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PRIVATE PARTICIPATION IN URBAN SERVICES

PROJECT PAPER

(PROJECT 497-0373)

UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

Jakarta, Indonesia

September, 1991

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: [X] A = Add, C = Change, D = Delete — Amendment Number _____

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Indonesia

3. PROJECT NUMBER: 497-0373

4. BUREAU/OFFICE: APRE — 29

5. PROJECT TITLE (maximum 40 characters): Private Participation in Urban Services

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 30 YY 98

7. ESTIMATED DATE OF OBLIGATION (Under "B." below, enter 1, 2, 3, or 4)

A. Initial FY 91 B. Quarter 4 C. Final FY 95

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 91 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	(1,500)	(350)	(1,850)	(11,350)	(3,665)	(15,000)
(Loan)	(-)	(-)	(-)	(-)	(-)	(-)
Other U.S. 1.						
Other U.S. 2.						
Host Country		135	135		5,400	5,400
Other Donor(s)						
TOTALS	1,500	485	1,985	11,335	9,065	20,400

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) HE						5,000		5,000	
(2) SD						10,000		10,000	
(3)									
(4)									
TOTALS						15,000		15,000	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

To increase the availability and efficiency of urban infrastructure and services through the expansion of private sector participation in the provision of these services.

14. SCHEDULED EVALUATIONS

Interim MM 07 YY 94 MM YY Final MM 07 YY 98

15. SOURCE/ORIGIN OF GOODS AND SERVICES: [X] 000 [ ] 941 [X] Local [ ] Other (Specify) _____

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a _____ page PP Amendment.)

17. APPROVED BY

Signature

Lee Twentyman

Title: Acting Mission Director, USAID/Indonesia

Date Signed: MM 09 DD 30 YY 91

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

AID 1330-4 (8-79)

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
AMERICAN EMBASSY
JAKARTA, INDONESIA

PROJECT AUTHORIZATION

Name of Country: **Indonesia**

Name of Project: **Private Participation in Urban Services**

Project Number: **497-0373**

1. Pursuant to the Foreign Assistance Act of 1961, as amended, I hereby authorize the Private Participation in Urban Services Project for Indonesia, involving planned obligations of not to exceed $15.0 million in grant funds over a seven year period from date of authorization, subject to availability of funds in accordance with the A.I.D. OYB allowance process, to help in financing foreign exchange costs and, as specifically authorized below, local currency costs for the project. The planned life of project is seven years from the date of obligation.

2. The Project consists of various activities to increase the stock of infrastructure essential for economic growth through the expansion of the private sector in the provision of selected urban services.

3. The Project Agreement which may be negotiated and executed with the Government of Indonesia by the officer(s) to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

a. Source and Origin of Commodities, Nationality of Services

Commodities financed by A.I.D. under the Project Agreement shall have their source and origin in the United States, except as A.I.D. may otherwise agree in writing. The suppliers of commodities or services shall have the United States as their place of nationality, except as A.I.D. may otherwise agree in writing. Local source financing is authorized for the following procurements or types of procurements:

* Local consultants, experts and trainers;
* Rental of local facilities for in-country workshops, seminars and forums;
* Office supplies; and
* Local administrative costs and logistics
* Other local source procurements authorized in Chapter 18, A.I.D. Handbook 1, Supplement B.

b. Conditions Precedent to Disbursement

Prior to disbursement of USAID funds, USAID will receive evidence that the Project Steering Committee has been established and a list of the names of the individuals assigned to the Project Steering Committee will have been sent to USAID.

c. Covenants

1. For activities implemented after April 1, 1992, the GOI will furnish each year to USAID Annual Plans for the Project.

2. The GOI and USAID agree to establish an evaluation program as a part of the Project. This program will include: (a) identification of a set of indicators and a means to measure progress against such indicators; (b) evaluation of progress toward attainment of the objectives of the Project; (c) identification and evaluation of problem areas or constraints which may inhibit such attainment; (d) assessment of how such information may be used to help overcome such problems; and (e) evaluation, to the degree possible, of the overall developmental impact of the Project.

3. The GOI will agree to provide sufficient funds from its annual development (DIP) or routine budget to adequately and properly maintain all equipment financed under the Project.

4. The GOI will agree to provide all staff required to implement the Project in a timely and effective manner.

Lee Twentyman
Acting Mission Director

September 30, 1991

Clearances:

PED:WFrej in draft	Date 9/19/91
A/DD:RBeckman in draft	Date 9/30/91
PROG:JBever in draft	Date 9/24/91
LA:PScott in draft	Date 9/24/91
CM:MLStevenson in draft	Date 9/24/91
FIN:CChristensen in draft	Date 9/22/91
RHUDO:EKessler in draft	Date 9/17/91

PRIVATE PARTICIPATION IN URBAN SERVICES (PURSE)
PROJECT PAPER

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LIST OF ACRONYMS

ADB	Asian Development Bank
BANGDA	Directorate General of Regional Development Affairs in Ministry of Home Affairs
BAPPENAS	National Planning and Development Board
BKPM	National Investment Coordinating Board
BOO	Build, Operate, and Own
BOT	Build, Operate, and Transfer
BPAM	A embryonic water utility project created and administered by Ministry of Public Works
Cipta Karya	Directorate General of Human Settlements, Ministry of Public Works
COP	Chief of Party
Dinas Kebersihan	Municipal solid waste agency
GDP	Gross Domestic Product
GOI	Government of Indonesia
IEE	Initial Environmental Examination
IQC	Indefinite Quantity Contract
IUIDP	Integrated Urban Infrastructure Development Program
Kabupaten	Local (level two) government regency in rural areas
Kecamatan	Subordinate level two government district under a kotyamadya or kabupaten
Kelurahan	Subordinate level two government district under a kecamatan.

Kotamadya	Local (level two) municipal government area in urban districts
Local Hire	Indonesian technical assistance
Lurah	Executive of a level two urban area kelurahan
MOHA	Ministry of Home Affairs
MOF	Ministry of Finance
MOI	Ministry of Industry
MOPW	Ministry of Public Works
PDAB	Provincial government owned water agency
PDAL	Regional wastewater enterprise
PDAM	Regional water enterprise
PDK	Regional solid waste enterprise
PIL	Project Implementation Letters
PU	Ministry of Public Works
PUOD	Directorate General of General Government Affairs and Regional Autonomy, Ministry of Home Affairs
PURSE	Private Participation in Urban Services
REPELITA	National five year economic plans
SOP	Standard Operating Procedures
SOR	Sarana Organtama Resik, largest private garbage collection firm
SWM	Solid Waste Management
TA	Technical Assistance
TKPP	Coordination Team for Urban Development, BAPPENAS

TOR	Terms of Reference
USAID	United States Agency for International Development
WASH	Water and Sanitation for Health Project

1 SUMMARY AND RECOMMENDATIONS

TITLE: **PRIVATE PARTICIPATION IN URBAN SERVICES (PURSE)**

PERIOD OF IMPLEMENTATION: 7 years (FY 1991-98)

1.1 SUMMARY PROJECT DESCRIPTION:

The **goal** of the PURSE project is to increase the stock of infrastructure essential for economic growth and improve access to efficiently delivered services that contribute to an improved urban environment. The **purpose** is to expand the participation of the private sector in the provision of selected urban services (water, wastewater, and solid waste) on a sustainable basis through direct investment or contracted participation in supply, delivery, or other operational functions. The project **strategy** is to offer strategic assistance to the GOI and the Indonesian private sector to establish a national consensus regarding: (1) legal and regulatory requirements and procedures; (2) priority areas for and acceptable forms of private participation; and (3) the technical and financial implications of prototype agreements for public/private partnership. In addition to providing technical assistance to the GOI in enacting policy, regulatory and institutional reform, the project will support and test the creation of appropriate conditions and incentives for expanding private sector participation in the provision of selected urban services through the use of pilot/demonstration projects.

