian Development Bank as well as the World Bank still strongly support all Policy Action Plan themes in principle and continue to provide loans for specific urban projects within it, but neither any longer conditions such assistance on the progress of the Plan as a whole.

cumbersome disbursement procedures than those of other major donors, HGL investments could generally be delivered with greater speed and flexibility).

Furthermore, it does appear that USAID management of the Program has been both diligent and innovative. Policy Action Plan performance was monitored regularly and, in recurrent policy dialogues, USAID worked actively with GOI counterparts to make mid-course corrections needed to address emerging problems and opportunities that had been identified. There is no doubt, for example, that these dialogues played a very important role in: securing the progress that has been made in the development of the RDA and the broader search for mechanisms to expand municipal credit; adding the emphasis that has been given to private participation in urban services; and the recent focus on targeting program benefits more tightly to the poor. In a number of cases GOI/USAID policy dialogues have led to the recognition of new priorities for short term attention within the framework of the overall plan and USAID has been quick to reorient technical assistance resources to support such priorities. Illustrations are the increased attention given to RDA reorientation and urban management training after these issues were raised as priorities in the Interim Evaluation.

#### **IMPACTS, CHALLENGES, AND RECOMMENDATIONS**

The progress achieved through MFSP is indeed impressive. Indonesia's acceptance of the themes of the Policy Action Plan—ranging from its most basic tenet of decentralization through its principles of financially disciplined and efficient development processes—has both broadened and deepened, particularly over the past two years. While progress has not always been as rapid as desired, none of these themes has been reversed. The evidence is now substantial that they will be sustained in national policy in the future.

Nonetheless, it must be recognized that the ultimate outcomes desired from this approach still seem a long distance away. Even after recent increases, Indonesia's rates of local taxation and the extent of cost recovery remain low by world standards. Particularly disturbing is that public urban infrastructure investment may now be falling behind the needs implied by rapid urbanization. Total per capita government investment in HGL-eligible environmental infrastructure sectors has actually declined of late in real terms: from Rp.15,900 in 1990/91 to Rp.14,200 in 1992/93 (constant 1992/93 Rupiah). It is likely that private and community investments in local infrastructure are growing more rapidly, but for the public sector contribution to be lagging at this stage represents a serious problem.

International experience suggests that Indonesia is on the right path. Decentralization, with the right financial and institutional incentives in the framework of a market oriented development process, are the most promising means of reaching a "take off" point after which effective delivery of urban services will accelerate. But that point has not yet been reached in Indonesia and a new sense of urgency is warranted in driving toward it. We have not identified any outstanding issues under the MFSP that need to be resolved before that project is closed out. But there is much to be done under MFEI. Within the

framework of the Policy Action Plan as adapted for the MFEI project, we recommend that the GOI and USAID focus their efforts on three key initiatives over the next few years.

**1. Eliminate bottlenecks in the delivery system (the first priority in urban environment quality management).** There is considerable consensus that, for the time being at least, the availability of money is not the only problem. Bottlenecks exist in the delivery system that are holding back investment of the financial resources that are available. It is not surprising that, during the difficult transition from central to local control, some slowdown in delivery might occur. But, in this program, expanded delivery of urban services is the "bottom line" and we judge that addressing this issue more forcefully should be given highest priority in the next stage of program implementation.

Several factors appear to play a role in blocking delivery. There may well be a need for: clearer and more forceful guidance from the Ministry of Home Affairs to local governments; heightened priority attention to infrastructure (maintenance even more than development) on the part of Walikota and Bupati; more aggressive recruitment and training of technical and project management staff at the local level (skilled at turning PJMs into implementable project plans, and then implementing them); streamlining approval and contracting procedures; and designing more effective ways of using trained central staff in support of local implementation programs. The severity of the delivery problem is not uniform. Some local programs, even where management has been highly decentralized, have been performing well, while others have not. This demonstrates that decentralization itself is not the problem.

TKPP and IMG should give higher priority to this issue. They should gain a clearer understanding of the bottlenecks and devise and implement an effective action plan to address them. It should be remembered that the lack of sufficient infrastructure delivery (water supply, sanitation, solid waste disposal, roads to open up good land for development) is the primary cause of environmental degradation in Indonesian cities today. Expanding delivery, per se, is the single most critical means of achieving the objectives of MFEI.

**2. Expedite the creation of a market-oriented credit finance system for municipal infrastructure.** International experience of the past few years confirms more vividly than ever two fundamental assumptions that lie behind this element of the Policy Action Plan: (1) government budgets alone can never be sufficient to finance the infrastructure demands of a rapidly urbanizing nation like Indonesia—private capital must be attracted to the sector; and (2) if the system is set up properly, private investors will indeed find the sector attractive and allocate substantial resources to it. The potential is especially high in Indonesia now, given the growing accumulation of relatively idle long-term capital held by institutional investors such as pension funds and insurance companies.

The steps to be taken here are already being suggested in the studies being conducted for the Ministries of Finance and Home Affairs. They include: (1) 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; and (2) providing assistance for the launching of pilot issues of limited obligation municipal bonds. Long discussed reform of the central government grant structure is also of vital importance here. Local leaders are unlikely to pursue credit financing for investments where it would be most appropriate if they can still hold on to the hope that grant financing is an alternative.

**3. Firmly establishing local leadership in urban development.** True take-off in decentralization is not likely to occur until local leaders (normally Mayors) finally believe that it is *they* who are fully responsible for effective urban development and management. Their job is no longer to wait for instructions from above—it is *they* who must innovate, build political coalitions, gain community support, secure private investment, forcefully motivate city staff, and do whatever else may be needed to produce results. And they must believe that *they*, personally, will be held accountable, gaining substantial praise if they succeed but facing serious penalties if they do not.

Several efforts under the Policy Action Plan are moving Indonesia in this direction (including recent initiatives by BANGDA in the Ministry of Home Affairs), but the destination has not yet been reached and more can be done in the short term. Possible actions include: involving selected Walikota more directly and visibly in central program planning; giving the most innovative and entrepreneurial Walikota prominent roles in communicating program themes to less proactive Walikota; building and strengthening associations of Walikota as key vehicles for local capacity building; and forcing Walikota to take community participation more seriously in planning, financing, and implementing their development strategies. Again, a working group should be formed to find ways to make this theme more prominent in the overall program. Current BANGDA initiatives along these lines should be given more prominence, and the proposed new public-private Urban and Regional Development Institute (URDI) would be well suited to play a leading role in achieving this objective.

**Other recommendations.** The accelerated implementation of urban investment under MFEI offers opportunities to further key strategic objectives endorsed by USAID. The program's importance to *environmental improvement* has been noted but (through its potential for related employment generation as well as effective delivery of services) it can also be a critical instrument for *poverty alleviation*. Both through appropriately sensitive improvements to immediate living environments and sensible incentive in staffing new urban management assignments, it could substantially enhance the role of *women in development* as well. Program managers should be alert to structuring new initiatives so they will have maximum impact on these objectives in addressing each of the three priorities noted above. Chapter 7 presents additional ideas on how these priorities could be implemented as well as other recommendations deemed important to progress under MFEI (related to expediting the classification of new urban areas, reforming the allocation of central grants, and expanding local capacity building).

## LESSONS LEARNED

**1. Focusing management on priorities within a broad policy framework can achieve impressive results.** Concerns are often raised about the ability of broad policy reform projects like MFSP to deliver clear results; i.e., if you try to cover too many objectives at once you may accomplish very little. On the other hand, projects with narrower objectives may have a higher probability of producing outputs but they often fail because, lacking linkage to the broader policy environment, their outputs have limited impact. MFSP implementation illustrates an effective approach to avoiding the problems of either extreme. The Program gained the benefits of joint government/USAID involvement on a long term basis with the ability to address a broad range of policy issues all of which, at one time or another, could be on the critical path to achieving a major institutional change. Program managers, however, recognized the need for clear focus on only a few priorities within the overall agenda at any one time. They could (and did) shift emphasis in policy dialogues and the allocation of technical assistance resources as needed to ensure progress in those priorities areas without losing linkage to the full range of Program objectives.

**2. Reliable performance monitoring, access to technical assistance resources, and strong RHUDO/Mission collaboration are critical to success in USAID management of urban policy programs.** In MFSP, the USAID Regional Housing and Urban Development Office (RHUDO) which managed the program: (1) insisted on, and secured, regular and unbiased monitoring of performance under the Policy Action Plan; (2) applied technical assistance resources to help GOI counterparts focus on emerging problems and opportunities in a flexible manner; and (3) kept USAID Mission top management well informed and maintained their active involvement and support in carrying through major program initiatives. It is doubtful that the program's major accomplishments would have been achieved if any of these elements had been lacking. All three should be given priority in MFA and similar programs in other countries.

**3. Recognizing, and taking advantage of, variation in local entrepreneurialism and pay-off opportunities may be an important means of expediting results in urban decentralization programs.** Studies done as a part of MFSP show that there is tremendous variation in the entrepreneurialism exhibited by local officials in different cities (zeal and skill in raising own-source revenues and implementing infrastructure projects differ dramatically between cities) even in the same city-size classes. Opportunities for results also vary in important ways. Some cities are at the edge of take-off: addressing infrastructure constraints there expeditiously will yield much larger benefits to the national economy (and poverty alleviation) than focusing now on urban areas where take-off may be many years away. There is evidence to suggest that similar variations are likely to exist in other countries during the decentralization process, and that a "one size fits all" approach will have limited effectiveness. This lesson is not yet well understood or incorporated into the literature of development; yet it may be an important one, both for MFA and for other similar USAID sponsored projects elsewhere.

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## Chapter 1

### INTRODUCTION

This chapter describes: (1) the circumstances that led to the initiation of the Municipal Finance and Shelter Program (MFSP); (2) the basic purposes and structure of MFSP and the magnitude of USAID contributions to date; (3) the purposes and methodology of this evaluation; and (4) the contents of the remainder of this report.

### BACKGROUND AND CONTEXT

At 5.4 percent per annum, Indonesia's urban growth rate is among the highest in the world. Between 1980 and 1990, 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). Concerns about this acceleration led the Government of Indonesia (GOI) to initiate a National Urban Development Strategy Project (NUDS) in the early 1980s.

The Strategy was completed in late 1985. It gave prominence to institutional issues, including decentralization. It was recognized that up until that point, 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 leadership 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, building on NUDS themes, 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. 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.

The program is administered by an interministerial coordinating group (Tim Koordinasi Pembangunan Perkotaan—TKPP), composed of representatives of all relevant Ministries (usually at the Director General level) and chaired by Deputy V of the National Planning Agency (BAPPENAS). Since early 1990s, much of the interministerial coordination and planning work has actually been conducted by the IUIDP Management Group (IMG), which reports to TKPP. IMG is composed of agency representatives below the Director General level and has been chaired by a senior Bureau chief working under BAPPENAS Deputy V (now the chief of the Bureau for Urban Development, Human Settlement, and Spatial Planning). In addition to BAPPENAS, the most prominent of the other agencies represented in TKPP and IMG are the Ministry of Finance (MOF), the Ministry of Public Works (MOPW—whose Directorate General Cipta Karya has played the leading role in implementing the IUIDP program), and the Ministry of Home Affairs (MOHA).

#### **THE MUNICIPAL FINANCE AND SHELTER PROGRAM**

The World Bank, the Asian Development Bank, and other donors provided considerable support for this program soon after it was adopted, particularly for the implementation of the Integrated Urban Infrastructure Development Program (IUIDP), the new and more decentralized GOI approach for infrastructure investment programming.

By 1988, however, no donor was conditioning its assistance on the progress of the Policy Action Plan as a whole (although the World Bank had previously done so for a time). In that year, USAID and the GOI recognized the opportunity for a new assistance program that would emphasize municipal finance objectives of the Policy Action Plan, but act as a force to promote progress of the full agenda. Accordingly the Municipal Finance Project (397-0365) was initiated. Its overall objective was:

*...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 (USAID/Indonesia, 1988).*

The central component of the Project was the Municipal Finance and Shelter Program (MFSP: 497-HG-001) under which USAID agreed to provide a \$100 million Housing Guaranty Loan (HGL) to support infrastructure development and the GOI agreed to continue to pursue the objectives of the Policy Action Plan and to comply with certain Investment Plan requirements (most important, that it invest the local currency equivalent of all HGL funds received in shelter-related infrastructure improvements suitable for households whose incomes are below the national median). The MFSP project period was to run for six years (from November 1988 through October 1994).

The overall Project also included \$5 million in Development Assistance grants for technical assistance and training. These resources were allocated to: (a) a Municipal Finance Project Contract (MFPC—administered by the Research Triangle Institute since 1990) which has provided, among other things, long-term advisors to four of the most prominent central agencies represented in TKPP as well as a National Training Coordinator; and (b) a separate fund which has supported short-term consultancies, training (mostly in the U.S.) and program administrative support.

The first \$25 million tranche of HGL funds under MFSP was authorized in 1988 soon after the Project was initiated and, over the next four years, three additional tranches in the same amount had been authorized, based on recurrent assessments of Program performance (Johnson, 1989, and Kingsley, 1990 and 1991). In 1992, the Program was amended to increase the full amount of the HGL to \$120 million and thus permit an additional \$20 million injection of investment funds before the end of the project period.

Also in 1992, a full Interim Evaluation of the Municipal Finance Project was conducted (Kingsley and Peterson, 1992). Based on MFSP achievements and assessment of future needs, USAID and the GOI then began planning for a new HGL program, the Municipal Finance for Environmental Infrastructure Project (MFEI—USAID/Indonesia, 1993a) to go into operation when MFSP is complete. The MFEI follows a similar approach, supporting elements of a new GOI Policy Action Plan which carries forward the main themes from the current Plan (with new objectives and action targets, building off of those completed in the MFSP) but adds a new major emphasis on policy change to avert urban environmental degradation.

## **EVALUATION PURPOSE AND METHODOLOGY**

This report contains the final evaluation of the MFSP (but does not directly review or evaluate the performance of the associated technical assistance and training component). The main purpose of the evaluation is to assess the GOI's performance under the Program's Policy Action Plan and Investment Plan requirements. However, to the extent evidence permits, we also comment on the Program's broader impacts and draw lessons that should

be of relevance to other USAID projects with similar objectives. With respect to the latter, specific recommendations are offered for the implementation of the MFEI.

The evaluation was conducted in August 1994 by two U.S. urban policy specialists. The work entailed reviewing numerous reports and other documents (see references in Annex A), interviewing 32 program officials and knowledgeable observers (listed in Annex E), and analyzing GOI and USAID records on sectoral investments and financing.

Two documents provided particularly useful sources of information for these purposes and are cited frequently in the remainder of this report. The first was a comprehensive review of accomplishments under the Policy Action Plan and an outline of future plans and policies for central level guidance and support of urban development prepared earlier this year by the newly created Bureau for Urban Development, Human Settlements, and Spatial Planning in BAPPENAS (BAPPENAS, 1994). Although it has a longer title, we refer to it as the *Progress and Prospects Report*. The second major reference is the most recent in the series of Policy Action Plan monitoring indicators reports, originally initiated by the MFPC team. This most recent edition (BAKD/BAPPENAS/MFPC, 1994) was prepared jointly by that team, the Bureau for Regional Financial Analysis of the Ministry of Finance and the new Urban Development Bureau at BAPPENAS. A third document that is often referred to as a basis for interpreting recent accomplishments is the Program's Interim Evaluation (Kingsley and Peterson, 1992).

## **STRUCTURE OF THE REPORT**

The next four chapters contain our review of performance under the Policy Action Plan. Chapter 2 discusses local responsibility and the investment program (Policies 1 and 2); Chapter 3, local resource mobilization and private sector participation (Policy 3); Chapter 4, credit finance and intergovernmental grants (Policy 4); and Chapter 5, local capacity building and program coordination (Policies 5 and 6). In the review of each major policy theme in these Chapters, we first offer background information (largely drawn from earlier assessment reports) to orient readers not familiar with the issues at hand and a brief overall assessment of performance. We then describe progress and problems related to that theme, divided into two time periods: through 1992, and 1992-1994. In many cases, we then offer a "comments" section where we interpret findings and discuss implications for the future.

Chapter 6 presents the remaining analytic findings of the evaluation, dealing with: performance in relation to Investment Plan requirements, accomplishments under the Program's Log-Frame Matrix and in relation to recommendations of the Interim Evaluation, USAID's administration of the Program, and the contribution of MFSP to the role of women in development. Finally, Chapter 7 offers our conclusions on program impacts, recommendations for the implementation of the MFEI Project, and lessons drawn from the MFSP experience that should be of relevance to other USAID projects with similar objectives.

Several annexes contain supplementary material for reference purposes. A listing of references is presented in Annex A; a complete status report on all Log-Frame indicators in Annex B; the full Policy Action Plan in Annex C; the terms of reference for this evaluation in Annex D; a list of persons interviewed in Annex E; and the Program's Statutory Check-List in Annex F.

*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 information on goals, targets, and accomplishments is provided in the most recent version of the Policy Action Plan matrix in Annex C.

**STRENGTHENING AND CLARIFYING LOCAL RESPONSIBILITY (Policy 1)**

***Background and Overall Performance***

Basic legislation assigning main responsibilities for urban development to local governments was passed in the 1970s (Law 5/1974). Some objectives in the current program under this theme were defined to extend and clarify authority consistent with this law and these have been achieved in full. Another basic need in this area, however, is the formal recognition of governments for individual cities. 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.

***Accomplishments through 1992***

An important early accomplishment was the issuance of a regulation (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). Little progress had been made through 1992, however, in classifying new urban areas. Only two Kota Administratif (Kotip) had been upgraded to Kotamadya status (Bitung, North Sulawesi, in 1990, and Denpasar, Bali, in 1991).

#### **Accomplishments 1992-1994**

In the judgement of this evaluation, the period since mid-1992 has been the most active ever in heightening and reinforcing the commitment of the GOI to decentralization and to actually implementing it (see the *BAPPENAS Progress and Prospects Report* for additional details). Most important are the strong policy statements to this effect in the new Repelita VI and a much more far reaching regulation (PP 45/92) concerning the implementation of regional autonomy with emphasis on the local (Tk. II) level.

In addition, a number of new laws and regulations have more specifically implemented this intent. They include: (1) Law 14/92, transferring responsibilities for road traffic and transport; (2) MOHA regulations 5/93 and 7/93, concerning the regulation of site planning for industrial development and procedures for issuing construction permits generally; (3) BPN regulation 2/93, dealing with procedures by which companies obtain locations and by which land rights are granted, extended, renewed, and certified; (4) Government regulations 50/92 and 51/92, concerning transfer of government responsibility for health affairs; and (5) Presidential Decree (Kepres) 16/94, dealing with the implementation of the Government budget and specifically increasing the contract approval authority of Tk. II governments from Rp.500 million to Rp. 2 billion.

