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**Municipal Finance for Environmental Infrastructure
Urban Policy Action Plan
Annual Assessment**

**Prepared for
United States Agency for International Development**

**Prepared by
David DeGroot
PADCO, Inc.
1025 Thomas Jefferson Street, NW
Suite 170
Washington, DC 20007**

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Executive Summary

The Municipal Finance for Environmental Infrastructure (MFEI) Housing Guaranty Loan Program provides the Government of Indonesia (GOI) with up to \$125 million in funding for urban environmental infrastructure investment over a four-year period. Two associated technical assistance and training projects (the Municipal Finance Project, or MFP, and Private Participation in Urban Services, or PURSE) provide assistance to the GOI in implementing an ambitious five-year Urban Policy Action Plan (UPAP). The UPAP charts the GOI's course in decentralizing resources, authority, and responsibility for increased infrastructure and service provision at the local government level.

An annual assessment is carried out by an independent expert to determine the degree to which UPAP targets supported by the MFEI have been met and to identify areas in which the MFEI implementation plan may require adjustment. This second annual assessment summarizes the continuing excellent progress that is being made in achieving key reform targets related to the six key UPAP objectives on which MFEI assistance is focused.

Achievement of Targets for the Period

Year 2 progress continued to be excellent, with all targets for the period met or exceeded. Whereas many of the Year 1 targets were largely preparatory in nature, during Year 2 many targets required very significant policy reform and innovative design and implementation activities. This assessment revealed, through more than 25 interviews, that GOI officials, consultants supported by the United States Agency for International Development (USAID), and USAID management have continued to work together in an exemplary fashion both to achieve stated targets and to creatively adapt resource deployment to meet situational requirements. All participants are to be congratulated on their skillful implementation of this ambitious sectoral reform program.

The key objectives and summary achievements for the period are as follows:

- **Strengthening GOI Apparatus for Urban Management.** Key Year 2 activities focused on urban environmental quality management (UEQM), including preparation of a management handbook on this subject and initial design work for a UEQM training module to be incorporated in the Urban Management Training Program (UMTP). In addition, support was provided to BKS AKSI, the Indonesian association of local governments, to hold the first national city-sharing conference. This event was, according to participants, extremely useful and will be continued on at least an annual basis.
- **Strengthening Local Government Urban Management Capacity.** The second module of the UMTP curriculum, focusing on urban financial management, was designed and pilot tested with favorable responses. An innovative approach to the future delivery of this module is being worked out with three regional universities recognized for their finance curricula.
- **Implement a Decentralized and Coordinated Process for the Provision and Management of Urban Infrastructure.** Year 2 targets concentrated on drafting regulations to govern private-public partnerships (PPPs) in environmental infrastructure and service provision. As

discussed in the body of this assessment, subsequent annual actions and end-of-project outputs for this UPAP goal require review.

- **Establish a Decentralized and Coordinated System for Urban Environmental Quality Management.** A number of useful workshops were held in support of this objective, and work is now under way in four centers to more effectively integrate aspects of UEQM in capital investment programming processes.
- **Increasing the Availability and Effectiveness of Financial Resources for Urban Development.** Huge strides were taken in preparing for the issuance of revenue bonds by up to three local water authorities, all expected to float before the end of 1996. Excellent progress continued to be made in reforming intergovernmental fiscal transfer systems, and real per capita growth in local government own source revenues continues at a healthy pace.
- **Mobilizing Private Sector and Community Participation in Urban Development.** Excellent progress was made in facilitating a range of pilot PPPs around the country. Accomplishments in establishing project life cycle processes as well as risk management strategies were equally impressive.

Themes Arising from the Assessment

The key summary finding arising from the Year 2 assessment is that, while progress in achieving MFEI-supported objectives in the UPAP remains excellent, additional attention will need to be paid to affiliated issues and reforms for MFEI assistance to have its greatest impact. Key areas for additional work, discussed fully in Section 3 of this assessment, are as follows.

- **Administrative Reform in Support of Decentralization.** While excellent progress is being made in resource mobilization, capacity building, and promotion of private participation — the key areas of MFEI support — more mundane administrative reforms related to local government human resources require attention.
- **Manageable Outcomes in PURSE.** The UPAP end of Repelita targets for PPP regulatory instruments, adoption, and enforcement are beyond the scope of PURSE, and this UPAP objective will require rethinking.
- **Broadening the PPP Net.** PURSE can and should provide guidance to the GOI on ways in which the models and instruments being developed under this project can be adapted to other local government activities.
- **Supporting Inpres Reform.** The impressive progress made in reforming the main intergovernmental fiscal transfer system should receive continued support leading up to preparation of the 97/98 GOI budget.
- **Incentives to Build Local Capacity.** While progress in developing the UMTF continues to be excellent, clear career path incentives need to be identified to ensure continuing participation by local government technical staff.
- **Water Resource Management.** The GOI must begin systematically considering bulk supply management options to ensure that the excellent progress being made in building the capacity of and improving access to finance for local water distribution authorities (PDAMs) will not be constrained by a lack of raw water.

- **The UPAP Overall.** While steady progress is being made in achieving the UPAP goals that directly receive USAID support, assessment of progress in achieving other key elements of the UPAP is less clear. The GOI would benefit from undertaking periodic assessments of the entire UPAP action agenda to ensure that key actions corollary to MFEI support and to sectoral reform as a whole are not neglected.

Implications for the GOI and USAID

The final section of this assessment summarizes actions that may be of utility to the GOI and USAID in supporting continued progress in achieving MFEI and UPAP objectives. During the upcoming third year of program implementation, consideration needs to be given to the broader sectoral reform agenda, and this focus may have implications for amendment of the current UPAP, as well as for design of the next sectoral action plan and future USAID support programs.

Summary

The second annual assessment again revealed that excellent progress is being made in achieving the complex and wide-ranging reform agenda embodied in the UPAP and the MFEI project design. Interviews with all key actors fully demonstrated the degree to which close and productive cooperation between GOI officials, USAID management, and project consultants continues to be the norm. USAID's support to the GOI in examining the multitude of options inherent in a decentralization program of this scope is very evidently bearing fruit in the form of well-reasoned GOI policy actions. Once again, the program's managers are to be heartily congratulated for their skill, dexterity, and dedication in guiding this challenging project along the road to success.

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MFEI Housing Guaranty Loan

Annual Assessment

June 1996

1 Introduction

This annual assessment of the Municipal Finance for Environmental Infrastructure (MFEI) Housing Guaranty (HG) Loan to the Government of Indonesia was carried out from May 28 to June 14, 1996. In the course of the assessment, more than 25 interviews were conducted with key Government of Indonesia (GOI) officials and consultants associated with the MFEI project (see Annex A for the list of persons met).