The technical assistance requirements for creating the appropriate conditions for private sector participation in urban services are considerable both in the range of expertise and in the amount of effort required. Accordingly, a long-term team of five resident expatriate experts and three locally-hired specialists, fielded by an institutional contractor, is planned for the project. The **Senior Urban Services Advisor** will serve as a senior advisor on institutional, legal, and regulatory issues, with an initial focus on issues affecting demonstration projects. No long-term advisor will be assigned for technical work to BAPPENAS or the Steering Committee; instead, BAPPENAS will call upon task-specific short-term technical assistance as needed.

The long-term local-hire **Project Administrator** will report to the Senior Advisor and will be responsible for administrative functions. This will include assisting with the recruitment of local short-term advisors and training resources, local subcontracting, management of project finances, support of the annual planning and quarterly reporting process, and assisting with the processing of trainees.

One expatriate and one local-hire **Municipal Services Advisor/ Specialist** will work with the Ministry of Home Affairs (Directorate Generals PUOD and BANGDA) and will be primarily responsible for helping cities and municipalities structure and package investment opportunities and identify private sector contracting and management services in water, wastewater, and solid waste management.

One expatriate **Urban Environmental Specialist** and one local-hire **Project Development/ Financial Specialist** will work with the Ministry of Public Works to assist the Center for Strategic Studies in the formulation of plans, strategies, and implementation arrangements to support effective public-private partnership in urban services provision.

The **Demonstration Project Manager** will work with the Senior Advisor specifically in support of demonstration projects. He or she will also focus attention on direct assistance to private sector companies interested in negotiating investment or contract opportunities in the provision of urban services. The **Contract Specialist** will work with the Senior Advisor specifically in support of the substantial sub-contracting component of the project. The design of the project includes considerable local sub-contracting within the demonstration project component, providing a direct linkage to the Indonesian private sector.

A total of 145 person months of expatriate short-term assistance and 220 person months of locally hired short-term assistance will be provided by the PURSE project. Initially, approximately 80 percent of the planned life-of-project short-term technical assistance will be allocated to the GOI agencies to whom long term advisors are assigned, to BAPPENAS, to local governments, and to project demonstration activities. In addition, these advisors will support private sector needs for assistance with feasibility studies, financing and other project development requirements. Unassigned short-term advisors (approximately 20 percent) will work on specified aspects of demonstration projects or on other short-term activities as designated by the Chair of the Steering Committee.

The Training and Communications Program will attempt to change the structure of urban service provision by improving skills, conveying information, and expanding the levels of expertise required by both the public and private sectors in addressing infrastructure and service deficiencies. The in-country training program, consisting of a public/private forum series, and workshops focusing on public/private partnership development, will be planned in conjunction with the Steering Committee Chair, attached to Deputy V for Regional Affairs in BAPPENAS. A formal overseas training program will include both short-and long-term study. Short-term training opportunities will be given to GOI senior, mid and junior level staff, and to potential private sector investors, owners or managers of urban services and infrastructure to participate in short courses and policy seminars (two-six weeks in duration) outside of Indonesia. Approximately 84 short-term participants are anticipated over the life of this project. Six Master's degree programs, in urban planning and/or business management, for mid-level GOI officials will be funded by the project.

The PURSE project will seek to develop a minimum of five BOT and/or BOO pilot projects and six service contracts in order to demonstrate the ability of the private sector, in partnership with government entities, to implement water, waste water and solid waste projects; test technology and methodology; examine legal, financial and organizational frameworks; and measure comparative efficiencies. For implementing demonstration

projects, the PURSE project team will work with the GOI to identify locations at which private sector firms may construct, own and operate new facilities and opportunities for private firms to improve the operation and maintenance of existing facilities through service contracts. The team, in close coordination with the GOI, will be involved in identifying potential projects; analyzing their technical feasibility and commercial viability; identifying potential contractors/investors; and using lessons learned from the demonstration projects to help the GOI develop new policies, regulations, guidance and model contracts. The projects will be directed at private participation of both foreign and domestic investors, large and small. The final selection of the specific projects will be determined in the early stages of the PURSE project by the TA team, the Steering Committee and the GOI implementing Ministries (Public Works and Home Affairs). Since the demonstration projects will specifically identify and surface policy and institutional shortcomings, training needs and required technical assistance, it is important that the projects have an early and vigorous start.

1.2 PROJECT MANAGEMENT

1.2.1 Steering Committee

The project will receive broad policy direction from a Steering Committee attached to the Deputy V for Regional Affairs at BAPPENAS who chairs the existing Interministerial Coordinating Team for Urban Development (TKPP). Agencies to be represented on the Steering Committee are the Ministry of Home Affairs (Directorate General PUOD and Directorate General BANGDA), the Ministry of Public Works (Directorate General Cipta Karya and the Assistant to the Minister representing the Center for Strategic Studies), the Ministry of Finance, and USAID as an ex-officio member. The Chair of the Steering Committee will be designated by the BAPPENAS Deputy V for Regional Affairs. In implementation of the overall Project, BAPPENAS, and the Ministries of Public Works, and Home Affairs will all have specific responsibilities. As specified in Section 8.2 of the Grant Agreement, the names of the representatives of the Grantee from these ministries, along with their specimen signatures, will be provided to USAID, and such designated representatives will be authorized to sign implementing documentation relating to activities within their respective areas of responsibility.

1.2.2 Annual Planning Process

An annual planning and budgeting process, supervised by the Chair of the Steering Committee, will be undertaken to assist in ensuring that both the required coordination and cooperation among concerned ministries is occurring. In addition, this process will ensure efficient and effective management and provision of both USAID and GOI inputs to the Project. The Annual Plan will provide specific deliverables and resources

according to an agreed upon schedule presented in the same document. Annual Plans will specify milestones and actions to be carried out by the Contractor and the GOI to meet the objectives of the Project. Progress against the Plans will be tracked on a quarterly basis and will be reviewed in meetings led by the Chair of the Steering Committee, and attended by USAID, the contractor, and Steering Committee representatives. Working in close collaboration, USAID and the Chair will have authority to reprogram Project resources if serious problems are encountered in the implementation of the Project. The Chair of the Steering Committee and the USAID Project Officer and/or Project Manager, will jointly resolve issues involving the technical assistance contractors.

Immediately following Project obligation, preparation of solicitation documentation will begin for the long-term A.I.D-direct technical assistance contract. It is anticipated that one prime contractor will be able to bring together the required subcontractors to carry-out the Project's specified activities, while at the same time, provide the administrative support, to all of the technical assistance team members working within and outside of the Ministries. It is the intention of USAID to have the long-term technical assistance team mobilized approximately nine months after Project obligation, or sometime during the summer of 1992.

During the six- to nine-month bridging period from project inception until a long-term technical assistance contract is in place, short-term contracting mechanisms, including Buy-ins and IQCs, will be used to provide important expatriate and Indonesian technical assistance inputs and other support to demonstration project initiation.

1.3 FUNDING AND RESOURCE REQUIREMENTS

The estimated total cost of the Private Participation in Urban Services Project is US$20.4 million, which includes USAID, GOI and private sector contributions. USAID contributions, amounting to $15 million, will consist primarily of the following: short- and long-term technical assistance; short- and long-term training; office rental for the PURSE Project team; commodities, including vehicles and computers; audits; and evaluations.

The GOI contribution, totalling $3.4 million, will include financing for local support for the long-term technical assistance team; in-country costs for training, including salaries, travel, per diem and honoraria; partial funding of local demonstration projects; and round-trip airfares to the U.S. west coast for the six projected long-term trainees and the short-term training participants.

The host-country private sector is expected to contribute approximately $2.0 million to this project. This amount includes funding for co-financing of in-country workshops, and repayment of costs incurred for demonstration project feasibility studies when the demonstration projects are implemented. All of these demonstration project-generated

funds will be recycled for additional uses within the Project, including the funding of additional demonstration projects at later stages of the project.