Unfortunately, upgrades of municipal status continued to move at a slow pace. Kotamadya status was conferred to only three additional Kotip (Tangerang, Jayapura, and Mataram, all in 1993) and only one previously unclassified urban area achieved Kotip status (Batu Malang, in East Java).

#### **Comment**

Under current rules, the granting of Kotamadya or Kotip status to new urban areas requires some very difficult shifts within the existing Government budget, which is sensibly constrained by current fiscal policies nationally. On the other hand, urbanization is a wealth-generating process and increases in local taxation and user charges should readily cover the costs of competent local government administration (see trends discussed in Chapter 3). Under MFSP, no study of possible changes to current financing rules to expedite the creation of responsive governments in urban areas has yet been conducted. Policy analysis along these lines (particularly with respect to the Subsidi Daerah Otonom or SDO) should be given high priority in the next stages of the GOI agenda.

## **COORDINATED LOCAL INVESTMENT PROGRAMMING (Policy 2)**

### ***Background and Overall Performance***

Through the mid-1980s, virtually all urban infrastructure in Indonesia was planned by central government agencies in Jakarta (primarily by the MOPW) 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 noted in Chapter 1, 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. However, it was also clear that few of Indonesia's local governments then had the capacity to assume this role effectively.

The Integrated Urban Infrastructure Development Program (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 (TKPP, 1987, and, Hendropranoto Suselo, 1985 and 1988). In its idealized form, the process entailed: (1) holding meetings with provincial governments to review NUDS analyses and prioritize cities for attention; (2) sending project teams to the selected cities (local staff with technical assistance provided from the center) to review and update local master plans or develop a new "structure plan" where none is available; (3) using those plans as a guide in developing a proposed local multi-year investment program (PJM) integrated across several sectors; (4) preparing a 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) preparing plans (LIDAP) for building the capacity of local government to assume ever increasing responsibility for infrastructure development, operation, and maintenance; and (6) sending individual city programs to the province and central levels for prioritization and funding allocations.

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, and 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.

Many problems have occurred in IUIDP implementation (as discussed below). Nonetheless, IUIDP is generally regarded as a major accomplishment. It was initiated in a short period of time in all of Indonesia's provinces under guidelines issued in 1987 (TKPP, 1987b).<sup>3</sup> By the end of 1993, completed IUIDP PJMs used as the basis for approved investment packages covered urban areas with 53 percent of the total urban population.

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<sup>3</sup>Progress of the program is reviewed in more detail in the 1994 BAPPENAS *Progress and Prospects Report*. Also see IISP, 1994, BAPPENAS, 1992, Directorate Bina Program, 1990, UNDP, 1990, and Budhi Tjahjati, 1990.

"Pre-IUIDP" investment packages covered an additional 27 percent, bringing the total with such plans to 80 percent. PJM planning was either underway or scheduled for areas accounting for yet another 9 percent. Basic IUIDP 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 rectify problems as they are identified: e.g., by revising IUIDP guidelines (see, for example, TKPP, 1989b).

### ***Accomplishments through 1992***

Partly because initial targets were so ambitious, IUIDP implementation faced many difficulties in process (see, for example, IISP, 1994 and Tjahjati, 1990). A particular problem in the early years was that consultants often dominated PJM preparation without providing adequate opportunity for meaningful local involvement. Even 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.

However, efforts were made on a continuous basis to improve IUIDP in process. One example is 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 Bina Marga's effort in shifting virtually all urban road planning into the IUIDP framework. Other noteworthy improvements prior to 1992 include the following points:

1. The MOHA 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 in prior MFSP assessments suggest that local government (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). MOPW 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 continued to improve the effectiveness of the program itself and to gain local acceptance and control. Under the leadership of the IMG, (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 assisted IUIDP Implementation Support Project (IISP) has provided special technical assistance in three cities particularly to enhance local governments' sense of "ownership" of the process.

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

5. Cipta Karya experimented with expanded versions of the IUIDP approach; i.e., to create a broader Integrated Urban Development Program (IUDP). It worked with local leadership on IUDP 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.

#### **Accomplishments 1992-1994**

IUIDP program coverage has continued to expand significantly. By the end of 1993, coordinated investment programs (PJMs) had been completed and approved for financing for areas accounting for 80 percent of the national urban population—up from 56 percent a year earlier (27 percent with pre-IUIDP loan packages and 53 percent with IUIDP loan packages). Planning work was either underway or scheduled for areas, accounting for another 9 percent.

Other achievements during this period include: (1) the preparation of a draft Kepres which would fully incorporate the IUIDP multi-year "rolling" capital programming and budgeting approach into the normal local government budgeting process; (2) the development of improved IUIDP implementation guidelines for the East Java/Bali and Sulawesi/Irian Jaya programs (which can serve as models for the next phases of IUIDP elsewhere); (3) MOHA's preparation of a more advanced LIDAP approach and manual (including the explicit use of performance monitoring indicators) which can serve as a basis for effective institutional development efforts of local governments beyond the IUIDP framework; (4) the development (by MOPW) of simplified PJM methodologies more appropriate for implementation by small and medium-sized cities; (5) the policy decision (incorporated into Repelita VI) to broaden IUIDP into the full IUDP approach with a special emphasis on environmental issues, and securing World Bank Technical Assistance funds to help the GOI implement this policy.

While all of this is impressive, a serious problem remains in the program delivery system. This is shown in Tables 2.1 and 2.2, which present data on the core of the urban investment program from 1986/87 through 1992/93 (1987/88 was the baseline year prior

**Table 2.1**  
**THE URBAN INVESTMENT PROGRAM, 1986/87-1992/93**  
 (Current Rp. in billions)

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93
<b>USE OF FUNDS</b>							
Water Supply	188.6	246.9	241.8	198.9	332.1	351.3	465.4
Flood Preventicn	28.6	103.6	113.1	105.3	41.5	52.7	35.3
Env.San.& Drainage	42.1	72.0	101.0	66.9	96.0	83.1	131.5
Kampung Improvement	23.4	38.8	57.4	52.0	58.4	51.8	64.5
Roads	115.6	146.7	196.5	255.8	186.4	207.2	142.1
Planning	30.2	49.3	54.5	48.8	36.3	44.2	53.7
<b>Total</b>	<b>428.5</b>	<b>657.3</b>	<b>764.3</b>	<b>727.7</b>	<b>750.7</b>	<b>790.3</b>	<b>892.5</b>
<b>SOURCE OF FUNDS</b>							
<b>National</b>							
Cipta Karya	133.8	215.7	208.8	202.0	239.7	318.6	354.0
Other	53.1	185.6	212.6	206.0	136.7	122.7	171.8
<b>Subtotal</b>	<b>186.9</b>	<b>401.3</b>	<b>421.4</b>	<b>408.0</b>	<b>376.4</b>	<b>441.3</b>	<b>525.8</b>
<b>Local</b>							
Domest. Loans	12.1	23.2	64.8	8.5	55.4	53.8	44.4
INPRES	60.5	70.5	72.0	106.8	71.9	65.4	71.1
SDO	4.8	4.2	19.7	2.0	1.2	2.3	1.8
APBD I & II	65.7	75.3	138.8	131.1	85.0	89.8	92.9
PDAM	98.5	82.8	47.6	71.3	160.8	137.7	156.5
<b>Subtotal</b>	<b>241.6</b>	<b>256.0</b>	<b>342.9</b>	<b>319.7</b>	<b>374.3</b>	<b>349.0</b>	<b>366.7</b>
<b>Total</b>	<b>428.5</b>	<b>657.3</b>	<b>764.3</b>	<b>727.7</b>	<b>750.7</b>	<b>790.3</b>	<b>892.5</b>

Source: DGCK

to implementation of MFSP). The data include investment programmed by central agencies as well as funds flowing through the PJM process.<sup>4</sup>

<sup>4</sup>These data are derived from the Policy Action Plan Monitoring Indicators system (BAKD/BAPPENAS/MFPC, 1994). For comparative purposes, data for 1986/87 are shown, as well. The data on these tables include non-wage O&M expenditures, as well as capital investments for the basic needs

**Table 2.2**  
**THE URBAN INVESTMENT PROGRAM, 1986/87-1992/93**  
 (Percent of Total)

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93
<b>USE OF FUNDS</b>							
Water Supply	44.0	37.6	31.6	27.3	44.2	44.5	52.1
Flood Prevention	6.7	15.8	14.8	14.5	5.5	6.7	4.0
Env.San.& Drainage	9.8	11.0	13.2	9.2	12.8	10.5	14.7
Kampung Improvement	5.5	5.9	7.5	7.1	7.8	6.6	7.2
Roads	27.0	22.3	25.7	35.2	24.8	26.2	15.9
Planning	7.0	7.5	7.1	6.7	4.8	5.6	6.0
<b>Total</b>	<b>100.0</b>						
<b>SOURCE OF FUNDS</b>							
<b>National</b>							
Cipta Karya	31.2	32.8	27.3	27.8	31.9	40.3	39.7
Other	12.4	28.2	27.8	28.3	18.2	15.5	19.2
<b>Subtotal</b>	<b>43.6</b>	<b>61.1</b>	<b>55.1</b>	<b>56.1</b>	<b>50.1</b>	<b>55.8</b>	<b>58.9</b>
<b>Local</b>							
Domest. Loans	2.8	3.5	8.5	1.2	7.4	6.8	5.0
INPRES	14.1	10.7	9.4	14.7	9.6	8.3	8.0
SDO	1.1	0.6	2.6	0.3	0.2	0.3	0.2
APBD I & II	15.3	11.5	18.2	18.0	11.3	11.4	10.4
PDAM	23.0	12.6	6.2	9.8	21.4	17.4	17.5
<b>Subtotal</b>	<b>56.4</b>	<b>38.9</b>	<b>44.9</b>	<b>43.9</b>	<b>49.9</b>	<b>44.2</b>	<b>41.1</b>
<b>Total</b>	<b>100.0</b>						

Source: DGCK

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 MFSP), sector investment has increased at an annual compound

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.

rate of about 4.5 percent, which is well below the rate of inflation. As a result, real investment per capita by government has fallen. For example, the data on Table 2.1 imply a drop from Rp.15,900 in 1990/91 to Rp.14,200 in 1992/93 (constant 1992/93 Rupiah). Given continued rapid urban growth, this directly implies further deterioration of environmental conditions in Indonesia's cities and towns.

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 (1991d) and BAPPENAS (1992 and 1994) recognize that public investment levels are falling behind targets. Each of these analyses concludes 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.

It is likely that private and community investment in local infrastructure has been accelerating of late--a very positive trend that should be furthered. Nonetheless, for the public sector contribution to be lagging at this stage represents a serious problem.

**Comment**

Our judgement is that the task of eliminating bottlenecks in the delivery system should be the overall program's (and MFEI's) highest priority in the short term. Recommendations as to how the issue might be approached are offered in Chapter 7.

### Chapter 3

#### **LOCAL RESOURCE MOBILIZATION AND PRIVATE SECTOR PARTICIPATION**

While MFSP is conditioned on achievements under the Policy Action Plan as a whole, USAID support gives special emphasis to implementing policy reforms in the financing of local governments and local capital investment.<sup>5</sup> The Project Paper (USAID/Indonesia, 1988) 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...

In other words, the Program 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. This chapter reviews performance toward these broader goals under Policy 3 which focuses on local resource mobilization and private sector participation. It has four subcomponents:

- Improving the performance and yield of the property tax, local taxes, and local service charges (Policy 3a);
- Improving cost recovery and management of local enterprises (Policy 3b);
- Improving local government financial management capabilities (Policy 3c); and
- Encouraging private-sector participation in the provision of local public services (Policy 3d).

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<sup>5</sup>References that explain the existing system of government finance in Indonesia and issues related to it include: Devas, 1989; Booth, 1989; Kingsley, 1991; Lamb and Binder, 1987; Quigley, 1990; and Shroeder and Binder, 1992. Broader discussion of many of the principles that lie behind the Policy Action Plan in these areas is found in Peterson, et al., 1991a.

As reviewed below, substantial progress has been made in implementing these 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 appropriate institutional mechanisms. Despite the many accomplishments, however, these efforts must still be substantially increased in scale to meet the needs of urban development.

### **IMPROVING PROPERTY TAX AND LOCAL TAX PERFORMANCE (Policy 3a)**

#### ***Background and Overall Performance***

Own source revenues (OSRs) of local governments in Indonesia include fixed shares of the nationally administered property tax (PBB—Pajak Bumi dan Bangunan) and a variety of minor taxes, fees, and user charges along with profits of local public enterprises. Through the 1980s, the yield from such sources in Indonesia was extremely low by international standards. The purpose of this objective was to improve both their administration and their yields.

Overall, this element of the program has been extremely successful, perhaps its most successful. Real per capita own source revenues of Tk. I and II governments grew from Rp.11,000 in 1987/88 to Rp.17,700 in 1991/92 (constant 1992/93 Rp.)—an increase of 60 percent in just four years (see Figure 3.1). PBB revenues grew most rapidly, but other sources in this category saw substantial increases as well. In addition, the share of OSRs from the PBB and user charges (the truly progressive sources in the OSR package) grew from 39 percent in 1987/88 to 47 percent in 1991/92. These changes are primarily due to major national efforts to improve OSR administration.

#### ***Accomplishments through 1992***

The PBB is a central government tax implemented with local government cooperation as the billing agent. Until recently, approximately 65 percent of revenues collected were returned to Tk. II governments on the basis of origin—the rest being shared with Tk. I governments (14 percent) or retained by central authorities. Improvements actually began in 1986 when the PBB base was broadened by reducing exemptions and the base was changed from rental to capital value.

Substantial yield enhancements only occurred, however, after administrative improvements were introduced. These included: (1) implementing an automated information system (SISMIOP) that offers improved procedures for assigning tax object identification numbers; (2) adopting a self-declaration system (pilot testing showed 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); (3) adopting a Payment Point System (SISTEP) involving banks as the primary collection agents (letters inform taxpayers that they must make their payments at only one location—Payment Point—in their community and a

common due date is established for all taxpayers); (4) simplification and regular updating of valuation procedures; and (5) giving focus in valuation and collection efforts to high-value properties.

Almost all of these innovations were pilot tested by mid-1989 (see HIID, 1989 and 1990). Broader implementation was largely confined to Jakarta and Surabaya through 1990, but efforts expanded to Indonesia's next 10 largest cities in 1991 and 1992. By then, implementation was complete or well underway in cities accounting for at least half of the nation's urban population.

Improvements to municipal collection of other OSRs 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. Rationalization may also include eliminating taxes or fees where potential revenue yields are likely to remain too small to justify the cost of administration. By 1992 the MAPATDA system had been introduced in all Tk. II governments and local revenue collection was climbing steeply. For example, in nine Tk. II governments sampled in North Sumatra, own-source revenue increases ranged from 19 to 96 percent (these increases, of course, were from an extremely low base).

#### ***Accomplishments, 1992-1994***

During this period, PBB administrative reforms were implemented in more localities (for example, the payment point system is now in effect in all Tk. II governments) and MAPATDA was further strengthened with additional computer systems support as well as training and technical assistance. Additional guidelines and policy clarifications have also been prepared—including full manuals for the preparation of RIAPs by MOHA.

And yields have continued to grow; for example, total PBB revenues increased nominally by 58 percent from Rp. 942.4 billion in 1991/92 to reach Rp. 1.49 trillion in 1993/94. Even though absolute levels continue to rise, the real growth rate in total OSRs is declining, however (dropping from a peak of 24 percent in 1989/90 to about 5 percent in 1991/92). As BAPPENAS (1994) suggests, this may mean that after the impressive performance of the past several years, gains from administrative improvements alone are becoming harder to achieve—a reconsideration of rates may be needed as well to sustain high levels of performance (see Comments below).

Three other recent legal/regulatory changes, however, should give local revenues a substantial boost over the next few years: (1) a revision of the PBB distribution formula (Kepmen Keuangan 83/KMK.04/1994) such that, beginning in 1994/95, the 10 percent share formerly retained by the central government will be redistributed to the Tk. I and II levels via block rebates; (2) the 1992/1993 implementation of Kepmen Dagri 30/1991, which will assign a 50 percent share of the motor vehicle tax and motor vehicle transfer tax to Tk.

II governments; and (3) the de-linking of a draft law to further rationalize local taxes and user charges from a broader (and more controversial) draft law on central-local fiscal relations, which should facilitate passage of the former.

### **Comments**

The opportunity for further OSR gains from administrative improvements has not been exhausted. An extremely important finding (Rosengard, 1993), is that there is tremendous variation in the skill and entrepreneurialism exhibited by local governments toward this end. The study found some important variations by city size. For example: (1) large cities (over one million population) derive almost half of their total revenue (47 percent) from local sources, significantly more than the 22 percent for small cities (less than 200,000 population); (2) PBB generates about 10 percent of the total for large and medium cities but only 3.8 percent for small cities; (3) the share accounted for other local taxes is 15.2 percent for large cities, 10.8 percent for medium-size cities, and 4.0 percent for small cities.

More striking, however, is that the study found enormous variations among cities in the same size class. For example, among large cities, Surabaya generated 50 percent more local revenue per capita than Bandung. In the medium-size category, Cirebon generated 74 percent more than Tegal. This suggests there are important additional gains to be derived from assisting urban areas where performance to date has been low.

Nonetheless, administrative improvements alone do have limits and the potential exists for much more substantial gains, particularly through the PBB. Total PBB collections are still very modest—Rp.4,500 (about \$2) 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 that are 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. The PBB is a progressive tax in the Indonesian context, a buoyant tax, and one that is now well administered. 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 0.5 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.

### **IMPROVING LOCAL SERVICE COST RECOVERY AND LOCAL ENTERPRISE MANAGEMENT (Policy 3b)**

#### ***Background and Overall Performance***

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 assigned priority in urban sector investment to water system expansion, and also to financial and institutional re-structuring of water authorities. In the 1980s most local water authorities (BPAMs) were managed by the central government (MOPW). Policy called for the BPAMs to improve their finances to the break-even point, at which time they are to be converted to independent public water companies (PDAMs). 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.