This annual assessment has two main purposes. First, an external expert is requested to review with all of the key parties progress made in achieving annual policy targets. These targets are very clearly set forth in the Urban Policy Action Plan (UPAP). The second purpose of the assessment is to allow all key participants to reflect on the continuing appropriateness of established targets, to identify emerging priorities, and to consider possible realignments in both targets and deployment of resources through associated technical assistance and training activities.

The main body of the report contains three sections. First, progress in meeting annual UPAP targets is summarized. Second, themes emerging from interviews are discussed and related to overall project and UPAP goals. Third, implications and recommendations for the GOI and the United States Agency for International Development (USAID) are set out. This assessment does not include a review of attributable GOI investments related to justification of HG tranche releases. That exercise has been conducted separately and the results are on file with USAID.

A sincere word of thanks is due to all of the GOI officials and project consultants interviewed during the assessment for their universal willingness to make available information and time from their busy schedules. Similar gratitude is expressed to USAID staff, who were uniformly informative and highly efficient in organizing a rather hectic three weeks. Any errors of omission or misinterpretation in this report are entirely the author's.

2 Summary of Progress toward UPAP Objectives

This section of the assessment examines progress made in achieving UPAP goals and annual targets for which MFEI and USAID support is explicitly provided. Comments are provided, where necessary, on the status of individual actions as well as summary comments for each major objective.

2.1 Strengthen Governmental Administrative Apparatus for Urban Management

This objective (Number 2 in the UPAP) focuses on strengthening intergovernmental coordination and development of clearer legal and regulatory systems and guidelines to support urban management. The key actions, second year targets, and accomplishments for the reporting period are reviewed below.

- 1) **Action:** Establish a full-time urban secretariat to support the interdepartmental coordinating committee (2.1B in UPAP).

Second year target: Urban secretariat organizational structure activated.

Accomplishments: TKPP continued to function as the primary coordinating mechanism for the UPAP. In addition, during 1995, TKPP took on the role of providing operational policy guidance and coordination for the Institutionalization of Integrated Urban Development Project (IIUDP). The need to establish a full-time secretariat in addition to the TKPP itself is under review; a draft Ministerial decree regarding changes in the roles and responsibilities of TKPP is under review by Bappenas.

Comment: As noted during the Year 1 review, the need for, composition of, and appropriate institutional home for a full-time urban policy secretariat in addition to TKPP is not entirely clear. What is clear, however, is that a secretariat-like body is required to monitor all aspects of the decentralization process, particularly with regard to capacity and human resources, as discussed later in this paper.

- 2) **Action:** Complete and continuously update an inventory and analysis of all existing laws, regulations, and guidelines issued by central agencies of relevance to urban management at the local government unit (LGU) level¹ (2.3A in the UPAP).

Target: Update inventory/analysis of laws, regulations, and guidelines related to urban management.

Accomplishments: Routine updating of the database continued.

- 3) **Action:** Prepare detailed urban management guidelines (UMGs) for specific functional areas for use by LGUs (2.3B in the UPAP).

Target: Expand urban management functions covered by UMGs via preparation and dissemination of UEQM guidelines.

Accomplishments: A local consultant was selected to carry out the UEQM UMG preparation, in conjunction with design of the UMTF UEQM module, which was underway while this assessment was being conducted. The guidelines will be completed and disseminated in October 1996 to 53 local governments with MOHA support.

- 4) **Action:** Improve the existing systems for dissemination of central laws, regulations, and guidelines to LGU managers (2.3C in the UPAP).

¹ Local government unit (LGU) is used in this assessment as a generic term to include municipal authorities, local enterprises, and other local authorities.

Target: Prepare training plan for dissemination system of central government laws, regulations, and guidelines to urban managers.

Accomplishments: BKS-AKSI has been identified as the organization through which urban management guidelines will be disseminated. An initial City Sharing conference was held in November 1995 on the theme of "Sustainable and Self-Sufficient Development." A second workshop will take place in FY 1996/97.

In summary, Year 2 progress was entirely satisfactory in achieving the stated UPAP targets to improve urban management administrative apparatus. As discussed later in Section 3 of this assessment, consideration may need to be given to expanding UPAP targets in this regard.

2.2 Strengthen the Institutional Capacity of Local Governments for Urban Management

MFEI-related support for this critical objective (Number 3 in the UPAP) focuses primarily on design and implementation of a coordinated and self-sustaining Urban Management Training Program. Four key actions were involved for the period under review.

- 1) **Action:** Design and continuously maintain an interministerial framework for urban management training and technical assistance, providing a basis and focal point for all such training and technical assistance (3.2A in the UPAP).

Target: Conceptual framework for urban management updated through reassessment and revisions to initial formulation.

Accomplishments: Assessments of the Urban Management Core Course, which was designed and delivered during Year 1, were secured through alumni surveys. These surveys identified the need to incorporate non-metropolitan case studies in the core course and other UMTTP modules to achieve greater relevance for officials from smaller cities. Alumni surveys will be institutionalized as a key assessment technique for the entire UMTTP. In addition, evaluation questionnaires are provided to and collected from all UMTTP course participants.

- 2) **Action:** Implement the UMTTP core course with selected local governments (3.2B in the UPAP).

Target: Issuance of a MOHA Decree requiring all TK II local governments to use the Core Course, which is to be offered on a regular basis.

Accomplishments: The necessary MOHA decree was issued providing the legal basis for the entire UMTTP. The Core Course was adopted by the MOHA training agency (Badan Diklat) and three training sessions were offered during the year under review. A MOHA DIP to fund an additional three sessions is anticipated for the coming fiscal year.

- 3) **Action:** Preparation of the Urban Financial Management Module of the UMTTP (3.2B).

Target: UMTTP Financial Management Module to be developed and piloted.

Accomplishment: The UMTF Financial Management module was developed and the pilot course was delivered during the period in which this annual review was undertaken. This module appears to be extremely well-conceived, covering 13 strategic issues in four main categories (Own Source Revenues, Expenditure Efficiency, Enterprises, and Debt Management). Six case studies, drawn from actual experiences in Indonesian cities, have been developed and the response of participants in the pilot course was markedly enthusiastic.

- 4) **Action:** Improved participation by regional universities and other management training institutions in developing and delivering urban management courses and programs (3.2C).

Target: Linkage of regional university programs to the UMTF for training urban managers through the Financial Management module.

Accomplishments: Three regional universities submitted proposals to serve as continuing implementers of the Financial Management module, and representatives from all three universities participated in the pilot delivery of the course. A final evaluation of the three proposals is expected early in Year 3.

In addition, the involved institutions established the "Regional Universities Forum on Urban Management" and held an initial conference in Bandung in January 1996. Support will be provided by USAID to institutionalize this forum.