1.4. RECOMMENDATIONS:

It is recommended that the USAID/Jakarta Mission Director authorize a technical assistance and training grant in support of the Private Participation in Urban Services Project (PURSE), in an amount not to exceed $15 million, $1.85 million of which will be obligated in FY 1991. The Project Assistance Completion Date (PACD) for this grant will be 30 September 1998. The GOI direct contribution toward technical assistance and training is estimated to be $3.4 million (equivalent in local currency), and $2.0 million in estimated host-country private sector contributions, constituting approximately 26 percent of total project costs.

2 THE PROJECT CONTEXT

2.1 The Development Context

2.1.1 Economic Situation and Policy

Indonesia's approach to economic policy in the past decade was both pragmatic and effective in responding to rapid private sector growth and the need for economic policy change. Reacting to the spiralling collapse of oil prices in 1982 and a current account deficit of US$ 4.1 billion in 1986, the government initiated far-reaching financial deregulatory measures and structural reforms over the last five years. To offset the sharply deteriorating terms of trade of oil, the country's most crucial export, the government curtailed public spending, announced two substantial devaluations, encouraged a greater private sector contribution to the economy, removed a number of protective trade barriers, promoted non-oil exports and introduced reforms in taxation, ports operation and customs service. These measures have paid off as the economy survived this crisis without significant damage.

What has followed has been one of the fastest growing economies in Asia, gradually shifting away from its dependence on oil earnings. Both domestic and foreign investment has accelerated. The private sector has responded well and become more active particularly due to reforms focused on relaxing import and licensing restrictions, making the Rupiah freely convertible, and opening the banking system to increase the availability of longer term financing. In the five years prior to 1989, GDP increased in real terms at an average rate of 5.3 percent. The 1989 performance achieved 7.4 percent, and the 1990 estimated figure is 7.01%. Of the latter non-oil GDP is expected to increase 7.8 percent. This indicates that the economy is continuing to respond positively to the ongoing structural reforms.

Estimates indicate that GDP will increase at about 7 percent per year over the next decade. The country's rapid economic growth also is accompanied by rapid urbanization. The 1990 census indicates that urban population is about 55 million and is increasing at a rate of about 5.4 percent per year. Total urban population at the end of the decade is estimated at about 93 million or 43 percent of the entire population. The country is however faced with relatively low per capita GNP (less that $600) and a continuation of poverty at unacceptable levels. If increased economic growth is to be translated into social progress in terms of raising living standards, providing productive employment, and reducing poverty, then urban infrastructure deficiencies must be addressed. At the present time, Indonesia's urban centers are unable to meet the challenges in feeding, housing and employing their burgeoning numbers.

Expansion of private sector participation in urban services fits in well with the GOI's current investment strategy. The GOI's fiscal and monetary policies include objectives of slowing the rate of growth of total debt, including public and private/foreign and domestic, and controlling the growth of the public sector budget. These reflect in part a concern for the balance of payments. The current account deficit is rising, due to soaring imports and a slower growth in exports, it could reach US$ 4 billion by the end of 1991. There is some concern for the high rate of inflation, currently estimated at about 10 percent per year, which suggests that the economy is beginning to experience capacity constraints arising from a surge in domestic economic activities. This is in part attributed to public sector investments being targeted to achieve the highest GOI priority goal of increasing exports. These factors contribute to an additional concern, the current high cost of capital. Annual interest rates currently for five to seven year commercial financing are 23 percent to 25 percent. The strategy of encouraging more direct private participation in the production and financing of urban and utility infrastructure is consistent with these fiscal and monetary policy objectives to the extent that: (1) it increases the supply of urban infrastructure without a corresponding increase in direct public sector investment (both Central and Regional budgets) and (2) the production of these additional services is at economically more efficient prices.

2.1.2 Urban Service Deficiencies

In the context of translating economic growth into social progress, urban service deficiencies are major priorities. A proper balance between the provision of urban services and the overall level of economic activity is essential to permit continued economic growth in Indonesia. If these services are limited in quantity, low in quality, and high in cost, the growth of the private sector and the entire economy will suffer. Recent estimates indicated that just over one-third of urban residents have access to piped water supply and a similar proportion have adequate on-site sanitation facilities. Less than 1 percent of urban residents are connected to wastewater systems. Only 40 percent of urban residents are currently served by some form of garbage collection. These service coverage estimates are low by regional Asian comparisons.

Infrastructure remains a largely public responsibility, reflecting in part the reality that capital requirements are heavy and returns often slow to materialize. The central government now finances 85 percent of all utility investments, almost exclusively through foreign loans. Despite these donor resources, urban services deficits will continue to rise as investment fails to keep pace with demand. The lack of provision of urban infrastructure will lead to production bottlenecks and inevitably slow down economic growth. Further inadequate water supply facilities, wastewater treatment and solid waste management have overwhelming environmental health and welfare affects as well as direct and irreversible environmental consequences to water resources. The urgency of the problem has led the GOI to support, in official statements, an increased role for the private sector.

A key objective of Indonesia's Urban Policy Action Plan is to increase private sector participation in the provision of urban services in order to (1) increase the absolute level of funds invested in urban services and (2) increase the efficiency of urban services provision. The expansion of private sector commercial activity in turn will require continuing improvements in efficiency and competitiveness, implying a need both for *deregulation* and also for appropriate *regulation* (supervision) to clearly define the rules of the game for both the public and private sectors. This must be accompanied by institutional improvements that help to ensure that such rules are disseminated to the public and are properly and fairly enforced. For private participation in urban services, it is clear that existing legal and regulatory structures and their application are inadequate.

2.2 Project Rationale

The solution to the growing need for urban services lies in the development of innovative, efficient approaches to providing these services, with the private sector assuming a role of partnership and, where appropriate, leadership. While currently the construction of public-financed urban infrastructure is largely contracted to private firms, the private sector is not heavily involved as an investor in urban service projects, as a provider of services directly to consumers (except in housing and transportation), or as a provider of contracted services to local government agencies and enterprises.

Within the Indonesian context, the financing and delivery of urban services such as water, wastewater treatment, and solid waste management are very complex. Such areas have been considered "social sectors" in which the Government cannot abdicate its responsibility to provide basic services to all citizens, regardless of the ability of individuals to pay for the facilities offered.

The fundamental rationale for the GOI to pursue private investment projects in providing urban services include (1) an expanded capacity for the provision of services and (2) increased efficiency in the allocation of scarce resources. As noted by the World Bank, the potential benefits of private investment will depend critically on meeting the

additionality test of either providing needed infrastructure capacity that would not otherwise be provided by the public sector, or providing infrastructure at lower investment and operating costs, given the likely constraints on public sector finance, management skills, and access to technology. Ensuring at the same time that private sector participation effectively serves the public interest will require the development of a sound policy framework that provides for an appropriate balance between the benefits and costs of private investment. A key concern in this regard is for developing opportunities to which small and medium scale domestic enterprises can respond.

There is no precise legal definition of "urban services" in the Indonesian context. According to government officials, the term generally encompasses services that are *regulated* by urban or municipal governments as distinct from national services such as power, telecommunications, ports, and harbors. Urban services include water, wastewater, solid waste, public markets, local transport, and public safety. The initial concentration of the urban services component of the PURSE project on water, waste water (water borne sewerage and surface drainage) and solid waste is based on the following rationale.

1. USAID Jakarta sponsored a significant study through the centrally-funded WASH project specifically addressing private sector participation in urban water supply. This study, which the GOI specifically requested USAID to carry out, was followed by a well-received workshop on the topic. This workshop including both GOI and private sector participants and the action plan developed at the workshop display significant momentum on the part of the private and public sector to further develop partnerships in water supply development.

2. The WASH study further provides a critical mass of recent and relevant information on private sector participation in the water supply sector. The close links among water, waste water and solid waste management in terms of health effects and environmental consequences makes their consideration a logical nexus of interrelated municipal services. The consequences of inappropriate pricing polices on rapid groundwater depletion, the damage to water resources from inadequate sanitation facilities and deficient solid waste management, demonstrate the close interrelationships among these three urban services and the importance of complementarity in regulatory policy.