Overall, we judge this performance in this area to be successful, although perhaps not in the way originally envisioned. Given studies (prominently by MFPC) the sector is now much better understood. The number of conversions to PDAM status has been substantial and there is no doubt that user charges have increased and PDAMs are increasingly being operated in a more businesslike and financially responsible manner. However, the studies have identified that many PDAMs do face serious financial problems in the near term. Accomplishments here have not yet created a financially sound and self-sustaining local water supply sector (and were not intended to at this point), but they have created some important performance improvements and provided essential information that should force the GOI to assist the sector in taking the sometimes harsh steps that may be needed to attain this goal in the future.

### **Accomplishments through 1992**

At the start of MFSP, studies were undertaken to help develop realistic new tariff structures for BPAMs. These were endorsed by a Ministry of Home Affairs decree (Pemendagri 690-536 of June 1988) and guidelines were promulgated on improved accounting systems. Substantial increases in cost recovery were attained in some cities that have implemented the new tariffs, although many have yet to do so.

Efforts to improve cost recovery by PDAMs continued over 1989/90 but with mixed results. A preliminary analysis of performance in 30 PDAMs was completed and, in these cases, problems were identified and action plans for corrective actions were prepared. The studies indicated that some PDAMs had substantially increased revenue, but many others had still not implemented new tariff structures (often being held back because they have not received formal approval from local officials as is now required). Also, capacity problems had been evidenced in implementing recommended management systems. Studies were undertaken to promote further strengthening (for example, in applying the financial management guidelines developed by the USAID sponsored Water and Sanitation for Health (WASH) Project—see McCullough and Walker, 1990).

### **Accomplishments, 1992-1994**

There has been a notable achievement in decentralization of late through the conversion of BPAMs to PDAM status: since 1992, 99 BPAMs have so converted—only 17 of the 293 all local water authorities nationally remain as BPAMs.

Reliable and comprehensive information on PDAM user charge increases and financial performance are still not available. Some useful evidence was compiled, however, in a study of the sector by the Municipal Finance Project (1992). For a sample of 14 PDAMs that have substantial borrowing, it showed that real revenues for these PDAMs rose at an average annual rate of 2.6 percent between 1984/85 and 1990/91. The study concluded that 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.

Several additional actions have been taken to encourage further PDAM performance improvement. These include: (1) the signing of Kepmen Dagri 690.000-327 which requires annual PDAM self-assessment of financial performance using a standard methodology (and reporting to MOHA); (2) the initiation of a new PDAM Financial Performance Training Program; (3) the strengthening of PDAM monitoring and support capacities of Cipta Karya regional offices; and (4) a joint MOF/MOHA study of methodologies to more quickly and reliably identify problem of PDAMs.

Outside of the water sector, not a great deal is known about the finances of other municipal enterprises (BUMDs—Badan Usaha Milik Daerah). 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. In mid-1994, MOHA initiated a more complete study of BUMDs to identify financial performance indicators for self-assessment and reporting purposes.

#### ***Comment***

Accomplishments in this area have been impressive, but it should be recognized that many PDAMs remain in very fragile circumstances financially (particularly those converted from BPAM status of late). As the burdens of PDAM debt payment have become more apparent, there should 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, 1991e). New guidelines may be called for to place the sector on a financially self-sustaining basis. Studies for non-PDAM BUMDs should form the basis of an action program to help localities decide which of them should be restructured, privatized, and/or liquidated and how best to implement such programs.

### **IMPROVING LOCAL GOVERNMENT FINANCIAL MANAGEMENT (Policy 3c)**

#### ***Background and Overall Performance***

Computer-based financial management and accounting systems (covering all sources of revenue, and capital, as well as routine expenditures) are essential to enhancing local government capacity today. When properly designed, they can form the core for broader planning and management control of municipal activities. This element of the Policy Action Plan focuses on the design and implementation of such systems at the local and central levels. This evaluation indicates that various GOI agencies have put considerable effort into systems development, and that substantial progress has been made. Still, there has been confusion and redundancy along the way and further efforts are required to coordinate and simplify systems established so far and to promote implementation in more urban areas.

#### ***Accomplishments through 1992***

Several systems supporting this objective have been developed and implemented at various locations. 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 has been developed to handle financial monitoring under IUIDP. POMMS is a budgeting and

management system that focuses on infrastructure operations and maintenance. SAPA is a local government accounting package.

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. Also, at the national level, SIKD has been developed for the MOHA to track local finances, as well as a number of other variables on local conditions.

An important step toward coordinating these efforts was taken in late 1990. The Municipal Finance Project 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.

#### ***Accomplishments, 1992-1994***

After some delay in mobilization, steps have been taken to follow up on the recommendations of the seminar. First, a Central Technical Unit has been established in PUOD/MOHA to 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. An initial effort to revise SAPA to create a consistent chart of accounts for all system packages did not meet expectations, but more work in this area is underway.

Also MOF and MOHA continue to collaborate in the effort to harmonize the collecting of local financial data to be used in national level monitoring and analysis (also with MFPC assistance).

While these efforts are underway, several of the individual systems are being implemented more broadly and, interviews suggest, they are assisting in local management and performance improvement efforts. Since 1992, POMMS has been implemented in all cities participating in the East Java/Bali urban development program and in five provincial capitals in Sulawesi. PFAM also has been implemented for all East Java/Bali program participants (45 TK. II governments as well as in central units in both Provinces). PAFPACK has been implemented in 5 Provincial governments, 10 Kotamadya, and 3 Kabupaten.

## **PRIVATE SECTOR PARTICIPATION IN URBAN SERVICES (Policy 3d)**

### ***Background***

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 was registered over the project period in not only the number of public-private partnerships but also in the attitude of the GOI and local governments towards promoting public-private partnerships.

### ***Accomplishments through 1992***

A large number of local experiments got 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 invested \$15 million, and the PDAM contributed about \$9 million. A large (\$125 million) bulk water supply Build-Operate-Transfer project at Umbulan Springs, East Java, continues in negotiation. The Salim Group of Singapore and Singapore's Public Utilities Board signed an agreement with the government to joint venture a \$480 million water supply project in Bintan Islands, with Riau Province and the local PDAM as partners. A 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, 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 were licensed by local government.

Septic tank de-sludging was another urban service scheduled for privatization 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, 1993).

Municipalities also became co-investors with private companies in local development projects. Surabaya's Proyek Supatman scheme actively solicited private-sector matching funds for infrastructure projects that benefitted the private sector. Many large cities are in some stage of negotiation regarding for-profit joint venture projects.

#### ***Accomplishments, 1992-1994***

Public investment in urban infrastructure has traditionally been underfunded in Indonesia. The World Bank reports that Indonesia allocates a little less than 4 percent of total yearly public development expenditures for urban infrastructure or about \$7 per urban resident (the amount includes investment in urban roads which represents about 42 percent of total investment). Given the attention to successful public-private partnerships over the last four years, numerous local governments have initiated partnerships with private firms to deliver services and help alleviate the backlog of infrastructure needs. Some more recent examples of centrally-initiated projects include: a demonstration project of the P.T. Wira Gulfindo Sarana Transfer Station in Jakarta; a Cibinong Hazardous Landfill Project (BOO) in West Java; a Cikarang Listrindo Power Plant project (BOO) in West Java; a power plant in industrial estates in Bekasi; a Palton One Power project (BOT) in East Java; and a pilot project ESI Hybractor in East Java.

One of the primary obstacles in Indonesia to the implementation of public-private partnerships has been an inadequate legal/regulatory framework regarding Build Operate and Transfer (BOT), Build Operate and Own (BOO), and joint public/private ventures. In addition, other obstacles to successful implementation of the public-private partnerships include:

- municipal reluctance to enter into what are perceived as difficult and time-consuming contracts with private firms when financing is available from traditional multilateral and bilateral donors;
- consumer preference for alternative, lower-cost urban infrastructure systems; and
- lack of local institutional capacity to enter into public-partnerships.

With the signing of the Project Agreement (September 1991) for the PURSE project the GOI committed itself to further lowering the barriers to private participation in the delivery of urban services. The PURSE project directed its early effort to cataloging and identifying legal and regulatory constraints to implementing public-private partnerships (PURSE, 1994a). This initial study identified regulatory constraints to implementation of public/private partnerships and suggested ways to alleviate the current bottlenecks to information for the

process of entering public-private partnerships.<sup>6</sup> Additionally, an interministerial project steering committee agreed to pursue a two-pronged strategy towards promoting private participation in the delivery of municipal services by combining legal and regulatory reform initiatives with demonstration project development. By utilizing this approach, the GOI identified eight demonstration projects using mutually agreed upon selection criteria. Field work has already been completed in all eight sites. With these initial steps in place, the PURSE project is well positioned to further promote the implementation of successful public-private partnerships.

To date, no reliable baseline exists against which to measure the number of private ventures in urban services. However, based on anecdotal evidence it is virtually certain that the number is rapidly accelerating especially in local contract services such as bill collection, system repair, and new facility design and construction. Coupled with the high level of demand for urban services and the PURSE initiatives in promoting public-private partnerships, the MFSP has gone far to achieve one important goal of the project: "improving long-term, sustainable employment and income opportunities through means which promote efficiency and productivity" (USAID/Indonesia, 1988).

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<sup>6</sup>These include priorities for policy reform by directing technical assistance to: 1) risk management strategy development, 2) setting environmental and performance standards, and 3) tendering regulations and guidelines on the competitive bidding process and contract administration.

*Chapter 4*

**CREDIT FINANCE AND  
INTERGOVERNMENTAL GRANTS**

The methods of resource mobilization discussed in Chapter 3 are important but alone incapable of generating the increases in local resources needed to meet the requirements of rapid urban growth. Objectives under Policy 4 relate to more substantial means of local resource mobilization and more equity in resource objectives. Objectives are:

- To provide a viable system of credit finance for local governments (Policy 4a);
- To modify grant allocation criteria so that the grant structure more directly supports sector policy objectives (Policy 4b); and
- To utilize the system of central-local grant funds to address poverty alleviation (Policy 4c).

**PROVIDE A VIABLE SYSTEM OF CREDIT FINANCE (Policy 4a)**

***Background and Overall Performance***

Through the mid-1980s local borrowing experience in Indonesia was negligible. Yet in developed countries, reliance on credit for local capital development is dominant. Loans have an important leveraging effect, permitting localities to make much larger investments in any given year than that year's budget could support because they can defer payments over a multi-year period (since major capital investments yield benefits over many years, financing them out of today's revenues in fact puts an unreasonable burden on today's taxpayers).

Therefore, one of the principal policy objectives of MFSP 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.<sup>7</sup>

A key objective sought under this Policy was achieved in 1992 by the GOI's formal establishment of a consolidated loan fund—the Regional Development Account—that is positioned to increase the volume of municipal credit and serve as a transition vehicle to eventual borrowing from the domestic private credit market. Because the idea represented a major break with past traditions, reaching this point was extremely difficult—USAID deserves substantial credit for giving the issue continued emphasis in its policy dialogues.

The 1992 Interim Evaluation noted some important weaknesses in the structure and operation of the RDA that could limit its effectiveness in achieving the longer term goals of credit system expansion. Since then, the GOI (with USAID support under the MFPC) has begun serious study to address those weaknesses and it has markedly expanded the volume of RDA loan disbursements. We judge progress under this Policy to be one of the most notable successes of MFSP, even though the longer-term objective still remains quite vulnerable. Actions to follow through on further institutional reform in this area warrant a very high priority under MFEI.

#### ***Accomplishments through 1992***

Procedures for operating the Regional Development Account were established by decree of the Minister of Finance on Sept. 30, 1991.<sup>8</sup> On January 31, 1992 an operations manual was promulgated (Ministry of Finance, 1992). 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, it establishes a positive real interest rate. It is based on the average inflation rate for the past three years (8 percent) plus an amount to cover risk and administrative costs (3.5 percent). Formalization of the RDA fully satisfied the sub-objective of creating a consolidated municipal loan fund, as specified in the Policy Action Plan.

As established in 1991/92, 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 GOI, foreign loans or grants, and payment of interest and principal on past borrowings. Loans can be made to either general-purpose Tk. I and II governments or the corresponding regional enterprises (BUMDs). However, loans must in general be used to finance income-producing activities, and cannot exceed 75 percent of project cost.

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<sup>7</sup>For further background information on these issues see Bastin, 1990; Devas, 1989; Municipal Finance Project, 1991e; Peterson et al., 1990, and the World Bank, 1991d.

<sup>8</sup>Though not formalized by ministerial decree until 1991, the RDA actually was created earlier as a special account at Bank Indonesia. It is administered by the MOF's Directorate of Subsidiary Loan Management which also has administered highly subsidized loans to local governments.

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 1992 Operations Manual states that the grace period is to be limited to principal payments. 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.

In addition to assistance in developing the RDA, MFPC had also supported other credit initiatives before 1992, such as efforts by Surabaya authorities to familiarize themselves with the U.S. municipal bond market, with the possibility that the city will issue municipal bonds directly at a future date.

While these accomplishments were viewed as important, the MFSP Interim Evaluation, as noted, did raise a number of concerns about the future of the RDA. These concerns included: (1) the possibility of cumbersome, government-influenced loan appraisals that could prevent RDA from becoming a quick-disbursing loan facility as needed to support decentralization; (2) political pressures to back away from the RDA's policy of uniform interest rates; (3) ambiguity concerning how forcefully RDA will enforce debt repayment obligations (clear penalties and enforcement mechanisms did not yet exist); and (4) problems associated with the lack of a clear plan for future RDA capitalization and RDA's current dependence on the GOI budget process. (Even so, the Evaluation concluded that "Despite the uncertainties, the RDA probably represents the best base in Indonesia on which to build a municipal credit system.")

#### ***Accomplishments, 1992-1994***

The most important clear accomplishment since 1992 is the GOI's substantial increase in loan disbursements to local governments and enterprises. The total of such disbursements grew by 52 percent from 1989/90 to 1992/93 (from Rp.168.7 billion to Rp.257.1 billion (see Lee, 1994). More important is that RDA disbursements accounted for the bulk of that increase—more than tripling over the same period (from Rp.26.0 billion to Rp.88.1 billion) while the older more subsidized GOI lending mechanisms (SLA and RDI) remained relatively stable. RDA disbursements were particularly noteworthy over the last year in this series (increasing by 84 percent in that year alone).

Rosengard (1994) notes that as of March 1994, RDA commitments totalled Rp.645 billion, comprising 155 borrowers and 256 loan agreements. Loans for clean water investments dominate the portfolio, whether in terms of value (71 percent), borrowers (40 percent) or loan agreements (48 percent).

Secondly, and probably more important in the long run, is that GOI/USAID policy dialogues are taking seriously the need for institutional and operating reforms of the RDA itself. A study of possible directions for change (Johnson, 1994) has been completed and high level reviews of its recommendations are underway. A major theme is the transition of the RDA from serving only as a conduit central government funds to becoming a true

financial intermediary whose operation is more autonomous is, thereby enabling it to raise funds from private capital markets. As summarized by Rosengard (1994), a sequence of changes may be called for, including:

- *Immediate actions:* change the annual RDA budget allocations from a project/tranche-based system to a general RDA block grant capitalization allocation; prohibit delinquent borrowers from receiving new loans; implement more effective management information systems; make a clear policy commitment to transform RDA into a financial intermediary.
- *In the medium term:* prepare a strategic plan for institutional development; market RDA more actively to potential borrowers and provide technical assistance to them to improve project quality and debt management capacity.
- *In the longer term:* implement final institutional changes and diversify RDA's capital base.

Thirdly, several other steps were taken in the interim to enhance the RDA. These included: developing and issuing a more simplified Borrower's Manual; securing an agreement by the Asian Development Bank to channel \$5 million from the Eastern Islands Urban Development Project through the RDA; conducting exploratory talks with the World Bank on channelling part of its Water Sector loan through the RDA; securing approval in principle by the Asian Development Bank for a \$600,000 grant to develop a facility to assist local authorities prepare feasibility studies for projects to be funded by RDA; and holding RDA interest rates constant as commercial lending rates declined (thereby, narrowing the differential).

Finally, MFPC has also supported another conclusion of the Interim Evaluation: "There is no reason for RDA to have a monopoly on municipal lending . . . USAID should continue to support other initiatives 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". Building off of its U.S. tour to expose Indonesian officials to the operation of municipal bond markets, MFPC designed and implemented a major nationwide conference on bond financing in 1993 (Municipal Finance Project, 1993). Since then, an interministerial working group to review barriers to, and options, for the issuance of municipal bonds has been established under TKPP/IMG auspices, and an MFPC supported short term advisory mission was fielded in August 1994 to help the group develop concrete recommendations.

As a part of this mission, experts made presentations at a major MFPC supported interministerial conference directed at developing an Action Plan for issuing municipal bonds. Key conclusions of the conference were that local government bonds are now viable to address some debt-financing needs of many local borrowers and capital market requirements of institutional investors.

### **Comment**

The development of a market-oriented credit system for municipal infrastructure finance is one of the most important, if not the most important measure, that remains to be achieved in Indonesia's urban policy agenda. While important initial steps have been taken, this theme again deserves to be one of the highest priorities for further GOI/USAID support and attention under MFEI. This point is discussed further in Chapter 7.

## **REFORM OF CENTRAL GOVERNMENT GRANT POLICY AND CENTRAL-LOCAL FISCAL RELATIONS (Policy 4b)**

### ***Background and Overall Performance***

The second objective under this Policy is to increase local discretion over the use of central government grant funds for urban development. Only a small portion of all central grants have been transferred in the form of block-grants that can be programmed by local officials based on their own assessments of priorities. It was reasoned that local governments have much stronger incentives than the center to apply funds efficiently in response real local priorities, thus higher cost-benefit ratios would be achieved if they could control a larger share of grant investment. Also, experience in other countries suggests that residents are more likely to be willing to pay more for services if they have more choice about what services to buy and how they should be delivered.

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. In general there has been considerable progress made towards achieving these goals.

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. Through 1992, however, these measures had not been seriously addressed.

The Interim Evaluation regarded the lack of concrete progress in this area as one of the program's "major disappointments". Since 1992, we judge that there has been a positive change in direction. The numbers do not yet reflect a marked alteration of past trends (i.e., a truly substantial increase in the share of grant funds over which localities have full discretion), but several GOI actions have helped to lay the groundwork for a more sizeable

change and demonstrate a stronger GOI commitment to that objective than has been evidenced in the past.

### **Accomplishments through 1992**

From the start of MFSP through 1992, the central/local mix of urban sector investment financing 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 over the prior 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. Cipta Karya direct spending rose substantially as a share of the urban investment program over the 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—the reverse of the trend sought by the Project Paper and Policy Action Plan.