In summary, UMTF development continues to be of the highest caliber. GOI officials, MFP consultants, and USAID management have worked together in a most productive manner to ensure that UMTF modules are developed and revised in full consultation with the "customers" for these courses. The importance of the UMTF in building local government capacity to responsibly carry out the critical functions inherent in the process of decentralization cannot be overemphasized.

However, as noted in the Year 1 assessment, the larger question of self-sustained delivery of the UMTF is key. MOHA will support delivery of the program in the coming year through a DIP, but it would be more effective for local governments to be empowered to acquire UMTF training on their own. Hence, consideration should be given, as discussed later in this assessment, to ensuring that incentives are provided to promote continuing consumption of UMTF courses by local officials.

In addition and as noted in the Year 1 assessment, training relevant to urban management being offered by other ministries — notably PU — should eventually be fully coordinated with the UMTF.

Finally, the question of a long-term "home" for the UMTF remains unresolved. The Urban and Regional Development Institute (URDI) held its launch meeting during the course of this annual assessment. The URDI was conceived with USAID assistance, is receiving UNCHS technical assistance, and has secured private sector support. This institute may provide an appropriate base for continuing coordination of the UMTF following the completion of MFP II.

2.3 Implement a Decentralized and Coordinated Process for the Provision and Management of Urban Infrastructure and Facilities, including Adequate Levels of Investment

This objective (Number 5 in the UPAP) has focused in MFEI mainly on improving regulations for private-public participation (PPP, e.g., BOO/BOT) joint ventures in development of sanitary landfills, wastewater treatment systems, and real property development.

- 1) **Action:** Improve and implement basic technical standards for design, construction, and operation of sanitary landfills (5.3E in the UPAP).

Target: Regulations and detailed guidelines prepared and adoption process initiated by PU.

Accomplishments: The draft regulations and guidelines were prepared and submitted to Cipta Karya, which reviewed and revised the submissions.

- 2) **Action:** Improve and implement regulations and technical standards for the design, construction, and operation of wastewater treatment systems (5.3F in the UPAP).

Target: Development of wastewater treatment regulations and guidelines to be initiated.

Accomplishments: The development of required regulations and guidelines was initiated.

Comment: Comments from the Year 1 assessment are reiterated: as in most other southeast Asian nations, wastewater treatment in Indonesia is not well-advanced. There is little consumer willingness to pay for such treatment, and in many urban areas the local water utilities are not well enough established to manage wastewater treatment. Consumer education will be required, as will innovative cost recovery schemes, particularly with regard to residential wastewater. Opportunities for commercially viable treatment schemes are most likely, at least initially, to involve industries and hotels.

- 3) **Action:** Improve and implement regulations requiring real estate, commercial, and industrial developers to construct and maintain environmental infrastructure (e.g., water and wastewater systems) as part of their developments (5.3G in the UPAP).

Target: Recommendations for improvements of existing regulations to be completed.

Accomplishments: Issues involving existing regulations and this UPAP objective were assessed.

Comment: See summary below.

- 4) **Action:** Provide MFEI financing for urban environmental infrastructure (5.4 in the UPAP).

Target: \$25 million.

Accomplishment: The annual borrowing was completed on schedule and, according to a separate review of investments, was fully used for the intended purpose of financing environmental infrastructure provision.

To summarize, there have been difficulties in achieving the Year 2 targets for the UPAP medium-term goal 5.3, for several reasons.

First, development regulations are not popular animals in Indonesia or most other countries. The promulgation of such regulations is a tedious business, requiring extensive reviews by technicians who, certainly in the case of Cipta Karya, have many other responsibilities in the planning and implementation of infrastructure funded through the central budget.

Second, at this point in Indonesia's development, regulations for PPPs may be viewed as somewhat arcane, given the very limited number of PPPs that are now planned or underway. It must also be appreciated that PPPs as a way of doing business represent a threat — at this point of a largely theoretical nature — to the traditional, centrally funded way of investing in Indonesian infrastructure. Therefore, assignment of the regulatory review and adoption functions to an agency that makes its living from central funding does not include many incentives for quick action.

Third, UPAP action 5.3G is both too complicated to be achieved through PURSE, and too narrowly focused, as written, to be of full utility to Indonesian authorities. The action, as currently written, requires revision of water and wastewater systems regulations for real estate, commercial, and industrial PPP developments. Regulations for these three types of development would normally encompass many volumes, especially in the industrial category under which tens, if not hundreds, of separate, specialized activities would require attention. Further, action 5.3G's focus on only water and wastewater for these types of development is impractical; even if production of these limited regulations was possible through PURSE, their promulgation in isolation from other necessary regulations — again, especially in the industrial category — would be of limited utility.

In short, therefore, UPAP actions 5.3E-G require reassessment. There is no question that water, wastewater, and solid waste regulatory frameworks for PPPs need to be developed in Indonesia. Given that PURSE's objective is to promote PPPs, it would be irresponsible for this project not to develop attendant regulations to ensure that standards of PPP developments are acceptable. However, the scope of 5.3G would appear to be beyond the capacity of PURSE, as would the end of Repelita targets of having all of these regulations being actively implemented by central, provincial, and local authorities.

As noted in the Year 1 assessment, many persons interviewed during the course of this assessment raised the general point that GOI capital investment planning at both the national and local levels tends to overlook the important role of infrastructure and services to be provided by the private sector. The end of Repelita targets for this objective do not include dissemination of improved regulations to the private sector, a factor that may conflict with other efforts through PURSE to mobilize private participation.

In addition, as privately funded, large-scale development in Indonesia takes off — as it already has, in a major way — there is a rapidly increasing need for GOI capital investment programming processes to detect and provide support infrastructure for private developments. At present, the capacity of the GOI to carry out this critical function is limited at best; perpetuation of this state of affairs will result in a proliferation of developed enclaves that are unrelated to bulk infrastructure and that, in many cases, will require expensive retrofitting at some point in the future.

2.4 Establish a Decentralized and Coordinated System for Urban Environmental Quality Management

This objective (Number 7 in the UPAP) is, in relation to the MFEI, fairly narrowly focused on pricing strategies and improved incorporation of environmental management considerations in urban capital investment programming.

- 1) **Action:** Formulate and implement improved pricing strategies for water sector services (7.3A in the UPAP).

Target: Conduct a natural resources pricing study, and draft pricing guidelines and regulations.

Accomplishments: A study of economic incentives in the pricing and financing of local wastewater services was carried out during Year 2, and the results were presented in a national policy seminar on “Urban Environmental Finance and Management.” An additional study on local government surface water user charges was also carried out.

In addition, a very interesting and potentially useful pilot project was initiated to examine best operational practices for septic tank sludge treatment facilities, about 80 of which have been or are being built around the country in recent years.