3. USAID currently has the initiative in developing a policy dialogue in terms of private sector participation in water supply and related services by facilitating and encouraging the private sector to enter into these discussions.

Although the Project will focus on strengthening private sector participation in urban services, the GOI is also undertaking a major effort to increase the role of the private sector in public utilities provided by the central government of Indonesia, including electric power, telecommunications, gas supply, ports, harbors and airports. If the

PURSE project is successful in its efforts to support private sector provision of urban services, and if the GOI requests assistance for other public utilities provided by the central government. Project emphasis could expand to include these utilities during the remainder of the Project.

2.3 Conformity with Indonesia's Strategies and Programs

The GOI has permitted private sector participation in water utilities since 1986. This was originally authorized through the publication of a nonexhaustive list of economic sectors open to private investment. In 1989, an exhaustive negative list was issued which recited all the productive sectors in Indonesia in which specified forms of new private investments would not be permitted. Water supply/drinking water, wastewater treatment and solid waste management as well as a number of other public utility operational areas has been noticeably absent.

The clearest authorization for public/private sector joint venture investments to provide for the transmission, treatment and distribution of electric power is found in Regulation of the Ministry of Home Affairs No. 4 of 1990. This explicitly permits regional enterprises to participate with the private sector in joint ventures as well as a variety of other financial arrangements such as "profit sharing cooperation". Under this regulation, regional enterprises, such as water enterprises (PDAMs) may purchase equity in existing private sector enterprises and/or cooperate with foreign private investors. This recent formal legal framework is the basis of current interest in BOT joint ventures with public water supply companies.

The process of bringing private participation into the provision of public services has started with the recently signed (May, 1991) agreement for the provision of the extension to the piped water supply at Nusa Dua, Bali. Several other joint venture investment projects in the water supply sector are in negotiation. In solid waste management, private contracting activity appears to be increasing in major urban areas, the most dynamic example is PT Sarana Orgamtama Resik (SOR) which operates in Jakarta.

In addition, there is widespread recognition among top policy makers that serious potential bottlenecks in urban infrastructure services will constrain economic activity. Speeches and public pronouncements at the highest level indicate that the scale of effort and finance necessary to avoid shortfalls requires the enlistment of the private sector.

More specifically and in direct support of this project concept, the Ministries of Home Affairs, Public Works and National Planning (BAPPENAS) have specifically requested USAID assistance in both policy advice and pilot /demonstration projects for private sector participation in the water, wastewater and solid waste management sectors to encourage further private sector participation. A major study just completed for USAID and the GOI (May, 1991) on private sector participation in urban water supply

concluded that private sector participation in water supply is to move forward a number of issues need to be addressed. These include: (1) regulatory constraints (such as GOI reversal of policies precluding local currency deficit financing by the central government and municipalities) and obstacles are removed or modified, and (2) a regulatory framework and related set of policies that will protect and promote the public interest are established. This project will address these recommendations.

2.4 Relation to A.I.D. Concerns and Activities

Strategic objectives and policy initiatives formulated by A.I.D. clearly place encouragement of the private sector at center stage. The June, 1986, *Blueprint for Development* calls for a healthy private sector and vibrant market forces as central dimensions in the development process and states A.I.D.'s intention to encourage these elements in its assistance. More recently, A.I.D. has reconfirmed its commitment to private sector participation and market economy principles through a draft Strategic Initiative dated December, 1990, entitled "The Business and Development Partnership." This document stresses A.I.D.'s commitment to encouraging a growing role for the private sector in development as a key contribution to sustainable economic growth.

The Project will support USAID/Jakarta priorities regarding the use of private sector enterprises to achieve program sustainability and the development of new financing instruments for urban infrastructure targeted at supporting Indonesia's continuing economic growth. It will directly contribute to the third objective of the USAID/Jakarta program performance contract, "Redefining the role of government through privatization of urban infrastructure, finance and services". The Project will support the Mission's private objective of creating incentives in local government infrastructure and service programs that emphasize economic efficiency/productivity and increased reliance on the private sector. It will also explore possible additional applications of A.I.D. loan guaranty programs which can finance urban services in Indonesia.

PURSE will support on-going policy initiatives presently undertaken through the Municipal Finance Project (497-0365), the Agriculture and Rural Sector Support Program (497-0357) and the privatization component of the Financial Markets Project (497-0360).

For example the Municipal Finance Project (MFP) plans to assist local governments to increase private sector investment in less capital-intensive, small scale urban services and private sector contracting to local government and regional enterprises. The MFP will focus on gathering data and drawing lessons based on previous local experience with private participation. MFP plans also to provide assistance to local government in the development of contract guidelines and contract management. PURSE will complement these efforts with a focus on the higher level regulatory framework, but can draw on

MFP experience in the development of feasible demonstration projects to support private participation in municipal services.

Both the Agriculture and Rural Support Program and the Financial Markets Project include a focus on privatization. While addressing different economic sectors, these projects are also addressing policy and regulatory constraints and are dealing with some of the same key GOI actors as PURSE. The efforts of these projects, therefore, will dovetail in attempting to create a more favorable business climate and a level playing field for the Indonesian private sector as well as opportunities for U.S. private sector investment.

Various centrally-funded AID programs may be used to leverage PURSE project funding. Among possible sources of funding or technical assistance in the Private Enterprise Bureau are the Environmental Enterprises Assistance Fund, the Market Technology and Access Project (MTAP), and the Loan Portfolio Guarantee Program (LPG). Capital Projects Programs are being investigated by the Office of Emerging Markets (PRE/EM) and the Office of Housing and Urban Programs (PRE/H). Other possible facilities are the Trade and Development Program and the U.S. Eximbank.

2.5 Other Donor Experience

The expansion of urban infrastructure necessary to sustain economic growth - including provision of such services by the private sector - is a major objective for the GOI in the next decade. In addition to USAID, the World Bank and the Asian Development Bank have extensive experience in improving the government's capacity to deliver urban services. However, partnership with the private sector in infrastructure development is a recent program initiative which has not yet been fully operationalized by the donors. The World Bank and USAID are simultaneously embarking on complementary projects in accordance with the new GOI initiative, while the ADB will continue its efforts in the public sector.

The World Bank and the GOI recently signed a $30 million loan agreement for the public and private provision of infrastructure. This loan is based on the "urgent need to formulate a strategy and create an environment for private sector participation" in Indonesia as "much remains to be done to define the framework for private sector participation." These funds will be provided to BAPPENAS for such purposes as: expert review panels to review ongoing strategies and policies ($2.7 million); in-house technical assistance to design methods for evaluating investment proposals ($4.0 million); study teams; preparation of bidding documents; prefeasibility and feasibility studies, and project monitoring and documentation. The main objective of the project is to increase the program evaluation capability of BAPPENAS such that they can effectively establish priorities in current infrastructure bottlenecks. Subsequently, the responsible agencies for the sectors identified will receive assistance in project preparation, with an emphasis

on financial cooperation with private enterprises. Initial investment projects will focus on urban transportation and toxic waste disposal, while pricing policy reform and development of financing strategies will be the priorities in the telecommunications and power sectors.

The overlap between the World Bank and USAID's activities will be complementary rather than competitive, in terms of both sectors and assistance to government ministries. Both the World Bank and USAID will facilitate the creation of an enabling environment for greater private sector investment in urban infrastructure. Given the weak base from which a regulatory and policy framework must be built to encourage private infrastructure provision, the initiatives of USAID and the World Bank will be mutually supportive rather than duplicative. Both donors will concentrate their assistance on the government, but USAID gives emphasis to expanding the capacity of the private sector.