### **Accomplishments 1992-1994**

Recent budget decisions that indicate a more positive trend in this area follow:

1. Although the INPRES grants as a proportion of total capital transfers from central to local government grew only modestly from 1990/91 to 1993/94 (from 20.0 percent to 22.3 percent), the absolute amount of the INPRES allocation more than doubled over the same period (from Rp.2.2 trillion to Rp.4.8 trillion). The implied percentage increase was substantially higher for INPRES (218 percent) than for central DIPs (189 percent).
2. The total of SDO plus INPRES allocations grew from Rp.6.3 trillion to Rp.10.7 trillion (an increase of 70 percent), implying substantial growth in the total level of resources over which local governments have a large amount of discretion.
3. The share of total SDO and INPRES allocated to the Tk. II level increased from 44.5 percent in 1990/91 to 52.7 percent in 1993/94 and is budgeted to go up to 57.1 percent in 1994/95.
4. The recently developed INPRES Perkotaan which provides discretionary support for urban development planning and programming activities by Tk. II governments increased from Rp. 38 billion in 1992/93 to Rp.54 billion in 1994/95.

5. The GOI has combined some previous categorical INPRES grants into INPRES block grants (INPRES Dati I and II) where local governments have broad discretion over spending decisions. The share of all grants (SDO plus INPRES) where such discretion exists increased from 20.0 percent in 1990/91 to 25.1 percent in 1994/95.

6. There are other sizeable INPRES accounts (for example, that for road development) in which the GOI still requires that funds be spent in the specified sector only, but full discretion has been turned over to local governments on project selection within the sector. Such accounts increased from 30.5 percent of total grants in 1990/91 to 38.1 percent in 1993/94.

Ironically, despite external donors' policy support for decentralization and grant flexibility, they have channeled their funds primarily through direct central-government spending. This remains a problem even for USAID. To address the issue, the Interim Evaluation recommended that a new requirement be added to the MFEI such that expenditures would not be credited against HGL investment targets unless they were a part of locally designed and approved PJM. This suggestion has not yet been implemented.

#### **Comment**

Progress is being made in this area, but continued pressure for more change should be applied in the MFEI 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 much more substantially, 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.

### **INFRASTRUCTURE AND POVERTY ALLEVIATION (Policy 4c)**

#### **Background and Overall Performance**

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, TKPP has not yet developed a complete and well focused program to implement this component of the Policy Action Plan.

One of the reasons for the lack of program action may be that there has been a dearth of information regarding the degree of poverty targeting in current sector programs. The Interim Evaluation of MFSP recognized that no progress had been made in this area through 1992 and recommended data gathering and analysis early in the next phase of the program.

#### ***Accomplishments, 1992-1994***

In response to Evaluation comments, USAID and the GOI have taken two steps. First a study of the possibilities for monitoring beneficiary impacts was undertaken (Gardiner and Gardiner, 1993). This was a thorough review of the options. It laid out several methodologies but recognized that there remain many difficult conceptual and methodological issues to be resolved in mounting full beneficiary assessments and showed that such studies would be expensive. The report also recommended further exploration of an approach analyzing PJM investment targets to subareas within cities related to poverty status.

A second study (Kingsley 1993) examined the subarea approach in more depth and found it unworkable (recent research showed more income mixing even in quite small urban neighborhoods than had generally been anticipated). The report, however, endorsed, an analysis of SUSENAS data as recommended by the Gardiners and the exploration of full beneficiary studies but using a smaller sample than presented in the Gardiners' trial estimates. It also encouraged more intensive analysis of the new "demand studies" being required for PJM preparation as a basis for program targeting.

This report also reviewed the current process for certifying the eligibility of program expenditures under HG income targeting criteria. It found that the current procedure is generally reasonable in line with program targeting objectives, but recommended that, to assure even greater safety factors, sector eligibility percentages be tightened in two areas (see further discussion in Chapter 6). The tightening of eligibility was adopted by GOI and USAID for MFA generally in accord with these recommendations. Another report (Taylor, 1993) examined the process for preparing the Investment Plan and accounting for investments in some detail (again, see further discussion in Chapter 6).

More broadly, the GOI has given much more attention to the issue of eradicating poverty in Repelita VI. A program (INPRES Desa Tertinggal) has been developed to focus additional resources on poverty alleviation in the poorest Desas (urban and rural) throughout Indonesia.

#### ***Comment***

These efforts indicate stronger focus on this issue than had been exhibited before. One study has used demand survey data to support income targeting in PJM preparation. However, the practice has not been broadly applied. Further, funding has not been made available to date either for the recommended SUSENAS analysis or more complete beneficiary survey techniques. These approaches should be supported under MFEI.

*Chapter 5*

**LOCAL CAPACITY BUILDING  
AND PROGRAM COORDINATION**

Even with improved delegation of authority to local governments and significant enhancement of their resources, the long-term goals of the Policy Action Plan could not be achieved without special efforts devoted to institutional development. The last two Policies in the agenda stress capacity building and institutional change at both the local and the central levels.

**STRENGTHENING LOCAL GOVERNMENT CAPACITY (Policy 5)**

***Background and Overall Performance***

Consistent with Policy 5, the Plan's objectives 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.

Progress in this area was quite slow through 1991 and it was also regarded as one of the Program's "major disappointments" in the 1992 Interim Evaluation. Some very impressive steps have been taken in this field, however, over the past two years. Two of these steps—a truly massive re-assignment of central employees to work for local governments, and a major expansion of skill training for local government employees—represent probably the most significant contributions to local capacity building since the program began. Others (like the beginning of a new urban management training program) are promising, but require considerably more development before needed results are delivered. Overall, we judge that the GOI is now addressing this Policy area realistically and with adequate force.

***Accomplishments through 1992***

This element of the Program had a promising starting point in the preparation of the Urban Institutional and Manpower Development Study (UIMDS—P.T. Hasfarm Dian

Konsultan and DHV Consulting Engineers, 1988). One of this effort's 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. It recognized that considerable time would 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.

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. Over the 1988-1992 period, substantial training had been offered under various elements of the program: e.g., for IUIDP. Some of the courses were reported to be effective, but the results were never documented or evaluated and it was clear that they did not add up to a comprehensive indigenous system for training local officials that Indonesia's urbanization challenge demanded.

By 1992, a collaborative effort by advisory teams of the Municipal Finance Project Contract and the IUIDP Implementation Support Project had begun to address this issue (Municipal Finance Project, 1992d). They prepared an inventory of all relevant domestic training programs currently available for local officials and used that as a basis for discussions with all sub-agencies participating in IMG. 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 would be required, and that it should focus on building capacity in *urban management*. An initial design for such a program had been prepared but not yet approved for implementation.

One important support for local capacity building that had begun by 1992 was civil service reform. 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. Ultimately those biases must be eliminated if the program is to succeed.

The reform program (as described in the World Bank, 1991) 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 Apparatus—MENPAN) 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, should eliminate that bias.

#### **Accomplishments, 1992-1994**

1. As noted earlier, a notable contribution to local capacity building since 1992 was the massive increase in the assignment of central government employees to Tk. I and II levels. The number of professional civil servants (defined as Golong an III and IV) under the jurisdiction of the Ministries of Home Affairs and Public Works assigned to work for regional and local governments more than doubled from 1991/92 to 1993/94 (growing from 54,700 to 132,800).

2. The urban management training program noted above is now being implemented. A TKPP working group on urban management training was established, program plans have been agreed to, a National Training Coordinator has been hired and training materials have been developed (and trainers trained) for the initial Urban Management "Core Course," which will be pilot tested in late 1994. The Core Course will offer materials on *strategic management* intended primarily for Walikota and other Tk. II top management teams (assessing conditions and potentials oties, setting priorities, allocating resources, organizing and motivating staff, and monitoring results).

3. While this urban management training program is being developed, the GOI has already dramatically expanded the skill training it offers that is relevant to the needs of local government officials. The total number of training days offered in these categories grew from 147,000 in 1992/93 to 213,000 in 1993/94—a 45 percent increase in just one year (see further discussion in BAKD/BAPPENAS/MFPC, 1994). One particularly relevant offering was a training program for 1,200 development planners from BAPPEDA Tk. II in regional analysis, planning, budgeting, and development management—this program is to be expanded under Repelita VI.

4. Recognizing that local governments can learn from each other, whether by sharing experiences within Indonesia or by formal twinning with cities in other countries, the MOHA plans to implement a "city sharing program" and has already supported individual initiatives along these lines. Momentum for this program should accelerate given the experiences of other countries implementing city sharing programs (most notably in the Philippines).

5. An "Urban Management Forum" of universities offering courses in urban planning and management was initiated and formalized as a recurring event (ITB/Bandung will serve as Secretariat). In addition, the university training program for local government finance officers was extended to include the universities of UNHAS (Ujung Padang) and UGM (JYogyakarta) in addition to the ongoing program at UI (Jakarta).

6. Although progress has been far from rapid, civil service reform does appear to be proceeding in line with original concepts as noted above.

#### ***Comment***

One theme that warrants more emphasis in local capacity building is developing a stronger role for local leadership in guiding and directing the program. The MOHA sharing program concept moves in this direction. Other countries have found that often the most powerful means of motivating most Mayors to become more entrepreneurial forceful leaders and teaching them effective approaches to urban management is to have them learn directly from other Mayors who are known as successful in these fields (see, for example, discussion of the effects of the USAID supported sharing program in the Philippines in Kingsley et al, 1994). One approach may be to strengthen and encourage a more active role for the Association of Mayors (BKS-AKSJ)—give it support but let it find its own course of action. The Mayors should come to feel that, among many players in the field, they are the ones that truly "own" the urban development process and are responsible for it. If training and other capacity building activities do not become "demand-driven" they may well prove ineffective. Further ideas for developing this theme are offered in Chapter 7.

### **CENTRAL SECTOR PLANNING AND COORDINATION (Policy 6)**

#### ***Background and Overall Performance***

The Program's last policy (Policy 6) addresses the need to strengthen central coordination and consultation in the urban development sector. This required: (a) establishing an institutional arrangement for effective program coordination at the central level; (b) active processes to plan and manage the policy change agenda; and (c) the establishment, and serious use, of systems to monitor performance.

In the view of this evaluation, this has been a quite successful component of the program. The most basic step under this policy was the 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 some decline in the activity of TKPP and the pace of policy reform by 1990. Since 1991, however, overall program momentum has been regained, particularly over the past two years. This culminated last year in a major review of Indonesia's urban policy which resulted in strong and explicit endorsement of MFSP Policy Action Plan themes in the nation's new development plan (Repelita VI).

### **Accomplishments through 1992**

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 IMG, established to support of TKPP in IUIDP implementation, was strengthened through clarification of responsibilities and the establishment of regular meeting schedules.

Also, after some delays in 1989/90, technical assistance teams funded under the UNCHS-administered IUIDP Implementation Support Project and USAID'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 to that point was the initial planning for a coordinated capacity building program in urban management discussed above.

Review and planning activities related to the Policy Action Plan also picked up after 1990. 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* (BAPPENAS, 1992) was submitted in March 1992. This report contained a thorough and frank review of both progress and problems, and laid out ideas for future work in urban policy in some detail.

Another notable improvement was in the area of performance monitoring. 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. An important response to this problem was the Municipal Finance Project's effort (1991h) to develop and report on a set of statistical indicators tracking 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.

### **Accomplishments 1992-1994**

Efforts by those involved with TKPP and IMG have been particularly impressive over the past two years in strengthening program management capacity and securing a strongly supportive environment for Policy Action Plan themes at the highest policy levels in the GOI. The most noteworthy accomplishments were:

- Preparing materials for Repelita VI which, as noted above, gives much more prominence to the challenge of urban management in national development and to the themes endorsed in the Policy Action Plan. An active process of inter-departmental coordination meetings and consultations with Tk. I leaders did much to improve the quality of the plan.

- The preparation of the *Progress and Prospects Report* (BAPPENAS 1994) contains a thorough and frank review of program accomplishments and firmly endorses the GOI's continued support for the Policy Action Plan.

- The creation of new units in key Ministries explicitly responsible for urban development and management functions: the Bureau for Urban Development, Human Settlements, and Spatial Planning at BAPPENAS; the Directorate for Urban Administration in PUOD/MOHA; a new urban division in the Bureau for Regional Financial Analysis at MOF; an Urban Management Training Unit as a part of MOHA's training directorate (Badan Diklat).

- The reorganization of the Directorate General Cipta Karya in the MOPW along regional rather than sectoral lines (this is an extremely important change that should do much to further appropriately balanced multi-sectoral planning and to simplify contact points for local officials).

- The continued successful operation of the Urban Policy Action Plan Monitoring Indicators analysis and reporting system, and its transition from an independent activity of MFPC to one now conducted jointly by BAKD/MOF, the new Urban Development Bureau at BAPPENAS, and MFPC.

- Preparing a proposal to create a permanent government-staffed Urban Secretariat in BAPPENAS) to support continued operation of TKPP and IMG (these groups have had to depend on donor-supported consultants for staff work in the past).

- The proposal to create a new public-private Urban and Regional Development Institute (URDI)—an independent think-tank that would act as a coordinating umbrella for research and policy analysis and as a forum for open exchange between key actors in the urban development process.

- Following recommendations in the Interim Evaluation, USAID supported the strengthened organizational focus of the program by, for the first time, assigning one of the

**MFPC long term advisors to BAPPENAS and by including BAPPENAS in a more prominent role in the MFPC counterpart team.**

*Chapter 6*

**THE INVESTMENT PLAN, LOG-FRAME  
ASSESSMENT, PROGRAM ADMINISTRATION,  
AND WOMEN IN DEVELOPMENT**

This chapter presents findings on topics outside of the Policy Action Plan which are also a basis for evaluating MFSP progress and achievements: (1) the extent to which the GOI has complied with the HGL investment plan requirement; (2) the level of achievement of measures specified in the Project Paper's Log-Frame Matrix and response to recommendations in the Interim Evaluation; (3) how well the program has been administered by USAID; and (4) the contribution MFSP has made to the role of women in development.

**THE HGL INVESTMENT PLAN**

As noted in Chapter 1, the MFSP agreement requires that the GOI invest the local currency equivalent of all HGL funds received (a total of \$120 million) in shelter-related infrastructure improvements suitable for households whose incomes are below the national urban median (this requirement is specified and explained in Section 5 and Annex 5 of the Project Paper, USAID/Indonesia, 1988). Under this requirement, the GOI has regularly submitted plans to USAID showing how it proposed to allocate these resources and then compiled reports on investments actually made after the fact. USAID staff have then reviewed GOI documentation and taken periodic field visits to confirm, on a sample basis, the existence of the listed projects and their compliance with HGL-eligibility criteria.

Compared to many other countries with similar requirements under HGL programs, Indonesia has adopted more forceful procedures to assure that its obligations in this regard will be met. When each tranche of HGL funds is received from U.S. lenders, the equivalent amount is set aside in a special account for use by the urban infrastructure program only. Program managers clearly label each improvement scheme funded from this account (specific KIP projects, water supply enhancement scheme, etc.) as a "HGL project" and advertise them 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.

The overall composition of the GOI's urban infrastructure investments has been weighted toward types of investments that are likely to benefit the poor (Kingsley, 1993).

However, not all are "suitable for below-median income urban households". Accordingly, some method had to be found to determine the share of GOI investments in shelter-related categories that could be considered "HGL eligible" in this regard. It would have been prohibitively expensive to try to do this by examining designs of each individual project proposal ahead of time. The approach selected instead was to establish an overall formula for each category based on studies conducted at the start of the program. For example, the studies indicated that, at the very minimum, 36.8 percent of all urban drainage investments would be suitable to benefit below-median income households. Thus, when the GOI presented documentation on its expenditures on urban drainage improvements to USAID, 36.8 percent were to be credited as being HGL eligible.<sup>9</sup>

As noted in Chapter 4, USAID sponsored independent research in 1993 to review this approach in response to recommendations of the Interim Evaluation. One report (Kingsley, 1993) concluded that the current procedure is generally in line with program targeting objectives, but recommended that, to assure even greater safety factors, sector eligibility percentages be tightened in two areas. In line with these recommendations, the GOI has agreed to alter the rules for MFEI implementation (eligibility for KIP will be reduced from 100 percent to 90 percent, and based on a special study of recent RDA investments, a new figure of 50 percent was set for the RDA component of the program).<sup>10</sup> Another report (Taylor, 1993) examined the process for preparing the Investment Plan and accounting for investments in some detail. It found that this process also was generally reasonable (given realistic limitations of current reporting processes within government), but recommended several improvements to gain additional clarification and certainty. These improvements have been endorsed by the GOI which intends to implement them under MFEI.

Since the start of MFSP, USAID staff have conducted random spot checks of the investment projects identified under the investment plan by the GOI to assure that HG requirements were being met. This has included field visits to selected cities in the following provinces: West Java, DKI Jakarta, East Java, South Sulawesi, North Sulawesi, Bali, Central

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<sup>9</sup>The distribution formulas have changed over time--see discussion in Taylor, 1993. For tranches I and II, the following percentages were used: 100 percent for KIP, 37.1 percent for water supply, 42.0 percent for human waste, 36.8 percent for drainage/flood, 47.6 percent for solid waste, 30.0 percent for access roads, and 38.5 percent for urban planning and studies. A separate share (37.5 percent) was applied to eligible types of investments financed with loans from the RDA. In 1991, these percentages were altered for tranches III through V, based on new research: water supply (50.0 percent), human waste (40.0 percent), drainage (40.0 percent), solid waste (30.0 percent), and urban planning (10.0 percent).

<sup>10</sup>Actually, it was recommended (Kingsley 1993) that RDA investments be tabulated separately by sector, and that the sectoral percentages accepted for the main program be applied individually to calculate the HG-eligibility of RDA expenditures. The GOI, judging that this might be administratively cumbersome, undertook the study of recent RDA investments by sector, found that applying individual sector percentages would yield an overall 50 percent eligibility rate as a weighted average, and requested that this overall rate be accepted for application to the aggregate of RDA investments under MFEI. This is not an unreasonable approach but it does not offer a clear safety factor. We recommend that USAID watch carefully for shifts in the composition of the RDA pipeline to assure that this proportion remains reasonable.