Each of these activities will feed into drafting of pricing guidelines and regulations.

- 2) **Action:** Develop and implement guidelines for more proactive consideration of urban environmental quality management in capital investment programming, including explicit analysis of consumer demand and willingness to pay (7.6A in the UPAP).

Target: Further development of community-based environmental infrastructure planning as part of the new generation PJM process. Development of urban environmental planning guidelines to be used in PJM updates in two cities and monitoring of previous work in Pangkal Pinang and Tasikmalaya.

Accomplishments: The two additional areas selected for further development of community-based environmental infrastructure planning systems are Kotip Ternate and the nine towns in the Lake Toba watershed. In Ternate, emphasis is being placed on community solid waste management and general cleanliness. In the Lake Toba area, efforts are concentrated on industries, businesses, and hotels to improve water quality management.

A policy seminar held in May 1995 reviewed the results of the "next generation" PJMs carried out in Pangkal Pinang and Tasikmalaya. A series of dissemination workshops followed in Kalimantan, Java, Bali, and Sumatra.

A short-term consultancy was carried out under the MFP to examine ways in which community participation could be increased in the formulation of urban environmental management programs. A handbook on local government urban environmental management was also produced, addressing public policy, legal, regulatory, institutional, and financial aspects. A discussion paper on "Indonesia's Opportunities for Proactive Urban Environmental Quality Management" was also produced, setting forth a variety of basic parameters, including integrated resource management, improved monitoring procedures, and real demand surveys to more accurately reflect community priorities. Finally, a national policy seminar on "Urban Environmental Finance and Management" was held in Mataram in October 1995 with more than 100 attendees from all levels of government, Indonesian universities, consultants, and USAID staff.

Comment: During Year 2, the amount of work carried out on urban environmental management was very impressive. Work in the two new areas of Ternate and the Lake Toba towns could lead to very important innovations, particularly in Lake Toba where an entire watershed area is being dealt with in a unified manner.

2.5 Enhance the Regional Finance System to Increase the Availability and Effectiveness of Financial Resources for Urban Development

Increasing the availability of finance for local governments and authorities is, of course, one of the cornerstones of decentralization. In the year under review, solid progress was made in achieving the three crucial medium-term goals under this objective, namely:

- improvements in the system for allocating intergovernmental capital investment grants, known as Inpres (9.1 in the UPAP);
- reducing LGU reliance on central grants through increases in own source revenues (OSR, e.g., locally generated and collected revenue) and through improved cost recovery and pricing mechanisms for urban services (9.2); and
- establishing a more viable credit system to finance LGU urban infrastructure and services investments (9.3).

The key actions required to achieve this ambitious agenda are numerous.

- 1) **Action:** Improve the overall intergovernmental allocation system incorporating: a) better targeting to low-income citizens; b) increased LGU allocative discretion; c) incentives for increased OSR generation, and d) increased revenue sharing with LGUs (9.1A).

Target: Develop an action plan to implement recommendations for the reform of the current system.

Accomplishments: A short-term consultancy carried out in July 1995 evaluated previous work and focused on the concrete changes to be made in increasing the proportion of Inpres funding to local governments through block grants. An Inpres Secretariat was established within Bappenas to oversee the reform process. Terms of reference were drafted for a consultancy, likely to commence in the third quarter of 1996, to be inventorying DIPS, which may be reprogrammed as Inpres block grants. A workshop held in May 1995 on Inpres reform produced a high degree of consensus that the time is now ripe for execution of substantial reforms, to be included in the 1997/98 budget.

Comment: The target for the period in support of this key action — development of an action plan for Inpres reform — was fully met. A suitably high degree of consensus now appears to have been achieved for significant increases, in the coming fiscal year, in block and discretionary grants. Achievement in this regard will be one of the key performance indicators to be evaluated in the Year 3 assessment.

2) **Action:** Improve local government revenues from local taxes and user fees (9.2A).

Target: Continuous increase in real per capita local government tax and user charge collections.

Accomplishments: Updated data show that, on average, OSR for all local governments increased from Rp 8,061 per capita in 1989/90 to Rp 11,868 in 1993/94.

Comment: The updated data, which was unavailable during the Year 1 assessment, show that this key goal is being fully met. It would be useful, however, to disaggregate this data in the future to show differences, if any, in OSR growth among LGUs categorized by size, capacity, or other useful criteria.

3) **Action:** Improve financial management of local water companies (PDAMs; 9.2D).

Target: Continued technical support to PDAMs in financial management through the MOHA-mandated process. Conduct national policy seminar on “Local Government Asset Management.”

Accomplishments: PUOD of MOHA implemented a PDAM Financial Performance Monitoring Indicators system and promulgated a series of guidelines and regulations regarding financial, loan, and personnel management and capacity building for PDAMs and local enterprises.

The asset management seminar was held in July 1995. Major conclusions were that: a) there are insufficient incentives for local governments to concentrate on infrastructure maintenance; b) competitive bidding procedures need to become transparent to optimize acquisition and disposal of assets; c) transaction-based asset inventories should be instituted; and d) procedures for transfer of assets from central and provincial to local governments must be clarified.

Comments: A key element of improving PDAM financial management will be completion of the "career path" study now underway in PUOD. This study should lead to personnel management practices that will result in the employment of better-qualified, better-compensated PDAM staff establishments leading, in turn, to greater capacity within these institutions to manage their finances. Completion and implementation of recommendations from this study will be another key performance indicator for evaluation in Year 3, particularly given the rapid progress being made in preparation for issuance of bonds by PDAMs.

- 4) **Action:** Improve cost recovery of other (i.e., non-water) local government services, including analysis of organizational options, operational efficiency, and tariffs (9.2E).

Target: Survey conducted of domestic experience on direct cost recovery from beneficiaries. Initiate study of natural resource pricing, and complete study of development impact fees as a cost recovery mechanism for TK II.

Accomplishment: A pricing study for wastewater management was initiated. The study of existing experience with impact fee utilization was completed and revealed that aspects of these fees are already in use by many local governments. A further assessment of how various impact fees can be institutionalized in local governments will be required.

Comment: As noted last year, any premature moves to concentrate on cost recovery in other local enterprises would probably overtax the capacities of all but the strongest local government and PDAMs. However, the impact fee initiative should be followed up as quickly as feasible, as this relatively direct form of combined regulatory/revenue-generating activity could produce significant results, especially in high-growth urban areas.

- 5) **Action:** Carry out an external evaluation of the RDA's operations capacity, its working relations with local governments, and its capitalization policy and collections record. Prepare a five-year institutional development plan for the RDA (9.3A).

Target: Complete version of the current RDA Ministry of Finance decrees, and develop a five-year action plan for reform.