3. PROJECT DESCRIPTION

3.1 Overall Project Strategy

The Government of Indonesia, led by BAPPENAS (the National Planning Ministry), has made a request to USAID for assistance in support of their policy development efforts in the provision of urban services. In addition, the GOI through a process supported by USAID, has promulgated a new urban policy objective as a component of their present five-year development plan which calls for strengthening and expanding the role of the private sector in financing and delivering urban services.

The Project will offer strategic assistance to the Indonesian private sector and the GOI in designing, testing and implementing a program to enhance private participation in selected urban services, including water supply, wastewater, and solid waste management. The project will result in new policies, standards, and models for private participation which can be replicated throughout Indonesia, as well as legal and regulatory reforms and recommendations for their implementation based on project-supported research and analysis (see Section 3.3 Policy Agenda).

Pilot/demonstration projects, five Build-Own-Operate (BOO) or Build-Own-Transfer (BOT) schemes and six service or management contracts, will be included in the project implementation plan, supporting and testing the creation of appropriate conditions and incentives for enlarging private sector participation in delivering urban services on an economic and sustainable basis. The pilot/demonstration projects provide a testing ground which can be used to establish national consensus regarding: (1) priority areas for and acceptable forms of private sector participation; (2) legal and regulatory requirements and procedures; and (3) the technical and financial implications of prototype agreements for public/private partnership. Demonstration projects may also

provide the Mission with the opportunity to explore applications of A.I.D.'s loan guaranty programs for financing guarantees in the provision of urban services.

3.2 Project Purpose, Outputs, Inputs, and Issues

3.2.1 Project Purpose

The goal of the PURSE project is to increase the stock of infrastructure essential for economic growth and improve access to efficiently delivered services that contribute to an improved urban environment.

The project purpose is to expand the participation of the private sector in the provision of selected urban services (water, wastewater, and solid waste) on a sustainable basis through direct investment or contracted participation in supply, delivery, or other operational functions.

Evidence of achievement of the project purpose will include the following end-of-project outcomes:

- Increased foreign private investment in urban services provision in Indonesia.
- An increase in the number of domestic private companies participating in urban services.
- Public/private and private sector projects developed and expanded services delivery and financing options utilized.

3.2.2 Project Outputs

Outputs of the PURSE project will include the following:

1. Establishment of a legal and regulatory framework enabling and encouraging private sector participation in the production and financing of urban services (water, wastewater, and solid waste).
2. Guidance issued to set pricing policy for urban services and encourage greater degree of self-financing for water, wastewater and solid waste services.
3. GOI requirements issued that regulate indiscriminate access to and negative impacts on water resources and land.
4. Pilot private/public demonstration projects are implemented that adapt, test and demonstrate technologies for improved urban service delivery and create models

for institutional, contractual, and financial arrangements in support of sustainable private participation.

5. Training and communications program implemented that expands public and private sector awareness of institutional, contractual and financial mechanisms that support private sector participation in urban services.

3.2.3 Project Inputs

Categories of project inputs include:

1. Technical assistance to the public sector in analyzing, reformulating, and drafting policies, standards, and regulations pertaining to private participation in selected urban services.

2. Technical assistance to strengthen private sector capacity to finance, deliver, and maintain urban services infrastructure.

3. Training for public and private sector participants to develop their regulatory and service delivery capacity respectively.

4. Formulation and development of pilot/demonstration projects to provide information for the policy analysis/implementation process and to obtain practical private participation experience.

3.2.4 Urban Services Issues

There is a wide range of possible private sector opportunities in the production and/or operating of urban services. These include management contracts; contracts for the supply of components of a service (such as bulk water supply); transport of solid wastes from collection points to disposal sites; operating disposal sites or treatment works; leasing and operating vehicles (such as municipal solid waste collection vehicles); providing capital to finance projects; and entering into joint ventures with public enterprises. In the longer term, the mobilization of private sector savings for urban infrastructure borrowing is an avenue for private participation in national development.

The determination of a realistic scope for private sector participation in urban service delivery and finance is a major task. It first requires the identification of areas in which such participation is readily acceptable. It requires that the legal and institutional framework is in place for binding agreements to be reached by interested parties in the public and private sectors. It also requires that responsible agencies receive clear guidance as to the range of activities in which private participation/partnership is

acceptable, and guidance regarding a regulatory framework applicable to each type of private participation, designed both to protect the public interest and to induce the mobilization of private resources. Instruments for private sector participation must be adapted to specific situations and opportunities, sector by sector. To support these requirements, PURSE will focus on moving beyond policy creation to policy implementation.

In summary, the project will focus on the following constraints to private sector participation in urban services.

Private Sector Constraints

- Weak definition of previously identified projects
- Substantial speculative costs for pre-engineering and feasibility studies
- Lack of model contracts defining rights and obligations
- Lack of government assurances regarding payment obligations and interference from regional governments

Public Sector Constraints

- Traditional equity considerations and GOI concerns for the public interest
- Lack of experience in public/private partnerships
- Lack of autonomy in government enterprises regarding entering agreements and pricing
- Limited regulatory framework for enabling public/private partnerships
- Inability of regional government/enterprises to be proactive and take advantage of existing momentum
- Practical and legal constraints regarding multiple-year contracts and contracting for management services

The project will produce the following benefits:

Private Sector Benefits

- Improved GOI understanding of the role and requirements of private sector partners

- Key GOI decisions regarding the types of projects appropriate for private sector participation and assurances it will provide

- Improved regulatory and legal structure to expand the market for privately-provided services

- Demonstration projects showing that public/private partnerships can be established and be profitable

- Enlarged market for local firms as a result of improved bid packages issued by GOI

- Improved capability of domestic consulting firms for preparing feasibility studies, designing financing packages, and contracting

- Increased utilization of domestic consulting firms

- Expanded market opportunities for U.S. firms from better information on potential projects in Indonesia, points of contact and bidding procedures

- Opportunities for U.S. and domestic firms to invest in new (for GOI) forms of private participation, such as vehicle and equipment leasing, franchising service models, BOT, BOO and BOOT models for private infrastructure provision.

Public Sector Benefits

- Improved GOI ability to conserve and make efficient use of public financial resources

- GOI consensus regarding the objectives of private sector participation, terms of agreements and means for protecting the public interest

- Better information in the public sector on the true costs of providing urban services, thereby enabling pricing policies to make private projects self-financing

- Regulatory structures that govern relationships between public and private partners

- Improved GOI ability to make efficient and environmentally sustainable use of natural resources

- Improved ability of GOI and government enterprises to negotiate with private sector regarding contract terms, government assurances, pricing, and security of performance by private firm

Addressing these policy, regulatory, and structural issues will help the GOI deal with the more specific negotiating issues that are the keys to actually completing productive transactions with the private sector. While it is unquestionably important to augment infrastructure capacity in support of economic growth, there has to be the right cost-benefit balance. Some proposals may not be worth doing because the demands of the private sponsors are too high or they fall outside the limits set by the policy parameters and negotiating guidelines. In any case, the allocation of risk among the parties is at the heart of the arrangements between the Government and private sponsors.

3.3 Policy Agenda

The Policy Agenda for the PURSE project is a framework to guide discussions between USAID/Jakarta and the GOI. Based on research both in Indonesia and the United States, the Policy Agenda identifies actions to enhance prospects for both domestic and foreign private sector sources to invest in urban infrastructure (capital works), to provide other services in water, wastewater and solid waste and to increase the efficiency of resource consumption in the provision of urban services.

Policy actions include both broad policy statements and the adoption of detailed guidelines or standard operating procedures. The framework recommended here for A.I.D. discussions with the GOI consists of policy actions that address three types of constraints affecting the production of urban services and the possibilities for increased private sector participation.:

- Constraints that affect the private sector's perception of the opportunity and incentive to invest their own resources in various forms of urban infrastructure and services provision;

- Constraints that arise from the structure of the prevailing system for financing urban infrastructure and services.

- Constraints that involve the inefficient use of natural resources in the production of urban services.

The following matrix summarizes the PURSE Policy Agenda.