Java, Yogyakarta, North Sumatra, South Sumatra, West Nusa Tenggara, and South Kalimantan. In each location, the staff verified the authenticity of the selected projects identified by the GOI as HGL-eligible. Together, approximately 112 projects were spot-checked through June 1994. USAID staff documented that, in all cases, the projects visited met the investment plan criteria.<sup>11</sup>

Table 6.1 shows the distribution of total GOI investment plan expenditures in HGL-eligible infrastructure categories for tranche periods I-V (periods correspond to fiscal years, starting with April 1989 and ending in March 1994). Data are shown in both current rupiah and U.S. dollars. Rupiah are converted to dollars using exchange rates prevailing at the time

**Table 6.1**  
**HOUSING GUARANTY LOAN (HGL) INVESTMENT PLAN EXPENDITURES - MFSP:**  
**Total Expenditures - Tranches I-V**

Program	Tr. I&II		Tr. III		Tr. IV		Total	
	Rp. (bil.)	USD (mil.)	Rp. (bil.)	USD (mil.)	Rp. (bil.)	USD (mil.)	Rp. (bil.)	USD (mil.)
KIP	14.45	7.88	33.97	17.64	27.50	13.55	75.92	39.07
Water Supply	95.89	52.31	138.23	71.77	117.53	57.92	351.65	182.00
Env. Sanitation	11.07	6.04	10.36	5.38	9.56	4.71	30.99	16.13
Drainage/Flood	10.48	5.72	14.37	7.46	12.03	5.93	36.88	19.11
Solid Waste	8.11	4.42	5.72	2.97	4.56	2.25	18.39	9.64
Access Roads	8.75	4.77	0.00	0.00	0.00	0.00	8.75	4.77
Urban Planning	6.65	3.63	19.04	9.89	7.34	3.62	33.03	17.14
RDA	53.50	29.19	40.00	20.77	0.00	0.00	93.50	49.96
- Tranche V							134.12	65.42
<b>TOTAL</b>	<b>208.90</b>	<b>113.96</b>	<b>261.89</b>	<b>135.88</b>	<b>178.52</b>	<b>87.98</b>	<b>783.22</b>	<b>403.24</b>

Source : GOI

<sup>11</sup>In our judgement, this monitoring process would appear to comply with requirements under FAA Section 223(j) as reflected in the Program's Statutory Check List (See Annex F).

of USAID approval of each tranche investment plan. Individual tranche investments by program are exclusive of other donor support for the named program.

Table 6.2 shows the share of the expenditures on the preceding table that are HGL-eligible with respect to the below-median income criterion. The fourth MFSP program amendment (MOF, 1993) which added \$20 million to the HGL program earmarked RDA investments as eligible expenditures for FY 1993/94 (tranche V), therefore, these monies are shown separately under the RDA row heading.

Except for the funds attributed to the RDA, the distribution of eligible expenditures by program type changed little over time. The centrally administered share of total eligible investment (Cipta Karya programs) was well over half of all investment over the course of the project period. Among the different programs administered by Cipta Karya, investment remained relatively even. For example, during the three tranche periods, the share of total centrally administered investment attributed to water supply was fairly consistent over the project period: 54.9 percent during tranche I and II, 60.3 percent during tranche III period, and 59.5 percent during the tranche IV period. Expenditures attributed to the RDA changed radically from one tranche period to the next given uneven capitalization of this program over the five year period.

Table 6.2 shows that cumulative eligible expenditures through tranche V (through March 1994) summed to \$188.5 million. Of this total, \$145.2 million went for projects being administered by DG Cipta Karya. Of this amount, the majority of expenditures was attributed to two programs: 58.2 percent for water supply projects, and another 26.8 percent for Kampung Improvement Program (KIP) projects. The other subsectors contributed to the total eligible expenditures to a lesser extent (4.5 percent for human waste and sanitation, 5.1 percent for drainage and flood control, 2.5 percent for solid waste disposal, and 2.9 percent for access road improvement and urban planning). The remaining \$43.3 million (or 23.0 percent of the total eligible investments) was channeled to the sector via loans administered through the Regional Development Account (RDA).

The \$188.5 million in eligible investments is well in excess of the \$120 million requirement under the MFSP agreement (\$100 original allocation plus \$20 million via the amendment) so the Program's basic Investment Plan objective stated in the Project Paper has indeed been met. The Terms of Reference for this Evaluation (Annex D) also asks whether the share of the Investment Plan implemented directly by local governments, and implemented by central government in accordance with local government plans, has changed over time. GOI Investment Plan submissions do not contain direct project level data on these issues, but it is virtually certain that trends have moved in these directions. When the Tranche I MFSP investments were being made, almost all construction was implemented by central government units and there were comparatively few PJMs to which they had to conform. By the tranche IV period, most local infrastructure investment had to occur under PJMs approved by local governments and project implementation teams in many cities were staffed by local government employees. It is unfortunate that data on the actual shares of

**Table 6.2**  
**HOUSING GUARANTY LOAN (HGL) INVESTMENT PLAN EXPENDITURES - MFSP:**  
**Eligible Expenditures - Tranches I-V**

Program	Tr. I&II		Tr. III		Tr. IV		Total	
	Rp. (bil.)	USD (mil.)	Rp. (bil.)	USD (mil.)	Rp. (bil.)	USD (mil.)	Rp. (bil.)	USD (mil.)
KIP	14.45	7.88	33.97	17.64	27.50	13.55	75.92	39.07
Water Supply	35.58	19.41	69.12	35.89	58.77	28.96	163.46	84.25
Env. Sanitation	4.65	2.54	4.14	2.15	3.82	1.88	12.62	6.57
Drainage/Flood	3.86	2.10	5.75	2.96	4.81	2.37	14.42	7.46
Solid Waste	3.88	2.10	1.72	0.89	1.37	0.68	6.94	3.67
Access Roads	2.63	1.43	0.00	0.00	0.00	0.00	2.63	1.43
Urban Planning	2.56	1.40	1.90	0.99	0.73	0.36	5.20	2.75
RDA	20.06	10.95	15.00	7.79	0.00	0.00	35.06	18.74
- Tranche V							50.30	24.53
<b>TOTAL</b>	<b>87.64</b>	<b>47.81</b>	<b>131.60</b>	<b>68.33</b>	<b>97.00</b>	<b>47.80</b>	<b>366.53</b>	<b>188.47</b>

Source : GOI

investment meeting these conditions are not available.<sup>12</sup>

It also appears that this program of investment meets the requirements of Foreign Assistance Act (FAA) Section 221(a), recognizing that appropriate urban infrastructure services are very much a part of the "low-cost housing" package (see Statutory Check-List in Annex F). The types of investments involved (and the overall policy framework that guided their design) were clearly intended to increase the availability of domestic financing and to marshal resources for low-cost housing. They were also intended to have a substantial demonstration impact, demonstrating the financial feasibility of this approach, developing

<sup>12</sup>In MFEI Investment Plan submissions, it might well make sense to ask the GOI to note for each project: (a) whether it is a part of a locally approved PJM; and (b) whether the Project Management Unit was staffed by local or central government employees.

domestic construction capabilities, and stimulating credit institutions to make available domestic capital.

## **PROGRESS IN RELATION TO THE LOGICAL FRAMEWORK AND RECOMMENDATIONS OF THE INTERIM EVALUATION**

### ***The Logical Framework***

In addition to the GOI's performance under the Policy Action Plan and Investment Plan requirements, the MFSP 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 assessment of progress under each element of the Log-Frame is presented in Annex B and summarized here; more complete information on many of the topics has been presented in earlier chapters of this report. The results of the OVI evaluation are mixed.

- **Project Goal:** 5 measures: achieved = 50.
- **Project Purposes:** 7 measures: achieved = 5; not achieved = 2.
- **Project Outputs:** 11 measures of "illustrative" magnitude of outputs: achieved = 6; not achieved = 5.
- **Project Inputs:** 3 measures, all achieved.
- **Total:** 26 measures: achieved = 17; technically achieved but concerns remain about underlying purposes = 2; not achieved = 7.

Our overall assessment of this record is positive, even though a number of these Project Paper indicators have not been met in full. Reviewing the seven targets that have not yet been achieved, we find that considerable progress has been made in almost all areas and, with benefit of hindsight and considering the nature of process of transformation now underway, we judge that Project Paper timing expectations were often overly optimistic. More specifically:

- The lack of achievement under two measures in the Purpose section (creating a fully consolidated loan/grant system and creating a uniform incentive system for improving revenue generation and expenditure control by local governments) is explained by the slow progress in grant system reform in the early years of MFSP. There are several indications that momentum for change has increased recently in this area (see Chapter 4), but these measures still warrant high priority attention under MFEI.

■ We judge considerable progress is being made in relation to three of the Output measures not achieved to date (issuing guidelines for private participation in urban services, reducing or eliminating concessionary government loans to local governments, and standardizing accounting practices): see discussion in Chapters 3 and 4. It seems likely that both will be fully satisfied in the next few years.

● There are strong reasons to support the objectives that underlie the remaining two Output targets not met (enabling the GOI to sell participation certificates in its RDA loan portfolio to the private sector, and tying grant allocations to measures of local government financial performance) although these specific means are not the only methods of achieving them. We believe more time is justifiably required for the GOI to evolve approaches to addressing these objectives (i.e., they are not realistic targets in the short term).

It is also important to comment on the two measures (in the Goal section) we rate as having been achieved, but where concerns remain about performance in relation to underlying purposes: a nationwide net increase in urban infrastructure investment and an increase in the level of such investment benefitting below-median income families. The problem is that while net increases (in real terms) have occurred, those increases have not been large enough to keep pace with urban growth. In real *per capita* terms, total public investment in relevant infrastructure sectors has been declining and investment in the components of those sectors suitable for below-median income households is just barely keeping up (see discussion in Annex B). As noted elsewhere in this report, we judge it not surprising that, even with some increase in funding availability of late, some slowdown in actual delivery might occur as handover of implementation responsibilities to local governments is actually underway. Nonetheless, these are the "bottom line" measures of program success. We recommend that they be given focus as high priority for action under MFEI (see Chapter 7).

### ***Recommendations of the Interim Evaluation***

The Interim Evaluation of this program (Kingsley and Peterson, 1992) made thirteen explicit recommendations to improve performance and further long term objectives. Responses to some of these have been discussed at more length elsewhere in this report. Here we summarize these recommendations and the actions since taken by the GOI and USAID with respect to each:

1. Establish a new HGL program and continue technical assistance support: Accomplished through the initiation of MFEI and an amendment to the MFP technical assistance component.

2. Carry forward the basic elements of the current Policy Action Plan in the new HGL program: Accomplished (see the Policy Paper for MFEI, USAID/Indonesia, 1993).

3. In technical assistance under the new HGL program, give emphasis to further work on the market-based credit system, effective urban environmental quality management,

and more local choice in revenue generation and investment planning: Accomplished (see the Policy Paper for MFEI, USAID/Indonesia, 1993).

4. Strengthen the RDA and establish (and operate under) an intermediate-term plan for opening municipal access to private credit markets: Partially accomplished. Initial studies as to the future of RDA are fully consistent with these themes (see Johnson, 1994) but an intermediate-term plan has not yet been adopted (see further discussion in Chapter 4).

5. Conduct local sample surveys of household beneficiaries to more effectively monitor income targeting of investment: Not accomplished (see reasons discussed in Chapter 4). We judge that efforts along these lines warrant priority under MFEI (see approaches recommended in Kingsley, 1993).

6. Provide technical assistance through the lifetime of the new HGL program: Accomplished through the amendment to the MFP technical assistance component.

7. Focus technical assistance more on principal bottlenecks to implementing the Policy Action Plan: Accomplished, in our judgement. See, in particular, discussion of work related to RDA development (Chapter 4) and training (Chapter 5).

8. Use more short-term technical assistance to reinforce long-term advisors—include budget for short-term technical assistance in plan for the new HGL program: Accomplished, both by actions of the past two years (e.g., short-term missions supporting RDA planning, municipal bond development, and planning the management training program) and the structure of the budget for the amendment to the MFP technical assistance component.

9. Provide emphasis in future technical assistance on priority topics identified: Accomplished. All priority topics identified are being addressed, either in work accomplished over the past two years or in plans related to the new MFEI program.

10. Channel a larger portion of HGL investment resources through the RDA and in support of private-participation in urban services and environmental infrastructure: Largely accomplished. All of the resources in the MFSP amendment (last \$20 million) were channeled through the RDA and the RDA will receive a larger share under MFEI (a minimum of 20 percent of each tranche). Given work being conducted under PURSE (see Chapter 3), it is likely that private sector participation in program investments will increase, but more work is probably called for to examine specifically how this will occur and to prepare for monitoring performance in relation to the objective.

11. Conduct quarterly meetings of the MFP Interministerial Counterpart Committee. Partially accomplished. Meetings have not been held consistently on a quarterly basis. However, we judge that other forms of communications between committee members, MFP staff, and USAID have been enhanced so that the lack of consistency in this regard has

not caused problems. Still, the idea of quarterly meetings should be considered for the MFEI implementation period.

12. Update the MFP monitoring indicators report semiannually: Not accomplished, because the data collection systems supporting several of the indicators only operate on an annual basis. Still, we judge that efforts should be made to expand the number of indicators tracked and to issue semiannual reports on those that are available on that basis.

13. Include BAPPENAS fully in the MFP Interministerial Counterpart Committee and provide technical assistance support directly to BAPPENAS: Accomplished. One MFP long-term advisor was assigned directly to BAPPENAS as a result of this recommendation and BAPPENAS is now playing an active role both within the Committee and in day-to-day activities of MFP.

#### **USAID PROGRAM MANAGEMENT**

The MFSP was directly managed by USAID's Regional Housing and Urban Development Office/Jakarta, under general guidance from the USAID Indonesia Mission Director and staff, and the Office of Housing and Urban Programs in Washington.

The terms of reference for this evaluation do not require a detailed historical examination of all procedures followed and actions taken to manage MFSP, but an overall assessment is possible and called for. At this level, we judge that USAID management of the Program has been both diligent and innovative.

Of first importance was that management did insist on regular unbiased monitoring of program performance and took the initiative to assure it. This took a number of forms, most notably: (1) requiring a series of comprehensive assessments and evaluations of Policy Action Plan performance by independent researchers (as listed in Chapter 1); (2) pressing for regular progress reports from GOI and establishing, through MFPC, the Monitoring Indicators Series (e.g., BAKD/BAPPENAS/MFPC, 1994); (3) undertaking regular field visits to spot check the accuracy of GOI reports on progress under the Investment Plan.

The next question, is what did the managers do with the information on performance once they received it. There are instances where assessment findings were considered but not acted upon (at least not acted upon rapidly) though such cases were generally trivial. On the whole, Program managers did pay close attention to monitoring, use it to identify important new problems and opportunities as they emerged, and take action to address them. The latter entailed not only giving new instructions to consultants and raising the issues in their own dialogues with GOI counterparts, but also in mobilizing active support from higher level managers within USAID.

The clearest example is the forceful and persistent (and ultimately successful) efforts by USAID at all levels to assure that the RDA would be established when, at several points,

It was judged that GOI progress in this area had stalled. Another important example is USAID's effort to introduce the notion of private participation in urban services to a broad range of GOI officials and, once initial acceptance was gained, to back this theme with substantial resources in mobilizing the PURSE project. (GOI officials interviewed as a part of this evaluation clearly give USAID a great deal of the credit for the progress that has been made in both of these areas.)

Other examples include the rapid refocusing of technical assistance resources and emphases in policy dialogues in response to issues raised in the Interim Evaluation: e.g., the need for progress in restructuring the RDA approach to lead toward long term municipal credit system expansion, the need to expedite a much expanded training effort in municipal management, and the need to pay more attention to the targeting of program benefits to the poor.

## **WOMEN IN DEVELOPMENT**

In the late 1980s (when the MFSP was designed), the field of development was paying scant attention to the role of women. Since then, the importance of women in development has gained much greater recognition. In this section, we: (1) review how this recognition has evolved in Indonesia, particularly in the context of the urbanization process; (2) offer observations on the way MFSP may have impacted women's roles; and (3) suggests avenues through which the GOI's urban development agenda (as supported under MFEI) might be able to make a stronger contribution in this regard.

### ***Women and Urbanization***

By 1990, nearly one-third of Indonesia's population lived in urban areas. Nearly half (27.7 million) were women, and a large portion of them were poor. While poverty has declined throughout the country, the extremely rapid pace of urbanization has shifted the geographical focus of the problem. By 1990, more of the urban population was poor (about 22 percent) than the rural population (14 percent). The literature is now replete with acknowledgement that women, in their roles as wives and mothers, face harsher impacts from urban poverty than men, and there is also evidence that an increasing share of all urban poor households are headed by women (Mboi, 1993).

As elsewhere, economic status in Indonesia helps to determine social status. And women are at an economic disadvantage in gaining access to the new jobs being created in cities, due to sex discrimination as well as inadequate education and training. Indeed, women account for 40 percent of the total labor force, but are paid only half of what their male counterparts make at similar jobs (USAID/Indonesia, 1993b). The poverty rate is undoubtedly higher for women than men.

Partly because of this economic disparity between women and men, gender related issues are receiving increasing attention by the Indonesian research community.<sup>13</sup> The issue is promoted by a relatively new emphasis on orienting economic development around people instead of places. Traditionally, women and men have been grouped together as recipients of inputs, rather than being identified for the different roles they play in society (and therefore for their differing needs).

Official GOI recognition of this issue is growing as well, as indicated by attention devoted to it in the country's Repelitas. However, a number of the interviews conducted for this evaluation suggests that many agencies are still groping toward defining appropriate programmatic means of enhancing the role of women in development. In the urban program, at least one promising direction may be the greater emphasis being placed on participatory community development. The GOI's June 1994 draft for a revised urban Policy Action Plan dedicates a section on expanding community participation in the development process. In this regard, the Kampung Improvement Program (KIP) is particularly important in that it is increasingly allowing community and women's needs to be expressed through a "bottom up" approach to prioritizing investment.

USAID/Indonesia is also increasingly recognizing the unique needs of women as beneficiaries of its programs and has instituted policies regarding gender issues when programs are designed and implemented (see its *Gender Action Plan*, USAID/Indonesia, 1993b). Among other things, the Mission has also promoted policy targets related to the involvement of women in its training activities and has recently required reporting on gender activities undertaken in all USAID-sponsored projects.

#### ***MFSP and the Role of Women in Development***

Fully assessing the impacts of MFSP on women would require primary research much beyond the scope of this evaluation. We can, however, offer a few general observations and hypotheses. Overall, we judge that MFSP (and broader future support for the urban Policy Action Plan) should rank as one of the most important vehicles USAID has at its disposal for addressing women's issues in Indonesia. The reasons are two-fold.