Accomplishments: The revised decree was completed and was awaiting ministerial approval as this assessment was carried out. All key recommendations appear to have been incorporated in the decree, including making alternative provisions for retail outlets in provinces where BPDs lack capacity to responsibly manage major new portfolios.

Comment: The annual target with regard to RDA reform was fully met through the preparation of the revised RDA decree. However, until the decree is signed and issued, it will not be possible to finally judge the extent to which all necessary reforms have been accomplished. In addition, it is still not finally clear that ADB will provide technical assistance to BPDs.

- 6) **Action:** Improve mechanisms to evaluate the creditworthiness of potential municipal RDA borrowers, including routine internal MOF disclosure of RDA borrowers' performance and implementation of procedures for imposing sanctions in cases of RDA loan repayment arrears (9.3B).

Target: Preparation of a report on the quality of regional lending portfolios and suggested improved policies and procedures for improved RDA risk mitigation and arrears management.

Accomplishments: Data on the overall status of RDA's loan portfolio was collected. The quality of this portfolio will be thoroughly assessed through an ADB-financed TA activity. In addition, TA under MFP to Pefindo to improve that agency's capacity to rate municipal institutions is being provided.

- 7) **Action:** Support procedures for domestic — public and private — capitalization of the RDA, including reflows of outstanding loans under RDA management, GOI resources, and private market borrowing (9.3C).

Target: Prepare a capitalization plan for RDA and continue policy research coordination with other donors.

Accomplishment: The capitalization plan was prepared and MOF presented projected requirements to donors. It now appears that the ADB and OECF will program block loans for the RDA subject to resolution of apparent conflicts with the internal operational guidelines of these institutions. The World Bank is still considering the move to block loans.

- 8) **Action:** Explore alternative short- and long-term mechanisms to mobilize domestic credit for local government financing of urban infrastructure investments (9.3D).

Target: Develop a short list of 3-5 PDAMs for water revenue bond issuances, including detailed investment and management plans, credit enhancement mechanisms as necessary, and legal documents and underwriting criteria.

Accomplishments: Four candidate PDAMs were identified: Kabupaten Badung, DKI Jakarta, Kotamadya Malang, and Kabupaten Semarang (Malang eventually dropped out due to a prior commitment). An interministerial Revenue Bond team, based in PUOD, is using the "Management Planning for the Issuance of Revenue Bonds by Water Authorities" handbook (prepared with MFP assistance) to prepare for the issuance.

A completely transparent competitive process was employed to select underwriters and legal counsel to package the PDAM bonds. Credit enhancement options have been evaluated, technical assistance is being provided to Pefindo to improve that institution's capacity to assess local government creditworthiness, and a training trip to the U.S. was conducted for participating officials to study successful examples of revenue bond sales. The first bond is

expected to float in July or August 1996, with the other two following in the third quarter of the year.

Assistance was also provided during Year 2 in the design of a Secondary Mortgage Facility and a capital subsidy scheme for housing low-income families.

Comments: The degree of progress made in Year 2 in preparing for bond issuances is truly impressive.

In summary, the GOI and the USAID-supported consultants are to be applauded for the substantial progress made during the period under review in pursuit of this very critical objective. The combination of Inpres and RDA reform, together with progress in the issuance of municipal bonds, constitutes a very well-designed and coordinated approach to the key objective of increasing finance available to LGUs for responsible infrastructure investments. Without indulging in hyperbole, it is reasonable to predict that continued, coordinated progress on all three of these fronts in the remaining years of Repelita VI would constitute a model process virtually without parallel in decentralization processes undertaken in other countries.

2.6 Mobilize Private Sector and Community Participation in Urban Development

USAID support for this objective (Number 12 in the UPAP) is focused, primarily through PURSE, on expanding private sector participation in provision of urban environmental infrastructure and services. Four key actions and associated targets are assessed below for the period under review.

- 1) **Action:** Develop risk management systems for "Build-Own-Operate"/"Build-Operate-Transfer" (BOO/BOT) project development and financing (12.1A).

Target: Incorporate project risk management within an effective overall risk management system. Approval of public-private project implementation procedures.

Accomplishments: A very good analysis of the risks facing PPPs in Indonesia was prepared during Year 2, culminating in a workshop held while this assessment was underway. This analysis will be developed into a Risk Management handbook to guide central and local officials. A training program on this subject will be designed and implemented during Year 3.

Comments: As noted last year, this is ground-breaking work in Indonesia. As with Action 12.1D and E below, this work has broader applicability than just the urban environmental infrastructure on which USAID assistance is focused. Also, it will be important that the training program developed through PURSE on this subject is well incorporated into the UMTP.

- 2) **Action:** Institute a financial guarantee mechanism to support local government initiatives in BOO/BOT projects (12.1 B).

Target: Assess need for credit enhancement and financial guarantees. Analyze options for new instruments.

Accomplishments: A paper examining options was prepared, and further work will be undertaken in Year 3 in parallel with the risk management task.

Comments: The need for and structure of any credit enhancement mechanisms and/or financial guarantees should be assessed as pilot projects are developed within the risk management framework that is now being detailed.

- 3) **Action:** Select and implement appropriate public-private partnership projects as PURSE demonstration projects (12.1C).

Target: Continue assistance to three demonstration projects. Conduct screening to select 4-8 additional candidate projects.

Accomplishments: Assistance is continuing to the demonstration projects in Mataram, Medan, and Tangerang, as well as to PAM JAYA in Jakarta. Seven additional demonstration project candidates — six in the water sector and one in solid waste management — have been identified and are being evaluated.

Comments: Good progress was made with the demonstration projects in Year 2. As with any innovative undertaking, the introduction of BOO/BOT projects in Indonesia is bound to be a delicate process and the responsible GOI officials, consultants, and AID management are to be congratulated for their steady approach to a difficult assignment.

- 4) **Action:** Establish a legal and regulatory framework to enable private firms and local governments to implement joint ventures in priority urban services with an appropriate balance of autonomy from and oversight by central government (12.1D).

Target: Recommend changes in the legal frameworks necessary to encourage investment and improve the regulatory environment.

Accomplishments: In late 1995, a report was submitted that identified 10 priority areas of concern and 5 specific actions to improve the legal and regulatory framework for PPPs in Indonesia. A draft PPP law is now being prepared in coordination with a World Bank-funded TA project managed by Bappenas.

Comment: Again, this is ground-breaking work that should find broad application beyond the PURSE focus on delivery of pilot projects.

- 5) **Action:** Develop technical guidelines and operational procedures for planning, implementing, and operating public-private partnerships.

Target: Complete all elements of the Project Life Cycle (PLC) documentation and detail an associated project management system.