FIGURE 1
POLICY AGENDA

POLICY OBJECTIVE	POLICY ACTIONS
1. Establish a legal and regulatory framework enabling and encouraging private sector participation in the production and financing of urban services (water, wastewater and solid waste)	a. Prepare and issue decrees for water, wastewater and solid waste services that: Make explicit the GOI's interest in private entrepreneurs' participation in the production and financing of those services; Formalize the legal basis for private investment of capital and other resources to build and operate facilities and to contract with regional governments and regional enterprises to provide services to public operators of facilities; Define the nature and extent of GOI guarantees or assurances of the performance of regional institutions in fulfilling contract obligations with private producers of services. b. Prepare and issue guidance and directives for Regional Governments that: Specify the types of Regional Governments or list the specific Regional Governments that are authorized to enter into contracts with private organizations to provide all or some portions of the respective services; Identify for the respective services the specific types of facilities and activities that may be contracted between Regional Governments and private entrepreneurs; Prescribe the procedures for announcing and issuing tender documents for competitive contracting for the construction and/or operations of facilities and the provision of specified services; Define the extent and nature of competition required; Specify procedural requirements for maintaining open competition and guarding the integrity of the bidding process; Provide model contracting procedures and documents for use by Regional Governments.

2. Clarify pricing policy for urban services and encourage greater degree of self financing for water, wastewater and solid waste services.	a. Revise accounting procedures for regional enterprises and regional government units that: Identify the full cost of capital works on an accepted accounting basis as well as annual operation and maintenance expenses and any transfers to other regional government accounts; Identify as sources of income or revenues all financing including user fees, central government direct construction of capital works, and transfers from other central or regional sources. b. Develop and publish guidelines on the extent to which water, wastewater and solid waste services are expected to be self financing from user fees or other direct charges to beneficiaries.
3. Develop policies for water resource use and residential and industrial estates development that improve the efficiency of allocation of scarce resources.	a. Review policies toward licensing for private wells, private intakes, private wastewater and solid waste systems to clarify: Private rights; Public interest in environmental management and preservation of resources. b. Review policies on zoning and land use to clarify: Private rights to develop land; Public interest in environmental management and preservation of resources. c. Issue ministerial guidelines for Regional Governments to regulate land use, water source tapping and wastewater disposal, and solid waste disposal by private individual and commercial/industrial users: Access to water resources (aquifers and surface sources) by private individuals and firms not connected to water systems will be subject to charges equivalent to the costs imposed on water system users for the cost of the water resource itself (not including the cost of extraction of water from the source); Wastewater disposal by private individuals and firms not connected to wastewater systems will be regulated to require treatment comparable to that determined by public policy appropriate for public systems; Solid waste handling and disposal through private facilities will be subject to the same standards for health, safety and environmental preservation as are applied to public waste handling and disposal systems.

3.4 Project Management

3.4.1 Steering Committee

The project will receive broad policy direction from a Steering Committee attached to Deputy V for Regional Affairs at BAPPENAS who chairs the existing Interministerial Coordinating Team for Urban Development (TKPP). This is also the coordinating location for the multi-donor sponsored Integrated Urban Infrastructure Development Program (IUIDP), the closest equivalent to an urban development master plan for Indonesia. Agencies to be represented on the Steering Committee are the Ministry of Home Affairs (Directorate General PUOD and Directorate General BANGDA), the Ministry of Public Works (Directorate General Cipta Karya and the Assistant to the Minister representing the Center for Strategic Studies), the Ministry of Finance, and USAID as an ex-officio member.

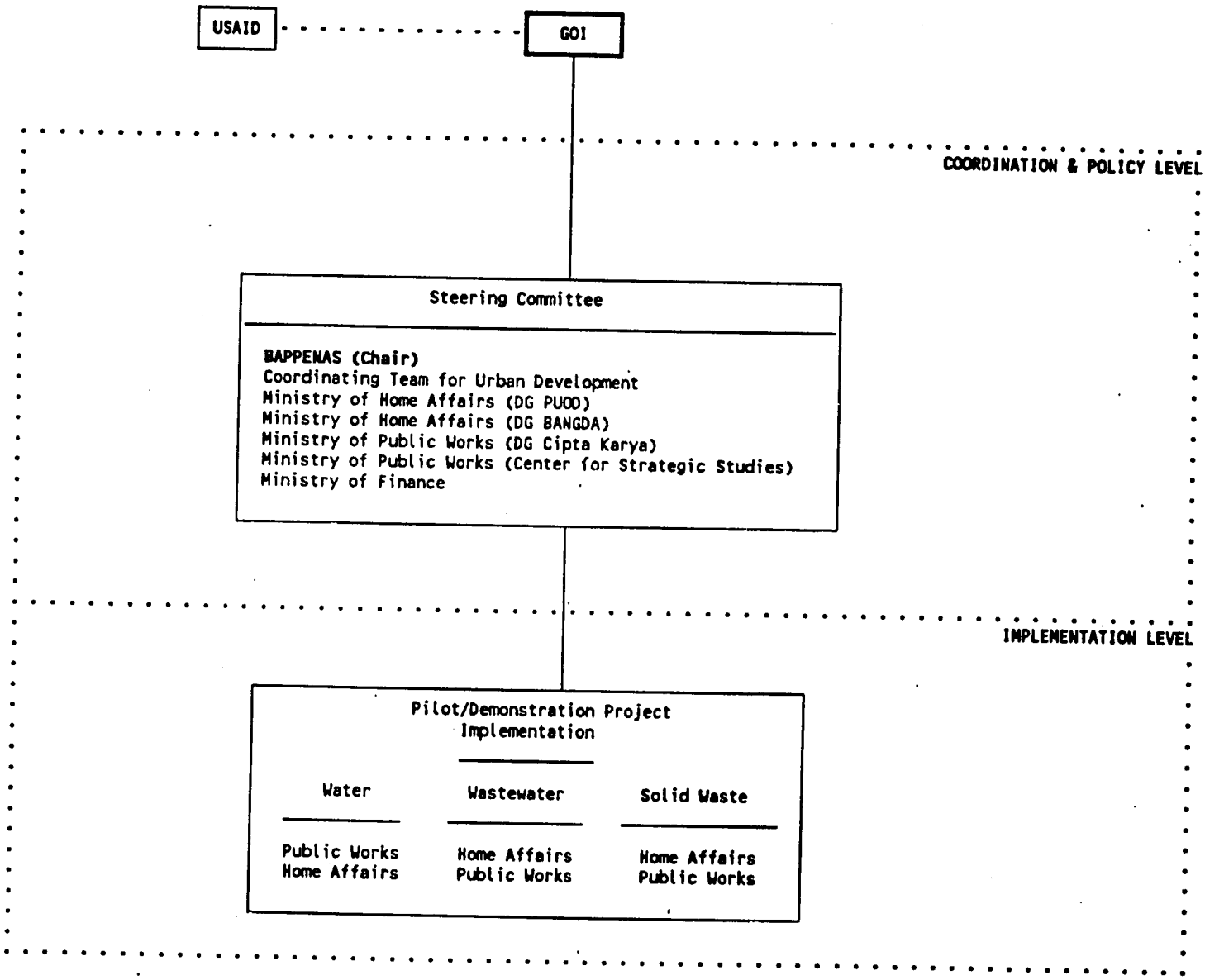
As described below in Section 4, PURSE technical assistance activities will be under the overall coordination of the BAPPENAS Deputy V for Regional Affairs and the USAID Project Manager, although allocated to various agencies over the life of the project. The Chair of the Steering Committee will be designated by the BAPPENAS Deputy V for Regional Affairs. The Steering Committee Chair will liaise with other GOI agencies involved with the project and maintain close contact with the USAID Project Manager. He will also designate the GOI officials from the implementing agencies (Ministries of Public Works and Home Affairs) who will have signature authority for PILs and other implementation agreements during the life of the project. In implementation of the overall Project, BAPPENAS, and the Ministries of Public Works, and Home Affairs will all have specific responsibilities. As specified in Section 8.2 of the Grant Agreement, the names of the representatives of the Grantee from these ministries, along with their specimen signatures, will be provided to USAID, and such designated representatives will be authorized to sign implementing documentation relating to activities within their respective areas of responsibility. As detailed in Section 4 below, the PURSE Project will not provide long-term technical assistance to BAPPENAS but will provide appropriate TA to the implementing Ministries of Home Affairs and Public Works.