First, the basic substance of the program (the provision of low-cost residential infrastructure), by definition, has profound effects on the quality of the lives of women and children in cities, particularly women in poverty. Women (and children), who typically spend much more of their time in the residential environment, feel the harshness of urban poverty more directly than men. Basic infrastructure services are potent weapons in alleviating this harshness: for example, clean and reliable water supply (which not only reduces the chance of disease, but also eliminates the need to spend substantial amounts of time and effort waiting for water at public taps and carrying it back home); drainage, sanitation, and solid-

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<sup>13</sup>Evidences of the increasing attention Indonesian researchers are paying to women's issues are found in Mbol (1993), Gardiner and Oey-Gardiner (1993), and the issuance of a report entitled *Social Indicators on Women in Indonesia* by Biro Pusat Statistik (1989).

waste management improvements (which substantially reduce the incidence of disease, as well as ameliorating the physical environment); street-lighting (which increases personal safety).

In this regard, while not specifically measured, we are confident that MFSP has had an important positive impact on women. Although we have no research results to confirm the hypothesis, it is reasonable to assume that this contribution could be further enhanced if women played a more important role in making decisions about the design and implementation of neighborhood service improvements. By its support for KIP (which has increasingly emphasized community participation in design), MFSP had some positive impact in this regard as well. However, anecdotal evidence suggests that community participation processes still typically remain male-dominated at this level. Women's branches of community groups (PKK) exist but their roles in decision-making are limited. This is a potential which has not been sufficiently recognized to date.

Second, the vast expansion of urban management jobs Indonesia must create (ranging from professional positions in local government and private firms to community workers, as implied by discussions elsewhere in this report) should offer unusually good career prospects for women. There are a some positive circumstances to report in this regard. It is noteworthy that two of the most influential figures now directing the GOI urban agenda (the chiefs of the new urban development bureau in BAPPENAS and of the regional financial analysis division at MOF) are women. And USAID has taken some steps to further women's roles in connection with urban development; e.g., urging more participation by women in MFSP-related training, sponsoring a baseline study related to the role of women in urban development (Gardiner and Oey-Gardiner, 1993), and incorporating gender issues into the project design for MFEI (including training quotas for women, and other inducements for gender recognition activities). By and large, however, very little has been done so far to take advantage of this important employment potential in a serious way.

#### **Comment**

Both the GOI and USAID/Indonesia have explicitly recognized the need to address gender concerns in the management of urban development, and the potential for doing so appears impressive. As yet, however, no concrete plan of action along these lines has been formulated. Such a plan would have to address, at a minimum: (1) enhancing the decision-making role of women's groups in neighborhood service planning and implementation; and (2) laying the groundwork to substantially increase women's participation in rapidly expanding urban management employment opportunities.

*Chapter 7*

**IMPACTS, RECOMMENDATIONS,  
AND LESSONS LEARNED**

In this chapter, we offer our conclusions on program impacts, recommendations for the implementation of the MFEI Project, and lessons drawn from the MFSP experience that should be of relevance to other USAID projects with similar objectives.

**PROGRAM IMPACTS**

What the GOI has accomplished under the Policy Action Plan (as documented in Chapters 2 through 5 of this report) amounts to a major institutional transformation in Indonesia's capacity and approach to managing the development of its cities and towns. The GOI has not yet fully achieved all of the objectives it set for itself in the Plan. In several important areas, commitment and momentum have ebbed and flowed over the course of the past six years and, clearly, much remains to be done. Nonetheless, this effort has been a substantial achievement. There are no signs that the basic themes emphasized in the Plan are likely to be reversed. Indeed, support for them appears to have both broadened and deepened over the past two years. Seven accomplishments are probably most notable to this point.

- (1) A comprehensive revision of the process by which urban infrastructure is programmed (from a highly centralized approach into 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) has taken place through IUIDP—PJMs have now been prepared (or are in preparation) for areas accounting for 89 percent of the nation's urban population and approved for areas accounting for 53 percent.
- (2) Responsibility and authority for urban development generally has been shifted to the local level more forcefully through a series of new regulations and institutional changes (including the transfer from central to local control of 99 water authorities over the past two years—only 17 of 293 are still controlled centrally).

- (3) The management of the property tax and other local own-source revenues has been markedly improved and their yield substantially enhanced: real per capita own source revenues of Tk. I and II governments (including PBB) increased by 60 percent in the four years following 1987/88.
- (4) A sound policy and technical base for expanding private sector participation in urban services has been much advanced.
- (5) A base for expanded municipal borrowing for urban infrastructure has been set through establishing and expanding the RDA (disbursements increased by 84 percent from 1991/92 to 1992/93) and the GOI has evidenced a new openness to expanding from the RDA concept into a broader approach to expediting the development of a sound market-based credit finance system.
- (6) The commitment to local government capacity building has been strongly evidenced of late; e.g., the number of professional civil servants under the jurisdiction of the Ministries of Home Affairs and Public Works assigned to work for regional and local governments has more than doubled from 1991/92 to 1993/94, and the number of person-days of relevant skill training provided to local officials by 45 percent from 1992/93 to 1993/94.
- (7) The GOI has established and maintained a viable framework for interministerial coordination of central government actions affecting urban development.

What role did MFSP play in these accomplishments? Clearly, it cannot be argued that they never would have occurred without USAID's assistance through this program. Nonetheless, we have presented evidence throughout this report that MFSP contributed in important ways to sustaining and expediting the program and influencing priorities to heighten the impact of the overall agenda.

The World Bank had earlier provided substantial loan funding linked to Policy Action Plan performance but, in the late 1980s, it withdrew from that approach and notably reduced its funding commitments for the program overall. The Asian Development Bank as well as the World Bank still strongly support all Policy Action Plan themes in principle and continue to provide loans for specific urban projects within it, but neither conditions such assistance on the progress of the Plan as a whole (see World Bank, 1991). MFSP thus entered to fill an important void at that time.

GOI officials readily acknowledge that HGL funds became vital to continuity in the investment program (and that, because of less cumbersome disbursement procedures than those of other major donors, HGL investments could generally be delivered with greater speed and flexibility). Probably more important was USAID's active work in policy dialogues with GOI counterparts to make mid-course corrections to address emerging problems and opportunities that had been identified in recurrent monitoring. There is no doubt, for

example, that these dialogues played a very important role in: securing the progress that has been made in the development of the RDA and the broader search for mechanisms to expand municipal credit; adding the emphasis that has been given to private participation in urban services; and the recent focus on targeting program benefits more tightly to the poor. Technical assistance resources (mostly through MFPC) were deployed proactively to support these priorities.

Still, the ultimate outcomes desired from this approach still seem a long distance away. Even after recent increases, Indonesia's rate of local taxation and rate of recovering costs from public enterprises remain low by world standards. Similarly, lending still represents a very small share of all municipal investment. Particularly disturbing is that urban infrastructure investment may now be falling behind the needs implied by rapid urbanization. Total per capita government investment in HGL-eligible environmental infrastructure sectors has actually declined in real terms of over the past several years; for example, from Rp. 15,900 in 1990/91 to Rp. 14,200 in 1992/93 (constant 1992/93 Rupiah).

#### **CHALLENGES AND RECOMMENDATIONS**

International experience suggests that Indonesia is on the right path. Decentralization, with the right financial and institutional incentives in the framework of a market-oriented development process, is the most promising means of reaching a "take off" point after which effective delivery of urban services will accelerate. But that point has not yet been reached in Indonesia and a new sense of urgency is warranted in driving toward it.

This evaluation has not identified any outstanding issues under the MFSP agenda that need to be dealt with before that project is closed out. However, the review presented in Chapters 2 through 5 suggests many areas in which the ongoing program needs to be strengthened and expedited, and these should be addressed under MFEI. All of them warrant some attention. However, we judge that at this point in the program's development three issues should be singled out for priority attention by the GOI and USAID under MFEI over the next few years:

1. Eliminating bottlenecks in the delivery system;
2. Expediting the creation of a market-oriented credit finance system for municipal infrastructure; and
3. Firmly establishing local leadership in urban development and management.

In the paragraphs below, we discuss the nature and importance of each of these issues and offer ideas on how they might best be approached. We also offer less detailed recommendations on other matters that should receive attention in the near term.

## **RECOMMENDATION 1—ELIMINATE BOTTLENECKS IN THE DELIVERY SYSTEM**

### ***The Nature of the Issue***

There is consensus that, for the time being at least, the availability of money is not the only problem. Bottlenecks exist in the delivery system that are holding back investment of the financial resources that are available. The issue was raised in the 1992 BAPPENAS *Issues and Priorities Report* and in this project's Interim Evaluation, and it is noted again in the 1994 BAPPENAS *Progress and Prospects Report*.

It is not surprising that, during the difficult transition from central to local control, some slowdown in delivery might occur. But, in this program, expanded delivery of urban services is the "bottom line" and we judge that addressing this issue more forcefully should be the single highest priority in the next stage of program implementation.

The MFEI, of course, gives a very high priority to improving the urban environment in Indonesia. It should be remembered that the lack of sufficient infrastructure delivery (water supply, sanitation, solid waste disposal, roads to open up good land for development) to keep pace with urban growth is generally recognized as the primary cause of environmental degradation in the nation's urban areas. Therefore, expanding delivery per se, is the single most critical means of achieving the objectives of MFEI.

Several factors appear to play a role in blocking delivery. For example, some of the more immediate constraints are: cumbersome procedures for funding and implementation (imposed by major donors as well as within the government); inadequately clear or forceful instructions from the Ministry of Home Affairs to local governments: Walikota and Bupati assigning inadequate priority to their infrastructure development programs; inadequately aggressive recruitment and training of technical and project management staff at the local level; complex project approval and contracting procedures; inadequate mechanisms for using trained central staff in support of local implementation programs.

Interviews conducted with the staff of Direktorat Bina Program (which monitors delivery most closely) indicates, however, that these problems are not uniform. Some local programs, even where management has been highly decentralized, have been performing well, while others have not. This demonstrates that decentralization itself is not the problem. It also shows that effective local management can be successful in Indonesia today.

### ***The First Stage: Organizing to Address the Issue***

TKPP/IMG are already working on this issue, but they should give it higher priority. They should intensify their efforts to gain a clearer understanding of the bottlenecks and then devise and implement an effective action plan to address them. The first step would be study of actual progress that has been made in IUIDP implementation and its timing so far—city-by-city—then using that information as a base for deeper probes to identify and analyze bottlenecks.

### **Implementation Support Units**

Farther along, we see the need for adapting institutional mechanisms to focus on expediting implementation. To illustrate how this might work, we suggest consideration be given to something like the following: First, implementation support units would be established at the provincial level, staffed by experts/trainers in relevant aspects of implementation management (probably as subunits within the PPMO/PPMU structure the Provinces are already establishing). These units would regularly update and analyze a simple and pragmatic information system, reporting dates when important milestones are achieved in the processes of project preparation, financing, contracting, and carrying out the work in at least all larger cities—perhaps those above 50,000 population. They would also do studies of past timing between milestones and set performance standards. When notable delays are evidenced, staff teams would be sent to assist the Tk. II governments involved in discovering and overcoming bottlenecks.

This approach illustrates two principles. First, the need to be selective. There are not enough skilled technical assistance resources to spread them evenly across all urban areas, and some (as noted above) appear to be moving their programs well; i.e., do not need more external guidance at this point. This approach focuses resources on places that need the help.

Second, this method emphasizes "learning by doing". It will be essential, of course, to develop more and better training courses in the practical techniques of project implementation management in a classroom setting. However, we judge that the lessons will be reinforced even more effectively if new Tk. II project managers have a chance to gain advice "on the job" from experienced staff of the provincial technical assistance units. Teams from those units might help several cities on periodic visits: for example, spending a week in a city to help local managers identify bottlenecks and develop an initial action plan for dealing with them, returning perhaps a month later to check progress and provide additional advice in light of recent events, and returning several times again over the year to do "trouble shooting" and help local staff build the lessons into a systematic approach such that they will require no (or very little) additional outside help thereafter.

The IISP program provided "hands-on" technical assistance to three cities in plan preparation in this manner (IISP, 1994) and these efforts were regarded as quite successful. We believe the approach could be broadened and applied successfully to implementation management as well.

### **The Next Round of PJM Preparation**

The 1992 BAPPENAS *Issues and Priorities Report* offered some more specific ideas about delivery bottlenecks. It stated 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 more 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.

While implementation problems are the first priority now in general, the implementation of initial PJMs in a number of cities is nearing completion. Continued expansion of delivery will, therefore, require expanded assistance to local governments in preparing the next wave of PJMs as well. We suggest a model similar to that above for the implementation process: i.e., establishing provincial technical assistance, subunits within the PPMO/PPMU structure to help local officials on a selected basis.

This approach would address two problems identified in the earlier IUIDP experience. First, in many cases, the consultants, normally under substantial pressure to produce results, did most of the work of PJM preparation themselves without meaningfully involving local counterparts. Second, PJMs generally suffered from a lack of analysis and strategic planning and priority setting across sectors before project lists were compiled. Program staff admit that IUIDP guidelines have been weak in these areas.

The process might work as follows: (1) the provincial 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 Walikota would call in his top management staff along with a few key community and business leaders for a one- or two-day retreat; (3) at the retreat, local technical staff (with assistance from the provincial 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 and extend current PJMs. Consistent with proposals for the broader IUIDP concept, these processes would address all infrastructure and land development needs (not just planning for the IUIDP subsectors).

This approach has also been tried of late—by Cipta Karya staff and consultants in Pangkal Pinang and Tasikmalaya. These efforts took advantage of the new requirement to conduct studies on the demand for urban services as a part of PJM development, and those studies led officials from the cities and their PDAMs to adopt quite different strategies than they might have chosen without them.

#### ***USAID's Role***

External technical assistance support for these activities (both expediting implementation and effective planning for the next generation of PJMs) is to be provided by the new United Nations sponsored IIUD initiative. Because of its importance to MFEI objectives, however, USAID should watch over this agenda carefully. The MFFC team should monitor IIUD progress (and provide supplementary assistance to it as appropriate) and USAID should feature these topics in its recurrent policy dialogues with GOI.

### **RECOMMENDATION 2—EXPEDITE THE CREATION OF A MARKET-ORIENTED CREDIT FINANCE SYSTEM FOR MUNICIPAL INFRASTRUCTURE**

#### ***The Nature of the Issue***

If the lack of financing is not the central problem today, it is certain to regain that status in the near future. And international experience of the past few years confirms more vividly than ever two fundamental assumptions that lie behind this element of the Policy Action Plan: (1) government budgets alone can never be sufficient to finance the infrastructure demands of a rapidly urbanizing nation like Indonesia—private capital must be attracted to the sector; and (2) if the system is set up properly, private investors will indeed find the sector attractive and allocate substantial resources to it. The potential is especially high in Indonesia now given the growing accumulation of relatively idle long-term capital held by institutional investors such as pension funds and insurance companies.

In addition, the issuance of municipal bonds would contribute to the mobilization of private capital to alleviate budgetary constraint. This type of infrastructure financing is particularly well suited to revenue generation projects such as water works. The emergence of a municipal bond market in Indonesia will not only add to the financing capabilities of cities but also allow local governments to become more self-reliant for their capital needs.

#### ***Action Plan***

The steps to be taken here are already being suggested in the studies being conducted for the Ministry of Finance and Ministry of Home Affairs. They include: (1) 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; and (2) removing regulatory and other barriers to other forms of credit financing like municipal bonds.

As noted in Chapter 4, a major theme is the transition of the RDA from serving only as a conduit for central government funds to becoming a true financial intermediary whose operation is more autonomous, thereby enabling it to raise funds from private capital markets. Within that general theme, it is worth summarizing some of the shorter term recommendations from the Interim Evaluation of MFP.

- *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 facilitator of it—is that they do not require prompt and universal repayment of loans. 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. 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 and that service prices be raised to restore the margin whenever it falls below the required level.

- *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? 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 would probably be a lien on central government PBB transfers.

- *The RDA should conduct its operations in an environment of full disclosure and transparency.* 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 record, as should borrowers' repayment histories. 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.* Without a clear policy, 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.

- *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.

- *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 is also likely to improve the payment record, as has happened with property tax and water payments when commercial banks become the payment point.

### **RECOMMENDATION 3—FIRMLY ESTABLISH LOCAL LEADERSHIP IN URBAN DEVELOPMENT**

#### ***The Nature of the Issue***

True take-off in decentralization is not likely to occur until local leaders (normally Mayors) finally believe that it is *they* who are fully responsible for effective urban development and management. Their job is no longer to wait for instructions from above—it is *they* who must innovate, build political coalitions, gain community support, secure private investment, forcefully motivate city staff, and do whatever else may be needed to produce results. And they must believe that *they*, personally, will be held accountable, gaining substantial praise if they succeed but facing serious penalties if they do not. Many elements in the Policy Action Plan are moving Indonesia in this direction and several initiatives have been taken by BANGDA and Cipta Karya but the destination has not yet been reached and even more can be done in the short term.

### **Approach**

BANGDA (MOHA) has taken some important initial steps along these lines in recent months. These have included holding a workshop to discuss methods of sharing information at the city level (including city twinning and sister-city initiatives), planning a survey to get a better understanding of city information needs, and attending meetings of the "City Sharing Program" in the Philippines to see if it offers lessons applicable to Indonesia.

We believe that this theme merits more prominence in the overall GOI urban development agenda. This might be accomplished by forming a new inter-ministerial working group to support, and expand beyond present BANGDA initiatives. The proposed new public-private Urban and Regional Development Institute (URDI) would also be well suited to play a strong supporting role in this area. Possibilities in this regard should be considered as part of initial URDI development planning.

There are many possible activities that could be applied toward this end, for example: involving selected Walikota more directly and visibly in central program planning; giving the most innovative and entrepreneurial Walikota prominent roles in communicating program themes to less proactive Walikota; building and strengthening associations of Walikota as key vehicles for local capacity building; forcing Walikota to take community participation more seriously in planning, financing, and implementing their development strategies.

The latter point deserves special attention. Among developing countries, Indonesia has one of the best established systems for community participation in public decision making (RT, RW, LKMD). This system is regularly relied upon in the budget process as a mechanism for expressing neighborhood and community needs and desires upward to higher levels. But it is seldom used as a sounding board to review higher level plans. This implies the need for new participatory processes where the Walikota and staff would present their plans for city-wide development at least at the LKMD level to get reactions. It has been found that where community groups are confronted with the costs and benefits of alternative city-wide development strategies, and then have a role in selecting priorities, they are more likely to be supportive of the strategy that is selected and be willing to pay the price for it. Doing so also gives the Walikota a much stronger sense of accountability to the people of his or her city.