Accomplishments: Revisions to the PLC documentation were carried out for both Volume 1, the "Operations Manual," and Volume 2, the "Model Documents." Translation into Bahasa Indonesia is now underway and an implementing ministerial instruction is expected during Year 3.

In summary, all of the annual targets under this objective have been fully met. Section 3 of this assessment includes a discussion of the potential for extension of the PPP framework being developed through PURSE to other enterprises.

3 Themes Arising from the Assessment

A key purpose of this annual assessment is to provide a forum through which all participants have the opportunity to raise issues related to the overall progress and direction of the UPAP and MFEI. This year, seven key themes emerged.

3.1 Administrative Reform in Support of Decentralization

The UPAP is carefully structured to improve urban environmental infrastructure in Indonesia by supporting the decentralization process through three key categories of actions: 1) mobilization of financial resources for local authorities, including new models for private investment; 2) support for LGU capacity building; and 3) regulatory reform. The progress achieved in all three of these categories in the first two years of UPAP implementation is truly impressive. As noted in the Year 1 assessment, the integrated approach to decentralization embodied in the UPAP constitutes a world-class model.

During the more than 50 interviews with the GOI and USAID officials carried out in the first and second annual assessments, a key theme that has repeatedly emerged has been the need to complement the core UPAP actions with corollary administrative reforms to increase LGU autonomy. The key concerns raised by both central and local government officials relate specifically to the degree of autonomy local governments — Dati II — exercise with respect to their ability to adapt their personnel establishments to specific and various needs.

The existing situation in this regard in Indonesia is that the staff establishments of all Dati II local governments are prescribed by MOHA, as are the levels of compensation and benefits for all similar staff positions throughout local governments. Thus, for instance, the head of the city engineering department in Surabaya will have the same basic compensation as his/her counterpart in Pankal Pinang, regardless of the fact that the work load and specialized skills needed to successfully carry out the job in Surabaya will greatly exceed those that are required in other Dati II local governments. Granted, there are additional sources of remuneration available for technical staff working in larger cities that have special projects, regulatory and planning boards, and greater access to training opportunities. However, the basic terms of employment offer no real incentive for a skilled employee to choose the more difficult job.

The same disincentives are true for local governments, which are less attractive to technical personnel due to their remoteness or comparative underdevelopment. Only the most altruistic and/or adventurous individuals will choose to live and work under more difficult circumstances for the same wage they could earn in more comfortable surroundings.

A third key consideration in this regard has to do with competition for scarce skills. In an environment of rapid urban development that is increasingly driven by private investment, as is and will increasingly be the case in Indonesia, the private sector inevitably becomes a major consumer of skilled technicians in government. If local governments are not allowed to adapt their staff establishments and terms of employment to compete with demand from the private sector, skills will inevitably be lost. This can be compensated for, of course, by increased reliance on consultants, but this alternative is not always cost-effective and, in itself, requires a conscious decision by government to make adequate resources available to purchase skills on a routine basis. In addition, this alternative is viable only in cases where an adequate pool of qualified consultants is readily available, a circumstance that is the case in developed countries, but is seldom so in developing economies.

Thus, failure to make terms of employment for skilled positions in local government competitive with the private sector and commensurate with actual work loads will inevitably result in loss of valuable human resources. (In fact, provision of specialized training to local government employees, as is the case with the UMTP, can actually have the unintended consequence of hastening the departure of skilled employees to more attractive private sector employment.)

There are a number of ways in which government can attempt to avoid this situation. The most comprehensive solution is to simply leave staffing matters entirely up to local authorities who are, in theory, best placed to determine the kinds of skills they need and the amount they can afford to pay for these skills. A less-radical solution is to differentiate compensation packages for technical positions according to the comparative complexity of the local government environments. This could, in Indonesia, be reflected through categories of Dati II governments based on population, annual budget, and other objective criteria with compensation for technical positions being set at higher levels for both larger and more remote cities, the latter category of which may be considered "hardship posts." There are other approaches to this problem as well.

While the need to address this key constraint on development of Dati II autonomy has been raised by numerous officials, all of these individuals have also noted that this is a particularly difficult problem in Indonesia for a variety of political and cultural reasons. And, while PUOD is currently being assisted in addressing the "career path" issues related to PDAMs, broader Dati II civil service reform is clearly beyond the scope of the existing MFP technical assistance package. However, it is clear that this key issue must eventually be addressed if Dati II autonomy is to be fully developed. Further, either the existing UPAP or its successor should begin to bring this issue into focus by explicitly incorporating objectives and targets related to administrative reform in support of decentralization.

3.2 Manageable Outcomes in PURSE

Another key issue identified in the Year 2 assessment has to do with the scope of regulatory reform expected to be accomplished primarily through the PURSE project. As discussed in Section 2.3 of this assessment, the end of Repelita targets for Action 5.3 are beyond the scope of the PURSE project, as they require adoption and implementation of regulations to be drafted by PURSE. Adoption and implementation of regulations is clearly a GOI function; PURSE as a TA project can only prepare recommended regulations. Hence, the end of Repelita targets needs to be modified with regard to PURSE's responsibilities.

A further amendment is required in Action 5.3G. Preparation of all the guidelines suggested in this action is clearly beyond the resources of PURSE. The project can and should prepare the water, solid waste, and wastewater guidelines, which are directly relevant to the pilot projects it is facilitating. However, the larger set of regulations for real estate, commercial, and industrial developers, while clearly a key activity, will require substantial technical assistance from a source other than PURSE.

The GOI may also wish to reconsider its assignment of institutional responsibility for reviewing, approving, and implementing the guidelines to be produced under this goal. Performance to date on adoption of guidelines prepared by PURSE has not been adequate. If capacity within Cipta Karya is too limited to undertake the review and approval process, or if that institution does not believe that these are appropriate activities for it to undertake, then the GOI will need to mobilize additional capacity or reassign this function to a more appropriate agency.

3.3 Broadening the PPP Net

A recurring theme that has emerged in both annual assessments has been that PPP guidelines being produced through PURSE (identified under Objective 12 in the UPAP) could, with a modest level of additional effort, be adapted to apply to other types of PPPs (e.g., roads, terminals, abattoirs, markets, etc). Again, this work is beyond the direct scope of PURSE. However, management of that project has indicated that PURSE could provide a TOR for the additional work that would need to be undertaken in order to broaden the applicability of the PPP guidelines being produced by PURSE. This would enable the GOI to pursue other resources, from USAID or elsewhere, to carry out this potentially very beneficial work.

It should also be noted that there appears to be a continuing lack of clarity as to the eventual "home" for training to be developed by PURSE with regard to PPP project preparation guidelines. This lack of clarity is somewhat puzzling since the UMTF is the obvious choice for incorporation of a PPP training module. The GOI may wish to explicitly reflect this in the UPAP as a way of bringing this issue to closure.