BAPPENAS through the PURSE Project Steering Committee will have responsibility for providing direction and setting priorities for project implementation. The Senior Urban Services Advisor will receive direction from the Chair of this Steering Committee. BAPPENAS will have particular responsibility for the policy and regulatory agenda and, as such, will work with implementing Ministries, especially Public Works and Home Affairs, to assess and help overcome constraints to private participation in infrastructure projects. The Steering Committee Chair will play a significant role in coordinating in-country training activities, as well as selection of appropriate participants for formal overseas training. The Chair of the Steering Committee will also have responsibility for coordinating Committee review and approval of the Annual Work Plans for the long term resident advisors.

Demonstration projects and other implementation activities involving local and regional government and regional enterprises will be managed by members of the technical assistance team in coordination with the Directorates General of Public Administration and Regional Autonomy (PUOD) and Regional Development (BANGDA) in the Ministry of Home Affairs. PUOD is responsible for guidance of Regional Enterprises and, with BANGDA, oversees all local government affairs. Guidelines affecting how regional governments or enterprises may conduct business with the private sector must emerge from the Ministry of Home Affairs. The focus of the MOHA in recent years has been on implementing a more decentralized local government structure. In this context, local authorities have considerable scope in dealing with pricing, contracting, and other issues of importance to facilitating private participation in urban services provision.

The structure of the PURSE Project Management Organizational Chart is depicted in Figure 2.

FIGURE 2
PURSE PROJECT MANAGEMENT ORGANIZATIONAL CHART



3.4.2 USAID Responsibilities

USAID will appoint a Project Officer, who will manage the PURSE project with the assistance at least one Indonesian Project Manager. It is expected that this will be a full-time responsibility for this individual for the first 18 months of project implementation. During this period, there will be significant demands on the mission to organize and manage temporary technical assistance resources and prepare for a long-term institutional contract solicitation. The Project Officer, in coordination with the Project Manager(s), will participate in periodic progress review meetings and will be responsible for reviewing and approving annual plans. The Project Officer's approval will be required for all short-term technical assistance and overseas training under long-term contracts and for procurement plans.

The USAID Project Officer and Project Manager(s) will be responsible for identifying, designing, and managing all "bridging" activities as discussed in Section 4 in consultation with other USAID technical and support office staff and the Steering Committee Chair. The USAID Project Officer and Project Manager(s) will also be responsible for designing, with the assistance of other USAID technical staff, the Steering Committee Chair, and the long-term advisors, scopes of work for mid-term and final project evaluations (see Section 5).

3.4.3 Procurement Plan

Immediately following Project obligation, preparation of solicitation documentation will begin for the long-term A.I.D. direct technical assistance contract. It is anticipated that one prime contractor will be able to bring together the required subcontractors to carry-out the Project's specified activities, while at the same time, provide the administrative support, to all of the technical assistance team. Such documentation will be cleared by the Project Steering Committee Chair prior to issuance. It is the intention of USAID to have the long-term technical assistance team mobilized approximately nine months after Project obligation, or sometime during the summer of 1992.

It is anticipated that the majority of the long and short-term technical assistance, training, commodities and demonstration projects required will be covered by one long-term A.I.D. direct contract. Most overseas training and in-country training will also be funded through the contract. It is anticipated that significant subcontracting will be done with domestic Indonesian suppliers of technical assistance and training services over the life of the Project.

The contract will provide the majority of the technical assistance, training and commodities, as follows:

* Senior Urban Services Advisor
* Long-term Municipal Services Advisor
* Long-term Urban Environmental Specialist
* Long-term Demonstration Project Manager
* Long-term Contract Manager
* Long-term Local Hire Project Administrator
* Long-term Local Hire Municipal Services Specialist
* Long-term Local Hire Project Development/Financial Specialist
* Short-term advisors/trainers
* Local hire Administrative Staff
* Demonstration Project Support
* Short-term overseas training
* Long-term overseas training
* In-country training program
* In-country Workshops
* Commodities and Office Rental
* Local Logistics Support
* Home Office Support

USAID will retain a limited amount of funding outside of the long-term contract to be used on a contingency basis for special training needs, short-term technical assistance, or purchase of materials. Such needs may be procured through direct A.I.D. contract or may be pre-financed by the GOI and reimbursed by USAID, pursuant to mutual agreement and issuance of a PIL. This will be a particular need in the period prior to execution of a long-term contract for project implementation. Evaluations will also be contracted separately through buy-ins or direct contracts.

3.4.4 Annual Planning Process

An annual planning and budgeting process, supervised by the Chair of the Steering Committee, will be undertaken to assist in ensuring that both the required coordination and cooperation among concerned ministries is occurring. In addition, this process will ensure efficient and effective management and provision of both USAID and GOI inputs to the Project. The Annual Plan will program specific deliverables and resources according to a agreed upon schedule. Annual Plans will specify milestones and actions to be carried out by the Contractors and the GOI to meet the objectives of the Project. Progress against the Plans will be tracked on a quarterly basis and will be reviewed in meetings led by the Chair of the Steering Committee, and attended by USAID, the contractor, and Steering Committee representatives. Working in close collaboration, USAID and the Chair will have the authority to reprogram Project resources as necessary. The Chair of the Steering Committee and the USAID Project Officer and/or Project Manager, will jointly resolve issues involving the technical assistance contractors.

4. IMPLEMENTATION PLAN

4.1 Technical Assistance

The technical assistance requirements for creating the appropriate conditions for private sector participation in urban services are considerable both in the range of expertise and in the amount of time needed. The necessary range of expertise includes technical familiarity with the priority target areas for private sector participation; knowledge of administrative and contract law to enable drafting new laws or amendments as necessary; ability to formulate draft licensing regulations and prototype contracts between the public and private sectors; and knowledge of public finance and administration in Indonesia to ensure that agreements with the private sector are entered into with the proper authority regarding the financial and administrative implications of such contracts and mutual undertakings.

For several reasons, the PURSE technical assistance (TA) team will be based in a separate project office. These reasons include (1) the fact that PURSE is not a traditional public sector institutional strengthening project, (2) the Senior Urban Services Advisor is not attached to a particular agency, and (3) members of the TA team will be attempting to work in support of demonstration projects requiring direct private sector interaction.

4.1.1 Objectives

The objectives of the technical assistance strategy are:

1. provide needed TA to involved GOI agencies to support business climate change;

2. solicit the direct involvement of the local private sector in urban services participation;

3. create a "critical mass" of TA personnel who can work together, backstop each other, and react in a flexible but coordinated way to changing conditions in different sectors and agencies; and

4. furnish experts to serve as intermediaries between private firms interested in infrastructure investments and relevant government agencies, particularly facilitating dialogue with potential U.S. investors.

Technical assistance for the public sector will be organized along the following parameters:

1. Coordinating responsibility for the TA cadre will be assigned to BAPPENAS (in cooperation with USAID and the TA contractor).

2. Total level of effort for the long-term technical assistance activities is initially programmed for 444 person months with the quantity and assignment of subsequent technical assistance to be determined by the PURSE Project Steering Committee and USAID (based, in part, on the findings of the project mid-term evaluation).

3. The total short-term TA level of effort for GOI agencies will be phased; each agency will have authority to define the scope of work for tasks using its allocated level of effort, subject to necessary sign-offs by the USAID Project Officer and scheduling constraints.