Another important opportunity to be stressed here is openly "celebrating the success stories" individual cities have had in urban development. This starts with developing well presented case studies of successful efforts by individual Tk. II governments in addressing a wide range of urban problems and opportunities; e.g., in revenue enhancement, public-private joint ventures, cutting out waste in public services, implementing useful computer management systems, creating more meaningful community participation, working with the private sector to develop land in a way that increases job generation and city revenue.

The next steps could include: circulating the case studies broadly among officials of other cities, having the responsible Walikota make presentations on them at meetings of

associations of Walikota, and, perhaps in some cases, making videos about them that could be shown at meetings of many groups and to the public at large on TVRI. This approach: (a) disseminates useful techniques in an effective manner; (b) creates a sense of pride on the part of the responsible city governments; and (c) creates a sense on the part of other Walikota that they should try to create some success stories of their own.

### **OTHER RECOMMENDATIONS**

Within the framework of the Policy Action Plan, we believe the TKPP/IMG and USAID should truly focus on the three priorities noted above. However, work needs to proceed in other areas as well. The following appear most relevant at this stage in the program's development in addition to the themes included in the new PAP and MFEI program.

*a. Expediting the classification of new urban areas.* As noted in Chapter 2, current rules for granting of Kotamadya or Kotip status to new urban areas represent a formidable barrier. A study is recommended to assess alternatives to the present system.

*b. Enhancing the role of women in development.* As stated in Chapter 6, women need to be recognized for the contribution they can make towards promoting the delivery of people-centered urban infrastructure and in urban management more generally. We have suggested (Chapter 6) the need for an action plan that would focus on: (1) enhancing the decision-making role of women's groups in neighborhood service planning and implementation; and (2) laying the groundwork to substantially increase women's participation in rapidly expanding urban management employment opportunities. Work toward this end should accompany further development of the GOI's urban Policy Action Plan and MFEI support agenda for the Repelita VI period. Clearly, some additional research on options may be needed before effective plans can be prepared. Such planning should probably examine the option of incentives, that are geared to performance rewards for GOI actors in the process.

*c. Giving more discretion to local governments in the use of central grants.* As outlined in Chapter 4, recent actions are beginning to move more rapidly in this direction but progress here remains one of the slowest in the Policy Action Plan. We have no detailed recommendations on how to proceed in this area—only that it continue to receive priority attention under MFEI.

*d. Expanding effective training capacity.* Our recommendation here is primarily for continued support to efforts already underway to expand effective training for local officials, particularly the new training program in urban management. However, there may also be a need to: (1) conduct a special study of means of strengthening the MOHA Badan Diklat Propinsi; (2) disseminate training materials to a broad range of potential training providers (including private institutes and firms) and to encourage them to participate in the emergence of a more competitive and demand drive indigenous system for local training; and (3) examine how the ideas discussed under the first priority above (province level technical

assistance and training units in urban development) might best be developed to provide better "on the job" training and reinforcement to assure that the concepts and techniques of the broader training program will actually be implemented.

*e. Monitoring program effectiveness.* The Monitoring Indicators series noted throughout this report is making an important contribution but it should be expanded. This expansion should take it beyond the measurement of outputs only (e.g., the number of new households receiving piped water supply) and into more direct measurement of the effectiveness of investment. For example, in some areas, additional piped water supply connections may not be highly effective (because water quality remains low, or because clean groundwater sources are ample and a piped system is not yet justified). Many other examples could be cited. The point is that analysis should begin on how effectiveness can best be measured in each sector. Also, taking gender concerns into consideration will help promote better measurement of the delivery of infrastructure.

*f. Endorsing the shift to local government control of investment programming.* As the GOI makes submissions for Investment Plan compliance under MFEI, it should indicate whether each individual project was: (a) a part of a locally approved PJM; and (b) implemented by a project management unit staffed by local (vs. central) employees. As recommended in the Interim Evaluation (but not yet agreed to), projects not conforming to a locally approved PJM should not be considered eligible in relation to basic MFEI objectives.

*g. Conducting additional analysis to support stronger program contributions to poverty alleviation.* Further research along these lines has already been designed (See discussion in Chapter 4 related to Policy 4d).

## LESSONS LEARNED

**1. Focussed management on priorities within a broad policy framework can achieve impressive results.** Concerns are often raised about the ability of broad policy reform projects like MFSP to deliver clear results; i.e., if you try to cover too many objectives at once you may accomplish very little. On the other hand, projects with narrower objectives may have a higher probability of producing outputs but they often fail because, lacking linkage to the broader policy environment, their outputs have limited impact. MFSP implementation illustrates an effective approach to avoiding the problems of either extreme. The Program gained the benefits of joint government/USAID involvement on a long-term basis with the ability to address a broad range of policy issues all of which, at one time or another, could be on the critical path to achieving a major institutional change. Program managers, however, recognized the need for clear focus on only a few priorities within the overall agenda at any one time. They could (and did) shift emphasis in policy dialogues and the allocation of technical assistance resources as needed to assure progress in those priorities areas without losing linkage to the full range of Program objectives.

**2. Reliable performance monitoring, access to technical assistance resources, and strong RHUDO/Mission collaboration are critical to success in USAID management of urban policy programs.** In MFSP, the USAID Regional Housing and Urban Development Office (RHUDO) which managed the program: (1) insisted on, and secured, regular and unbiased monitoring of performance under the Policy Action Plan; (2) applied technical assistance resources to help GOI counterparts focus on emerging problems and opportunities in a flexible manner; and (3) kept USAID mission top management well informed and maintained their active involvement and support in carrying through major program initiatives. It is doubtful that the program's major accomplishments would have been achieved if any of these elements had been lacking. All three should be given priority in MFEI and similar programs in other countries.

**3. Recognizing, and taking advantage of, variation in local entrepreneurialism and pay-off opportunities may be an important means of expediting results in urban decentralization programs.** Studies done as a part of MFSP show that there is tremendous variation in the entrepreneurialism exhibited by local officials in different cities e.g., zeal and skill in raising own-source revenues and implementing infrastructure projects differ dramatically between cities even in the same city-size classes. Opportunities for results also vary in important ways. Some cities are at the edge of take-off: addressing infrastructure constraints there expeditiously will yield much larger benefits to the national economy (and poverty alleviation) by promoting economic development than focusing now on urban areas where take-off may be many years away. There is evidence to suggest that similar variations are likely to exist in other countries during the decentralization process, and that a "one size fits all" approach will have limited effectiveness. This lesson is not yet well understood or incorporated into the literature of development, yet it may be an important one, both for MFEI and for other similar USAID sponsored projects elsewhere.

**Annex A**

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Annex B

**ACHIEVEMENTS UNDER THE LOGICAL FRAMEWORK MATRIX**

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

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**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.

*Achieved. From 1986/87<sup>14</sup> to 1992/93, total investment in relevant urban infrastructure sectors did increase in real terms—from Rp.668.6 billion to Rp.892.5 billion (constant 1992/93 Rupiah). However, an more important objective here should relate to keeping up with the pace of urban growth, and in this respect overall performance has been disappointing. Real per capita investment in these sectors actually declined—from Rp.15,200 in 1986/87 to Rp.14,200 in 1992/93 (constant 1992/93 Rupiah)—see data presented in Chapter 2 and BAKD/BAPPENAS/MFP 1994.*

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<sup>14</sup>We choose 1986/87 as the base year for this comparison, since using 1987/88 (the year of MFSP initiation) for these purposes would probably distort the underlying trend. This is because of unusually large injections of World Bank resources into the program in 1987/88 (and the subsequent two years)--World Bank support has subsequently been scaled back substantially in real terms.

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

*Achieved.* While fully reliable measures of the income profile of beneficiaries have not been prepared, we can at least roughly estimate relevant changes by applying the "below-median income" shares accepted for HGL eligibility (Chapter 6) to estimates of total program investment (Chapter 2). Overall results are positive: (1) the share of total program investment attributable to the lower-income group goes up consistently over time (average of 48 percent from 1986/87 to 1989/90, average of 59 percent from 1990/91 to 1992/93, reaching a high of 63 percent in 1992/93); (2) total investment attributable to that group increased from Rp.286.6 billion in 1986/87 to Rp.411.9 billion in 1992/93 (constant 1992/93 Rupiah). However, results on a per capita basis are again disappointing. Total program investment attributable to the below-median group per urban resident shows hardly any increase: Rp.6,500 in 1986/87, Rp.6,550 in 1992/93.

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

*Achieved.* While there is no fully systematic monitoring of levels of private sector involvement in urban services (financing and other), there is substantial evidence that those levels have increased (see Chapter 3). The Ministry of Home Affairs has begun to catalog public-private service agreements and reports 100 new agreements of this type over the past year.

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

*Achieved.* Municipal own-source revenue has grown rapidly in real, per capita terms (see Chapter 3). Real per capita own source revenues of Tk. I and II governments grew from /Rp.11,000 in 1987/88 to Rp.17,700 in 1991/92 (constant 1992/93 Rupiah)—an increase of 60 percent in just four years.

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

*Achieved.* Central funding for this sector should increase given the historically low level of sectoral budget expenditures. The appropriate objective is that locally controlled funding increase more rapidly than centrally controlled funds; i.e., that the local share increase. BAKD/BAPPENAS/MFPC, 1994, indicates that locally controlled INPRES funds have increased as a percent of total capital transfers—from 10.5 percent in 1987/88 to 22.9 percent in 1993/94.

**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 Chapter 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 Chapter 3). The PURSE project is attempting 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.*

■ 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 of, and issuing of operating guidelines for, the Regional Development Account (see Chapter 4). Many loans have now been issued pursuant to the new guidelines.*

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

*Largely achieved. Under both the RDA and GOI agreements related to the East Java/Bali Project, loan terms have moved considerably toward market terms and away from the highly concessional approach of the recent past. Positive real rates have been achieved.*

- 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 various initiatives (see discussion in Chapter 3).*

#### **OUTPUTS:**

- Provision of shelter-related urban infrastructure, valued at the equivalent of \$120 million benefiting below urban 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.

*Achieved. With strong support by AID in policy dialogues, this objective was added to the Policy Action Plan for MFSP and further elaborated in the PAP for MFEI and Repelita VI.*

- The rupiah equivalent of \$120 million is spent by the GOI to provide shelter-related urban infrastructure for the urban poor.

*This measure has been achieved in full—documented eligible expenditures through March 1994 total \$188.5 million. See discussion in Chapter 6.*

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

*Achieved (although not on a nation-wide basis). 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. The measure has almost certainly been achieved, but data to demonstrate changes nation-wide are not available.*

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

*This measure has been achieved (see discussion in Chapter 2).*

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

*Not yet achieved. With assistance from the PURSE project, draft guidelines have been completed for private participation in solid waste management and draft guidelines are in preparation for other subsectors. None of the guidelines, however, has yet been issued.*

- 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.

*Not fully achieved. Progress has been made by the MFPC in developing and regularly updating relevant indicators (see, for example, BAKD/BAPPENAS/MFPC, 1994) but these are not being used by the GOI in determining grant allocations.*

- 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. Technically, this measure has been achieved, however since these records are not regularly made public, 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. GOI officials have only recently begun to examine institutional options that would permit it. 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.

*This measure has not been achieved (see BAKD/BAPPENAS/MFPC, 1994), although a good deal of progress has been made in reducing concessionary terms in loan rates. 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. \$120 million authorization over the 6 years life of project (FY88—FY94).

*The full amount of the loan has been disbursed.*

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

*This measure has been achieved in full.*

- **GOI INVESTMENT.** \$120 million in rupiah equivalent expenditures from April 1, 1989 through March 31, 1994.

*As documented in Chapter 6, this measure has been exceeded with documented GOI eligible investment of \$188.5 million over this period.*

**Annex C**  
**POLICY ACTION PLAN**

No.	Policy Area/Objectives	Medium-term goals	Action Proposed
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 Kecamatan's and assign functional responsibilities (1987 - 1991)	Assign working group that would define classification policy (by Tim Koordinasi - TIQ); approve to carry out classification (by DSEM, DSKEK, DSKK, and DDPUCD)
		1.02 Define structural responsibilities for traffic management in urban areas (1987 - 88)	Study and assign responsibilities for traffic management and policy coordination (by TK, DSKK, DSKT, and DDPUCD)
		1.03 Develop program responsibilities for local governments in integrated Urban Infrastructure program (IUIOP)	Application of IUIOP programs in 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 MMA)
2.	Integrated expenditure planning and programming improvement (a) local governments to prepare investment plans on basis of guidelines from Central Government (b) financial support of local governments to be based on local capabilities and needs (c) emphasis to be given to MPW projects and low-income group needs	2.01 Develop and refine IUIOP planning	Develop & implement guidelines for non Cipta Karya subsectors with 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, MOP and MMA)
3.	Strengthen Local Government resource mobilization and financial management	3.01 Fully implement PBB tax law (1988 - 89)	Improve revenue performance of Property Tax (PBB) through technical and management improvement programs.
	(a) improve PBB performance, local tax performance, and service charge performance		

**POLICY ACTION PLAN HGL**

No.	Policy Area/Objectives	Medium-term goals	Action Proposed
		3.02 Improve revenue performance of local taxes and service charges (1987 onwards)	Improve the structure of local taxes and charges (by DGFN and DGFUD)
			Implementation of local tax office procedure improvements (by DGFUD)
	(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 charges/cost recovery performance of PDAMs in Java (by DGCK and DGFUD)
			Assign water enterprises monitoring and development functions to PMO's throughout Indonesia (by DGCK and DGFUD)
			Review optimal water enterprise organizational arrangements for all provinces based on efficiency criteria by TKPP
			Develop guidelines for restructuring, privatizing or liquidating BUMDs (Local gov't Enterprises)
	(c) improve local government financial management capabilities	3.04 Improve financial management capacity in all TK I & TK II gov'ts	Initial design/pilot tests of financial management & MIS packages under ISRD Urban IV, V & UBL1 (SPMKI, POMMS, PAPPACR, SIKDD, MAPATDA).
			Develop framework resolving conflicts & filling gaps between various financial mgmt & acctg info systems designated/piloted under ISRD Urban IV, V & UBL1.
			Expand Performance Oriented Maintenance Management System (POMMS)
			Develop a consolidated, coordinated and controlled system of Urban Management guidelines for use by TK II governments

**POLICY ACTION PLAN HQL**

No.	Policy Area/Objectives	Medium-term goals	Action Proposed
(c)	Encourage private sector resource mobilization and private sector participation in the provision and delivery of urban infrastructure services	<p>3.05 Establish an acceptable legal and regulatory framework for private sector involvement in the financing, implementation, operation and management of urban services and infrastructure</p>	<p>Assign working group to define and encourage the role of the private sector (by TRPP)</p> <p>Provide guidelines for appropriate forms of private sector participation in each selected sub-sector (by MPW)</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>3.06 Develop appropriate conditions to achieve the level of cost recovery required to motivate private sector investment in public services and infrastructure</p>	<p>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, LHA, and MPW)</p>
4	<p>Improve financing systems and mechanism for urban infrastructure and incentives for local resource mobilization</p>	<p>4.01 Provide a viable system of loan finance for local governments (1987 onwards)</p>	<p>Strengthen Central-local Government borrowing scheme (by DGMON)</p>
	<p>(a) create a consolidated loan fund for local governments</p>		
	<p>(b) improve grant allocation criteria</p>	<p>4.02 Improve allocation mechanisms of grant finance (1987-88)</p>	<p>Improve allocation criteria and guidelines for Central-Local grant system (by TR)</p>
		<p>4.03 Improve information base for policy development and operational decisions on local government finance</p>	<p>Improve system of Th. I &amp; II reporting to MOF &amp; MHA (PUOD) for APBD Local annual budget/belanja.</p>

**POLICY ACTION PLAN HGL**

No.	Policy Area/Objectives	Medium-term goals	Action Proposed
(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 channeling financial and technical assistance to the target groups and for monitoring and evaluating the effectiveness of such programs.	Improve information base for mobilization of local resources.	Improve information base required by Central Gov't to prepare policies & programs and monitor local gov't performance.
5 Improve local government capabilities	5.01 Strengthen Local Govt. institutions responsible for urban infrastructure	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).  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 UNDP framework (by DGCK and DG BANGDA).	Carry out a comprehensive study of urban institutional and manpower development needs of local governments (by MMA and Civil Service Administration Agency - SARUK).
(a) evaluate Local Government needs, with particular emphasis on urban managers and coordinate long-term training programs	5.02 Strengthen management and staffing capabilities in MPW DGs and Provincial Urban PU, to provide guidance to local governments (1987-1988)	Review coordination arrangements between MPW DGs in UNDP process	Identify skill skills and training experiences required to provide adequate management, technical and financial advice to Local Govts. (by MPW, MMA and M&HPA)
(b) raise staff capabilities of local revenue administration, planning and programming, and operations and maintenance	5.03 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 TL, II governments.	Develop a consolidated, coordinated and controlled system of Urban Management guidelines for use by TL, II governments.
(c) provide guidance to all gov. units in coordination of urban development			

**POLICY ACTION PLAN HGL**

No.	Policy Area/Objectives	Medium-term goals	Action Proposed
6	Strengthen coordination and consultation in the urban development sector	6 01 Develop effective policy coordination in the urban sector as well as the development of mechanisms to support policy review and decision making (1987 onwards)	Establishment of an Interagency Coordination Team for Urban Development (TKPP and an executive secretariate)
	(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 - 1990)	Assign working group to guide medium-term planning and programming and assign support teams to respective agencies as needed in policy option formulation and recommendations (by TK)

**Annex D**

**TERMS OF REFERENCE FOR THE EVALUATION**

**STATEMENT OF WORK**

**MUNICIPAL FINANCE AND SHELTER PROGRAM**  
**FINAL EVALUATION**

**BACKGROUND**

A major challenge facing Indonesia 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 more 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, USAID and the GOI initiated the Municipal Finance and Shelter Program.

The program was designed to address 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 MFSP emphasized 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 MFSP. This PP presented the GOI's urban Policy Action Plan (PAP), which was the basis for approving \$100 million of Housing Guaranty (HG) resources and \$5 million in grants for technical assistance and training under the MFSP. Subsequently, the MFSP was amended by adding a further \$20 million HG resources, to bring the total to \$120 million.

To enable USAID to authorize loan guarantees under the HG program, (1) the GOI agrees to finance rupiah expenditures on an Investment Program of shelter-related environmental infrastructure for the urban poor in an amount equivalent to the loan guarantees. Urban environmental infrastructure is defined as potable water systems, wastewater systems, storm drainage, solid waste collection and disposal, and other infrastructure services related to community improvements in low-income urban neighborhoods. In addition, (2) the GOI will have demonstrated support for implementation of the PAP.