3.4 Supporting Inpres Reform

A key finding in the Year 1 assessment was that GOI interest in vigorously pursuing Inpres reforms was greater than had been assumed during the design of the MFP assistance package. USAID management and the MFP consultants responded admirably to this opportunity by realigning resources to support Bappenas' excellent efforts in this regard. It is apparent as a

result of the Year 2 assessment that this support to Bappenas needs to be continued, and even intensified to the extent that resources allow.

Bappenas is already working on identifying DIPS for 9 of the 20 identified investment sectors that could be reprogrammed to Inpres block grants. Bappenas management would like to extend and systematize their efforts to include all 20 sectors through the following work program:

- development of clear and concise criteria to guide selection of DIPS that are suitable for reprogramming to Inpres;
- application of these criteria to the more than 4,000 existing DIPS to produce a list of candidates for reprogramming by the end of September 1996;
- review and approval of the proposed reprogramming for inclusion in the draft budget for next fiscal year, by December 1996; and
- design of a system to monitor the impact of increased Inpres block grants at the Dati II level, to be in place by the beginning of FY 1997/98.

Achieving the critical mass of consensus necessary to accomplish thorough Inpres reform has taken a number of years. It appears that there is now a clear window of opportunity to fully realize this reform process, the result of which would be a massive transfer of resources to Dati II discretionary use. Therefore, it is strongly recommended that — within available resources — USAID act as expeditiously as possible to provide the support required by Bappenas.

The GOI may also wish to consider whether the proposed accelerated pace of Inpres reform should be reflected in amended UPAP targets. Such amendments may help to codify the inter-ministerial consensus that has now been forged, and would clearly identify agency responsibilities for achievement of reform on the accelerated timetable.

3.5 Incentives to Build Local Capacity

The continued success in designing and implementing the UMTP is one of the clear achievements of MFEI to date. The GOI, USAID management, and MFP consultants have shown great creativity in planning for sustained UMTP delivery by identifying delivery agents that are most appropriate for each specific module. As noted in the preceding section of this report, careful consideration is also being given to the best base in which to institutionalize UMTP management following completion of the MFP.

The MOHA decree, issued during Year 2, legally establishes the UMTP and mandates that all local governments should participate in the UMTP. The existing requirement that 5 percent of all Dati II budgets be devoted to training provides a potential source of finance for future participation in the UMTP. However, requiring participation in training programs can be an empty exercise in the absence of positive incentives for successful participation.

MFP is already discussing with the Association of Regional Finance Officers ways in which successful completion of the UMTP finance module can be reflected in career advancement.

Working out similar career incentives for all other UMTP modules would also appear to be desirable.

As noted in the Year 1 assessment, a variety of useful training programs is offered by other ministries, notably Bappenas and PU. However, there does not yet appear to be a significant degree of coordination between these efforts and the UMTP. This may simply be a temporary condition, as UMTP has been handling a large work load and may not have had capacity to coordinate with other training programs. But it is also likely that there is an element of institutional resistance to incorporation of other training programs into the UMTP, particularly as many of these programs are directly funded multilateral assistance.

UPAP Goal 3.2 clearly defines the need for a self-sustaining system of urban management training. The actions enumerated in this goal do not, however, explicitly reflect the need for: 1) incorporation into the UMTP of all relevant training activities for local government management capacity building, or 2) the importance of ensuring that incentives for participation in relevant training programs are available to local governments.

Transfer of financial resources and authority to local governments can only be responsibly executed if capacity to manage exists in local governments. Training is the key to building this capacity. The GOI may wish to consider, therefore, a more aggressive approach in identifying key training programs for integration in the UMTP and establishing clear career incentives for local governments officials to participate in these programs.

3.6 Water Resource Management

Assistance provided through MFEI to PDAMs is well-targeted. The stated UPAP goals of increasing both the management capacity and the financial resources available to PDAMs are being achieved. However, the ultimate goal of increasing the supply of potable water to urban Indonesians will only be achieved if PDAMs have adequate access to bulk water supply.

Several PDAMs are now facing serious constraints in gaining access to new sources of bulk water supply. This constraint is not due, at least in Java and Sumatra, to lack of raw water. Rather, the main source of this constraint seems to be the way in which the Indonesian water resource management system is organized.

The management of water supply in Indonesia has traditionally been oriented to meeting the demand for irrigation, rather than human consumption. This is reflected in the fact that no equivalent to a Ministry for Water Affairs or a national water utility administrative unit exists in the country. PU includes a directorate for irrigation and Bappenas has an equivalent office for irrigation planning. Thus, there appears to be limited central capacity to set policy for bulk water supply for human consumption.

The country's over 300 PDAMs must, therefore, individually secure their own bulk supplies. Given that all PDAMs (except Medan, which is apparently unique in its province-wide coverage, and Pam Jaya, which serves the entire national capital region) are mandated to serve the geographic areas corresponding to administrative jurisdictions, this approach to securing bulk supply

will work as long as the sources of that supply are within the jurisdiction of each PDAM. However, when this is not the case, the PDAMs must, in a virtually ad hoc fashion, seek to secure supplies through third parties.

Surabaya is currently experiencing precisely this problem. Although the PDAM has secured financing for extension of its retail delivery system through the World Bank-assisted urban development project, it does not have adequate bulk supply to serve new consumers. A PPP for bulk supply from Umbulan Springs is being negotiated with PURSE assistance, but the Surabaya PDAM has no direct means of ensuring that this new source of bulk water comes on-line in a timely manner.

The "best practice" in the field of water resources management currently approaches water supply as a wholesale and retail operation. The wholesale, or bulk supply, function generally tends to be carried out by organizations that are supra-local in jurisdiction, and these jurisdictions are normally defined in terms of natural watersheds.

In the U.S., for example, regional water authorities manage watersheds and either directly sell water to local utilities/retailers, or facilitate supply agreements among constituent bodies. In South Africa, for another example, 20 regional water supply boards covering the entire country have been established. The jurisdiction of each board corresponds not to political boundaries (there are nine provinces in that country), but to natural watersheds that are determined by geographic and hydrological factors. Other countries have developed other approaches. In the Philippines, the Local Water Utilities Administration plays a dual role of both bulk financier and overall resource management planning for that country's independent local water districts.

Water resource management has been widely identified as a critical issue in sustaining urban development throughout the world, regardless of the comparative level of economic development of individual countries. It appears that Indonesia has not yet sufficiently focused on this key macroeconomic issue. As rapid urban development continues, this issue is likely to grow in importance. The national association of Indonesian PDAMs, PERPAMSI, would appear to be a natural focal point for assistance in developing appropriate water resource management strategies and identifying corollary approaches to bulk supply. The upcoming USAID TAGS project could be a source of such assistance, possibly through a twinning arrangement with appropriate U.S. institutions. Whatever the eventual source(s) of support, this issue clearly deserves GOI attention before limited supply becomes a significant constraint on economic development.

3.7 The Overall UPAP

The UPAP in its entirety consists of 12 key goals that, taken together, constitute the full GOI urban sector agenda for Repelita VI. USAID support to the GOI in achieving the Repelita VI urban sector agenda is limited to specific goals and associated annual targets under only 6 of the 12 overall goals for the sector. During the Year 1 assessment, the GOI had summarized progress made in achieving other UPAP goals and objectives that do not receive direct USAID support.

During the Year 2 assessment, no such summary of progress for other UPAP goals was available, nor was any indication given that an annual review for other goals was underway or planned. This situation presents several potential difficulties.

First, while it is possible to assess progress toward goals supported by USAID independently of the balance of UPAP goals and objectives, it is unlikely that progress in USAID-supported areas will have the desired cumulative effect if similar progress is not being made in goals that are not directly supported by USAID. This multiplier effect is implicit in the discussion of some of the key themes above. For instance, recommendations for recapitalizing the RDA (a goal that does receive USAID support) are somewhat empty gestures unless progress is made in attracting other investors to supply the necessary capital and eventually eliminate SLAs.

Another key example can be drawn from the work being undertaken through PURSE. It has been widely noted that PURSE is focused on urban environmental infrastructure PPPs. The World Bank-assisted TAP4I project has, in theory, a broader focus on all types of PPPs, which presumably relate to other key objectives under the UPAP Goals 5 and 12 with which PURSE works. However, in the absence of an annual review of progress toward UPAP objectives that are not directly supported by PURSE, it is difficult to gauge the extent to which the overall UPAP goal of increasing private participation in all types of public services is being met and, therefore, to determine to what degree — if any — refocusing PURSE support may be necessary.

Second, the lack of overall UPAP progress assessments makes planning for the next Repelita a rather hit-or-miss affair. Indonesia's Repelitas are justly renowned for their comprehensiveness and acuity in detailing steps to be taken to achieve specified goals. However, if progress, or lack thereof, across a sector is not systematically monitored, there is little basis on which the next UPAP may again incorporate objectives that require further work, and include new objectives as they arise. An interesting example of such a new objective would be the view expressed by a Cipta Karya representative that current PJM processes do not effectively capture private investment in infrastructure. Another example might be the deficiencies in watershed management discussed above.

In summary, then, the UPAP was conceived holistically, and broader success in sectoral reform will only be achieved through coordinated action on the entire UPAP agenda. It remains very important, therefore, for annual assessment of USAID-supported UPAP objectives to be complemented by assessment of the UPAP as a whole.

4 Implications for the GOI and USAID

This section of the assessment summarizes points raised during interviews and focuses on actions that may be required as a result of the themes discussed in Section 3. In most cases, these actions would not strictly be required to comply with terms of the MFEI HG agreement. Rather, the suggested actions could improve overall implementation of the UPAP and, thereby, enhance the impact of USAID support to the GOI in the sector.

4.1 Administrative Reforms in Support of Decentralization

- The extent and nature of purely administrative reforms that could promote a higher degree of local government autonomy in Indonesia should be determined and catalogued. This analysis could be accomplished through consultations with key local government officials around the country and with corresponding regulators in MOHA and other key ministries. The output of such an exercise should be a list of key reforms that is prioritized in terms of urgency, key actors and actions, and capacity of local governments to accept new responsibilities (which might correspond with a more realistic categorization of Dati II local governments; see following paragraph). Following appropriate consultations, new goals, objectives, and annual targets could be added to the existing UPAP Objective 2 and/or could be incorporated in the next UPAP.
- A more realistic categorization of Dati II local governments, reflecting the wide diversity of available resources and capacities within this level of government, is clearly required. While this issue is politically sensitive, the task of identifying objective measures of differing levels of local government capacity and complexity is not difficult and models from many other countries are available. Establishment of workable, capacity-related Dati II categories will be crucial in guiding the orderly decentralization of both resources and responsibilities in Indonesia. Work on this key area should begin within this Repelita.
- Probably the most urgent administrative reform required for local governments is the establishment of a system or systems through which competitive compensation packages can be offered for key skilled personnel. Again, design of such a system is not difficult and precedents exist in many countries. The urgency of this matter will continue to increase as private sector infrastructure investment accelerates, requiring more and more skilled personnel.

4.2 Manageable Outcomes for PURSE

- Revision of the UPAP Objective 5.3 will be required prior to the Year 3 assessment, as PURSE clearly does not have adequate resources to meet the annual targets as now written.
- The GOI should review the process by which development guidelines for PPPs are to be adopted and implemented. The current UPAP actions in this regard do not appear to take account either of appropriate institutional roles in the adoption process or of capacity to enforce such regulations once adopted.

4.3 Broadening the PPP Net

- PURSE should respond to numerous requests for adaptation of the PPP life cycle process and attendant documentation to other local government activities by drafting a Terms of Reference for the GOI to use in securing necessary technical assistance for this task.

4.4 Supporting Inpres Reform

- USAID should provide the technical assistance necessary to complete work on selection criteria and inventorying of all DIPs that are suitable for reprogramming as Inpres block grants. For this activity to have the maximum near-term impact, this TA will need to be available in line with the schedule discussed in Section 3.4.

- USAID should also provide assistance to establish an effective Inpres block grant impact monitoring system. To be most effective, this system should include procedures for allocating block grants to local authorities, which, *inter alia*, initiate the monitoring process each fiscal year. Recommendations should also be provided relative to institutional capacity required for an effective monitoring program and for performance indicators that could eventually lead to an incentive system in allocating block grants.

4.5 Incentives to Build Local Capacity

- Explicit linkages need to be established between participation in the UMTF and career advancement for local government employees. Identification and adoption of these career path incentives should become an end of Repelita target under the UPAP.

4.6 Water Resource Management

- The entire issue of bulk water resource management and supply requires thorough analysis, including definition of watershed management options suitable for the variety of conditions to be found throughout the country. USAID should consider the possibility of a twinning arrangement between PERPAMSI and appropriate U.S. regional water management authorities. All such work should, obviously, be coordinated with ongoing donor-assisted activities in this sector.

4.7 The Overall UPAP

- The GOI should reinitiate its annual assessments of the overall UPAP.
- The GOI should also review the need to amend and/or supplement all existing UPAP goals, objectives, annual targets, and end of Repelita outcomes. USAID should, within its resource constraints, consider providing technical support to what could amount to a mid-term UPAP review.