In accordance with the implementation plan for the project, USAID undertook Assessments of PAP progress in July 1989, August 1990 and September 1991, which detailed and evaluated actions the GOI had made in reforming the municipal finance system. The Assessments of 1990

and 1991 summarized program accomplishments since the prior assessment, and recommended priorities for modification in subsequent periods. In July 1992, there was an Interim Evaluation of the MFSP and MFP, which also incorporated an assessment of PAP progress.

That evaluation concluded that MFSP served as a model for operating a policy-based sectoral HG program, and led directly to the establishment of a second HG program in support of the GOI's evolving urban policy. The new program, MFEI, is based on an extension of policy objectives established under the previous PAP, with the inclusion of a new initiative designed to advance integration of urban environmental management within the GOI's decentralized investment program.

USAID/Indonesia and RHUDO/Jakarta now wish to evaluate the progress which the GOI has made related to municipal finance policy since the inception of the MFSP, and the degree to which the MFSP has assisted the GOI to formulate and undertake these policies. This evaluation will provide USAID/Indonesia and RHUDO/Jakarta with a basis for possible modifications to implementation of the MFEI project, and the on-going associated MFP.

In doing so, the evaluation will necessarily need to (a) determine the extent to which policies developed under MFSP to date are sustainable, and (b) reassess the relevance of those policies to (i) the national policy on urban development, newly restated in Repelita VI, and (ii) the revised Policy Action Plan for MFEI. The evaluation will not include any evaluation of the performance of the MFP Advisory Team.

#### Article I - TITLE

Municipal Finance and Shelter Program (497-HG-001) Final Evaluation

#### Article II - OBJECTIVE

To provide a team which shall undertake a final evaluation of the Municipal Finance and Shelter Program, Indonesia: Project No. 497-HG-001, funded with \$120 million in Housing Guaranty loan resources (period of implementation, FY88 - FY93).

1. The purpose of this evaluation is to provide the Government of Indonesia (GOI) and USAID/Indonesia with an assessment of the impact of the HG-funded Municipal Finance and Shelter Program (MFSP) in contributing to improved urban management. This will be used in the annual review of the GOI's urban Policy Action Plan.
2. The evaluation will provide the Government of Indonesia (GOI) and USAID/Indonesia with an assessment of the impact of the project in financing appropriate urban investments in Indonesia, in order to assist in the revision of subsequent Investment Plans under the successor project, Municipal Finance for Environmental Infrastructure

(MFEI).

3. It will evaluate achievements and deficiencies of administration of the program in order to give guidance to USAID/Indonesia on the management of MFEI and the associated on-going grant-financed Municipal Finance Project (MFP)(497-0365).

4. It will also assess whether key issues identified in the Interim Evaluation of July 1992 have been adequately resolved.

The evaluation will focus on sector assistance through provision of HG resources, not on technical assistance and training provided under the MFP.

#### Article III - STATEMENT OF SPECIFIC EVALUATION TASKS

In addressing the issues summarized above, the team will perform the following tasks. The evaluation team will seek to provide empirical findings to answer the questions identified below, and the team's report will provide conclusions and recommendations based on these findings.

##### 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 Papers for MFSP and MFEI, and the Project Paper Supplement for MFP;
- b. all previous MFSP program Assessments and the Interim Evaluation report;
- c. the two most recent *Urban Policy Action Plan Monitoring Indicators* reports (GOU/MFSP);
- d. the most recent report on urban policy progress by BAPPENAS;
- e. sections of Repelita VI dealing with urban policy issues;
- f. *MFEI Eligible Expenditures Monitoring System*, John Taylor for RHUDO/Jakarta and USAID/Indonesia, October 1993;
- g. *Urban Infrastructure and Poverty Alleviation in Indonesia*, G. Thomas Kingsley, The Urban Institute for USAID/Indonesia, October 1993.

In Washington, DC, The team members will attend a briefing arranged by the PRE/H Backstop Officer for Indonesia. They will also meet with representatives of the World Bank in Washington, DC, to determine the Bank's views on implementation of urban projects in Indonesia, specifically in relation to the Bank's future involvement in Indonesia's urban sector during the next five year development plan.

Before departure for Jakarta, the team members will finalize a plan of work for the field work in Indonesia. This may include the preparation of evaluation instruments and criteria, and interview forms. 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 July 1992 to the present, based on urban policy monitoring indicators and reports from BAPPENAS. This review will describe actions taken, policies adopted and changes initiated, and will identify issues which still need to be addressed. The team will summarize progress made in the preceding period, i.e. from project commencement. Since this has previously been reported in some detail in annual assessment reports and in the report of the Interim Evaluation, the information need be re-presented only in summary fashion.

The team will update the issues discussed in the July 1992 report of the Interim Evaluation. The update should include a review of 1992-94 performance, plans for the future, opportunities to strengthen the program, and relevant critical policy issues impacting the urban development strategy for the remainder of Repelita VI.

The team will describe the overall impact of the MFS? in relation to Indonesia's urban policy reform activities.

Team members will also review the likely impact of policy changes on women.

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 Finance, Home Affairs and Public Works. Other meetings will be held with representatives of the TKKP, MFP Advisors, resident representatives of the World Bank in Jakarta, the USAID/Indonesia WID officer, and the Chief and staff of RHUDO/Jakarta and the Urban Policy Division (UPD) of

**USAID/Indonesia.**

In addition to the documents listed in the description of Task 1, the team will review the routine reports of the MFP Advisors, other reports written in support of PAP implementation, and IUIDP project reports.

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 Logical Framework with actual outcomes.

The team will provide answers to the following questions:

- 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, especially since the date of the most recent Evaluation, in July 1992? What is the relevance of these accomplishments vis-a-vis current urban problems? Are the accomplishments sustainable? Has GOI progress on the policy objectives been commensurate with investment of the HG resources?

- b. To what extent have the measures of goal achievement and the objectively verifiable indicators of project purpose and output, as stated in the LogFrame of the PP, been reached?
- c. To what extent were gender concerns integrated into the implementation of the project? Have women benefitted from the project to any significant degree? Is there a need for gender-specific monitoring of the impact of urban investments? How can the MFEI project be implemented to address

gender concerns more directly?

- d. To what extent have the issues identified by the Interim Evaluation of the MFSP been resolved?

**Task 3: Prepare an Assessment of the Impact of Investments made under the Annual Investment Plans**

The team will review the annual investment plans as submitted by the GOI and approved by USAID, and the relevant memoranda which describe USAID's review of the investments, and will summarize the plans and accomplishments in a single tabulation. The team will compare the value and type of investments attributed to the MFSP with overall urban investment levels, to derive a measure of relative impact. The team will also examine GOI budgetary records to ascertain the extent to which the HG resources have been used as additional to the GOI's normal revenue sources.

The team will provide answers to the following questions:

- To what extent have expenditures made under the annual Investment Plans satisfied the objectives and forecasts described in the PP? 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? To what extent have the HG-generated resources been used as additional to the GOI's own-source funding?
- To what extent have the recommendations of the October 1993 report *Urban Infrastructure and Poverty Alleviation...* been implemented?

**Task 4: Identify Lessons Learned**

From the preceding tasks, the team will assess the probability for sustained impact of the successor project, MFEI. The team will identify emerging opportunities which could be incorporated into any later amendment of the PAP, and the annual Investment Plans. The team will identify any obstacles to PAP implementation, and propose new approaches to overcoming these obstacles.

The team will describe the extent to which successes and/or failures of the MFSP could impact on the design and implementation of future USAID policy-based, sector HG programs.

The team will provide answers to the following questions:

- a. What are the principal lessons learned from the MFSP?
- b. Have the RHUDO, USAID and GOI management and implementation mechanisms of the project been the most efficient and effective way of meeting its objectives? What lessons does the project teach for the management of MFEI?
- c. What is the implication of these lessons for the design and implementation of new USAID policy-based, sector HG programs?

**Task 5: Briefings**

The team will be required to meet with Mission evaluation and UPD/RHUDO 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 leader will provide a briefing on their findings to PRE/H.

**Article IV - REPORTS**

The team will prepare, in the field, a draft final report which corresponds to the questions in Article IV above, and which corresponds to USAID's required format for evaluation reports. The following sections must be included in the evaluation report prepared by the team:

1. **Executive Summary**
  - Purpose of activity evaluated
  - Purpose of the evaluation and methodology used
  - Findings and conclusions
  - Clear and succinctly stated LESSONS LEARNED, both regarding project design implications and broad action implications
2. **Project Identification Data Sheet (Mission will provide)**
3. **Table of Contents**
4. **Body of the Report**

This is usually 30-40 pages, including sections on:

  - purpose and study questions
  - the economic, political and social context of the project

- team composition and study methods (1 page maximum)
- evidence/findings of the study concerning the evaluation questions
- succinctly stated conclusions drawn from the findings (including lessons learned)
- recommendations based on the study findings and conclusions.

**5. Appendices, including:**

- a copy of the evaluation scope of work
- the project log frame
- a list of documents consulted, and of individuals and agencies contacted
- more detailed discussions of methodological or technical issues as appropriate.

**RHUDO/Jakarta strongly favors concise writing and the avoidance of jargon.**

**This draft report will be submitted to the RHUDO Deputy Chief, USAID/ Indonesia prior to the team's departure from Indonesia.**

**RHUDO/Jakarta will provide the team with comments from USAID (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 before August 15, 1994.**

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

**The team will also be responsible for drafting Sections H and J of the standard USAID Evaluation Summary. This will be done before the team's departure from Indonesia. A copy of this form, and of the instructions for completing it, are attached for reference.**

**The RHUDO Deputy Chief will be responsible for review and approval of the final report, and the language of the report.**

**Article V - RELATIONSHIP AND RESPONSIBILITIES**

**The team will report to the RHUDO Deputy Chief, Joel Kolker, and will periodically consult with a representative of BAPPENAS. Day-to-day liaison will be provided by Michael Lee, who will also assist the team by providing the literature specified in Task 1 above, in facilitating meetings in Jakarta and obtaining the necessary statistical and other information.**

**Article VI - PERFORMANCE PERIOD**

The evaluation will begin in Washington, DC, on or shortly after June 1, 1994, and will be completed within a period of about one month.

**Article VII - THE EVALUATION TEAM & WORK DAYS ORDERED**

The Mission believes that the outputs described in this Scope of Work can be achieved within a total 50 person-days of input, including 6 person-days spent in Washington, DC.

	<u>Position</u>	<u>Work Days</u>
1.	Senior Urban Policy Specialist	25
2.	Urban Management Specialist	25
	Total	50

**Article VIII - AID ILLUSTRATIVE BUDGET**

See Attachment No. 2.

**Article IX - SPECIAL PROVISIONS**

1. Duty Post  
Jakarta, Indonesia.
2. Language Requirements and Other Required Qualifications

The evaluation team should consist of two people, at least one of whom must be thoroughly familiar with urban issues in Indonesia. A knowledge of Bahasa Indonesia would be useful but is not essential. At least one team member should have prior experience of conducting evaluations of USAID HG programs. At least one team member must have experience of integration of gender concerns into urban programs.

The team leader should be a senior 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 Indonesia.

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

3. Access to Classified Information

Contractor shall not have access to any Government classified material.

4. Logistical Support

The team is responsible for providing its own computer facilities. They should be advised that (1) USAID Mission security regulations preclude the use of the team's computers on the Embassy compound; and (2) USAID uses a DOS-based system.

The Mission cannot undertake to provide office space, but will provide office space on an as-available basis. The contractor will provide office supplies and equipment for the team. Secretarial services are to be arranged by the contractor.

5. Work Week

A 6-day working week is authorized.

*Annex E*

**PERSONS INTERVIEWED**

The evaluation team interviewed the following individuals in August 1994 to obtain information contributing to the analysis presented in this report.

- **Hatta Ahadis, Chief, Sub-Directorate for Human Settlement, Directorate of Urban Development, Directorate General of Regional Development, Ministry of Home Affairs**
- **Michael Conlon, Demonstration Project Advisor, PURSE Project**
- **Steven Dice, World Bank, Project Director, East Java and Bali Urban Development Project**
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- **William Frej, Director, Private Enterprise Development Office and Director, Regional Housing and Urban Development Office, USAID/Indonesia**
- **Mayling Oey-Gardiner, Insan Harapan Sejahtera**
- **John Herbert, Consultant to Deputy V, Bappenas, Development Studies Project II**
- **Susiyati Hirawan; Chief, Bureau for Regional Finance Analysis, Ministry of Finance**
- **Dono Iskandar, Chairman, Board of the Analysis of State Finance, Credit, and Balance of Payments**
- **William Kugler, MFPC Advisor BAPPENAS**
- **Kismet Kosasih, National Project Director, IIUDP Implementation Support Project**
- **Nancy Langworthy, Office of Program and Project Support, USAID/Indonesia**
- **Achmad Lanti, Director for Program Development, Directorate General Cipta Karya, Ministry of Public Works**

- Michael Lee, Urban Policy Advisor, Regional Housing and Urban Development Office, USAID/Indonesia
- Hasan Abas Nusi, Director, Directorate for Urban Development, Directorate General of Regional Development, Ministry of Home Affairs
- Arlen Pakpahan, Staff, Bureau of Regional Financial Analysis, Ministry of Finance
- William J. Parente, Chief of Party, PURSE Project Team
- Gutheng Prabowo, Directorate General of Public Administration and Regional Autonomy, Ministry of Home Affairs
- Cuci Raharjo, Direktorat Pengelolaan Penerusan Pinjaman, Ministry of Finance
- Jay K. Rosengard; MFPC, Chief of Party, Ministry of Finance
- Pirulan Sidabutar, Assistant to the Minister of Public Works for Human Resource Development
- Karen Smith, Special Assistant to Nafsiar Mboi, Jakarta, Indonesia
- Budhy Tjahjati S. Soegijoko, Chief, Bureau of Urban Development, Human Settlements, and Spatial Planning, BAPPENAS
- Pungky Sumadi, Bureau of Urban Development, Human Settlements and Spatial Planning, BAPPENAS
- Hendropranoto Suselo, Assistant to the Minister of Public Works for Integrated and Urban Spatial Planning
- Suwarso, Direktorat Bina Program, Ministry of Public Works
- Suyoto, Director of Sub Loans, Direktorat Pengelolaan Penerusan Pinjaman, Ministry of Finance
- Birong Tambunan, Secretary to the Director General, Directorate General of Public Administration and Regional Autonomy, Ministry of Home Affairs
- John Taylor, MFPC, Urban Development Specialist, Directorate General of Cipta Karya
- Philip B. Tjakranata, USAID Urban Program Analyst, USAID/Indonesia

- **Agus Wijanarko, Head, Subdirectorate Bina Program, Planning and program, Cipta Karya, Ministry of Public Works**
- **C. Mark Williams, International Economist and Project Financial Advisor, PURSE Project**

Annex F

**FAA STATUTORY CHECKLIST AND PROJECT DATA SHEET**

**THE HOUSING GUARANTY PROGRAM**

**STATUTORY CHECKLIST**

**INDONESIA**

**PROJECT NO. 497-HG-001**

**ANSWER YES/NO OR PUT PP PAGE  
REFERENCES AND/OR EXPLANATIONS  
WHERE APPROPRIATE**

**A. General Criteria Under HG Statutory  
Authority**

**Section 221(a)**

Will the proposed project meet the  
following criteria:

1) is intended to increase the  
availability of domestic financing by  
demonstrating to local entrepreneurs  
and institutions that providing low-  
cost housing is financially viable;

**YES (See Annex 11, GC/PRE  
Memo, Issue 1.A, p. 11-2)**

2) is intended to assist in marshalling  
resources for low-cost housing;

**YES (See Annex 11, GC/PRE  
Memo Issue 1.A, p. 11-2)**

3) supports a pilot project for low-  
cost shelter, or is intended to have a  
maximum demonstration impact on local  
institutions and national policy; and

**YES (See Annex 11, GC/PRE  
Memo, Issue 1.A, p.11-2)**

4) is intended to have a long run goal to develop domestic construction capabilities and stimulate local credit institutions to make available domestic capital and other management and technological resources required for effective low-cost shelter programs and policies

YES (See Annex 11, GC/PFE  
Memo, Issue 1.A, B. 11-2)

Section 222(a)

Will the issuance of this guaranty cause the total face amount of guaranties issued and outstanding at this time to be in excess of \$2,150,000?

NO

Will the guaranty be issued prior to 30 September 1988?

YES

Section 222(b)

Will the proposed guaranty result in activities which emphasize:

1) projects providing improved home sites to poor families on which to build shelter and related services

NO

2) projects comprised of expandable core shelter units on serviced sites

NO

3) site upgrading projects designed to conserve and improve existing shelter

YES (See Annex 11, GC/PFE  
Memo, Issue 2, A, B, C p. 5-7)

4) shelter projects for low-income people designed for demonstration or institution building

YES (See Annex 11, GC/PRE  
Memo, Issue 2, A, B, C, p. 5-7)

5) community facilities and services in support of projects authorized under this section to improve the shelter occupied by the poor?

YES (See Annex 11, GC/PRE  
Memo, Issue 2, A, B, C, p. 5-7)

Section 222(c)

If the project requires the use or conservation of energy, was consideration given to the use of solar energy technologies, where economically or technically feasible?

N/A

Section 223(a)

Will A.I.D. guaranty fee be in an amount authorized by A.I.D. in accordance with its delegated powers?

YES

Section 223(f)

Is the maximum rate of interest allowable to the eligible U.S. Investor, as prescribed by the Administrator, not more than one percent (1%) above the current rate of interest applicable to housing mortgages insured by the Department of Housing and Urban Development?

N/A

Section 223(j)

1) Will the proposed Housing Guaranty be coordinated with and complementary to other development assistance in the host country?

YES

2) Will the proposed Housing Guaranty demonstrate the feasibility of particular kinds of housing and other institutional arrangements?

YES

3) Is the project designed and planned by A.I.D. so that at least ninety percent (90%) of the face value of the proposed guaranty will be for housing suitable for families below the median urban income for housing in urban areas, in the host country?

YES (See Annex 11, GC/PRE Memo, Issue 3, p. 11-8)

4) Will the issuance of this guaranty cause the face value of guaranties issued with respect to the host country to exceed \$25 million in any fiscal year?

NO

5) Will the issuance of this guaranty cause the average face value of all housing guaranties issued in this fiscal year to exceed \$15 million?

NO

Section 238(c)

Will the guaranty agreement provide that it will cover only lenders who are "eligible investors" within the meaning of this section of the statute at the time the guaranty is issued?

YES