TA for government ministries will be directed to the following areas of GOI performance and responsibility:

- the "policy agenda";
- identifying direct private sector investment opportunities and potential contracting arrangements in accordance with GOI priorities.
- managing project feasibility studies designed to generate interest from potential investors;
- evaluating the technical and economic merits of project proposals submitted by potential investors;
- clarifying interpretations of laws/policies that appear to be impediments to private projects;
- building capacities for contracting and contract management;
- developing guidance and organizational structures for necessary oversight (supervision) of private project development;
- evaluating and drawing lessons from private projects that are currently underway, using such lessons to (1) prepare SOPs other GOI units can use in initiating private projects, (2) develop materials for training and communication activities, and (3) identifying common impediments and needs for oversight that should be addressed by the GOI in new laws and regulations.

Technical assistance to the private sector will be organized along the following parameters:

1. Project TA personnel will work with the private sector in support of demonstration projects, including direct outreach to potential U.S. investors.

2. Through subcontracts with local consulting firms, banks, or other private sector sources, the institutional contractor will obtain the services of consultants who will work part-time out of the PURSE office to support potential private sector investors in urban services.

3. Their services will be available for a reasonable fee to firms with a serious and demonstrated interest in a specific potential project.

4. Fee income will be reinvested in training specifically designated for private sector suppliers of consulting services relevant to private sector participation in urban services delivery.

5. Substantial work will be subcontracted to local firms for pre-design engineering and financial studies and the preparation of other material necessary to attract private investors to the demonstration projects. Successful bidders will be required to reimburse AID for those pre-bid feasibility and design studies, allowing the funds to roll over for similar studies supporting additional demonstration projects.

TA to potential investors - both domestic and foreign - will include the following:

- preparing feasibility studies
- preparing proposed financing plans
- identifying legal/regulatory/institutional impediments to potential projects
- packaging, marketing and negotiating contracts and projects

4.1.2 Long-Term Technical Assistance

The Technical Assistance Team initially will consist of the following **long-term** positions:

TABLE 1

LONG-TERM TECHNICAL ASSISTANCE (BY POSITION)

Source	Position	Assignment
Expatriate		
	Senior Urban Services Advisor	PURSE Office
	Municipal Services Advisor	MOHA
	Urban Environmental Specialist	MOPW/CSS
	Demonstration Project Manager	PURSE Office
	Contract Specialist	PURSE Office
Local		
	Project Administrator	PURSE Office
	Municipal Services Specialist	
	Project Development/Financial Specialist	

The **Senior Urban Services Advisor** will work with the PURSE Project Steering Committee Chair at the Deputy V for Regional Affairs in BAPPENAS to coordinate project activities. The Senior Advisor will provide guidance on institutional, legal, and regulatory issues, with an initial focus on issues affecting demonstration project implementation. This advisor will have particular responsibility for assuring that appropriate lessons from demonstration projects are learned and applied through in-country training activities and outreach to U.S. firms. No long-term advisor will be assigned for technical work to BAPPENAS or the Steering Committee; instead, BAPPENAS will call upon task-specific short-term technical assistance as needed.

The long-term local hire **Project Administrator** will report to the Senior Advisor and will be responsible for the central administrative functions of the PURSE project. This will include assisting with the recruitment of local short-term advisers and training resources, local subcontracting, management of project finances, administrative coordination of the annual planning and quarterly reporting process, and assisting with processing of training participants.

One expatriate and one local-hire **Municipal Services Advisor/Specialist** will work with the Ministry of Home Affairs (Directorate Generals PUOD and BANGDA) and help cities and municipalities structure and package investment opportunities and identify

private sector contracting and management services in water, wastewater, and solid waste management.

One expatriate **Urban Environmental Specialist** and one local-hire **Project Development/Financial Specialist** will work with the Ministry of Public Works to assist the Center for Strategic Studies in the formulation of plans, strategies, and implementation arrangements to support effective public-private partnership in urban services provision. The advisor will play a major role in the development of demonstration projects, including new investments as well as a range of private sector contracting arrangements, working both with the MOPW and in cooperation with the Municipal Services Advisor/Specialist and their counterparts in MOHA as appropriate.

The expatriate **Demonstration Project Manager** will work with the Senior Advisor specifically in support of demonstration projects. He or she will market trade and investment packages, as well as contracting opportunities, to U.S. and small and medium sized Indonesian businesses.

An expatriate **Contract Specialist** will work with the Senior Advisor specifically in support of the substantial sub-contracting component of the project. The design of the project includes considerable local subcontracting as direct outreach to the private sector. This component is expected to involve a high degree of supervisory organization and management from the PURSE office and liaison with USAID. This position will become active in year two of the project.

The following table sets out the allocation of the long term technical assistance according to major activity assignments. These generalized assignment categories are project management, policy dialogue, demonstration projects and training/communications. Table 3 on the following page sets out details of the allocation of technical assistance during the implementation period.

TABLE 2

LONG TERM TECHNICAL ASSISTANCE
(BY MAJOR ACTIVITY ASSIGNMENTS)

Long Term TA Team	Proj.Mgnt	Policy	Demo	Training	TOTAL
Senior Urban Services Advisor	24	24	6	18	72
Project Administrator (Local)	72				72
Municipal Services Advisor		18	24	30	72
Municipal Services Specialist (Local)		12	18	30	60
Urban Environmental Specialist		24	12	12	48
Proj. Dev./Financial Specialist (Local)		24	12	12	48
Demonstration Project Manager			48		48
Contract Specialist	24				24
TOTAL	120	102	120	102	444

4.1.3 Short-Term Technical Assistance and Subcontracting

As noted above, the approach to provision of short-term technical assistance and local subcontracting will be flexible. Project short-term technical assistance will be allocated to various GOI agencies, in terms of quantity rather than exact description. In this way, these agencies will have a defined level of support that they may draw on as needed. Each agency will have the authority to define the scope of work for tasks using its allocated level of effort, subject to necessary sign-offs and scheduling constraints. The TA team will prepare periodic reports of balances remaining in each agency "account."

Requests for assistance will be prepared by government agencies and submitted to a TA Working Group designated by the PURSE Project Steering Committee. This Working Group will have the authority to approve requests and allocate the TA effort, again subject to necessary approvals and scheduling considerations. If feasible, it would be most efficient to consider requests semi-annually.

The PURSE Project will provide approximately 145 person months of short term expatriate assistance and 220 person months of short term local assistance. Initially, approximately 80 percent of the planned life of project short term assistance will be allocated to the GOI agencies to whom long-term advisers are assigned, to BAPPENAS, to local governments, and to project demonstration activities. Short-term advisers will work on specified aspects of demonstration projects or with other public agencies (such as the Ministry of Finance) as the need arises. In addition, these advisers will support technical assistance for feasibility studies, financing, and other demonstration project requirements. Approximately 20 percent of the short term assistance will be targeted to specific aspects of demo projects or on other short term activities as designated by the Chair of the Steering Committee and the cognizant USAID Project Officer.

Categories of expertise to be provided on an overall level-of-effort basis by the contractor will include:

- Urban policy and planning
- Privatization
- Financial Management
- Law and Regulation
- Public Administration
- Financial Management
- Project Management
- Infrastructure Engineering
- Contract Negotiations
- Economics

The following summary level of effort table details these long-term and short-term expatriate and local assignments according to major categories of assistance. Section 4.2 below provides details on the nature of training to be rendered.

TABLE 3

LEVEL OF EFFORT SUMMARY
(in person-months, Life-of-Project)

	LTA Expat	LTA Local	STA Expat	STA Local	Total
Project Management	48	72			120
Policy/Regulatory	66	36	28	20	150
Demonstration Projects	90	30	51	104	275
Training/Communications	60	42	36	36	174
UNALLOCATED			30	60	90
TOTAL	264	180	145	220	809

The TA Contractor will subcontract (through the project implementation contract) for the services of local firms, banks, and other sources to provide direct assistance to the private sector as opportunities arise. This subcontracting will be undertaken on a competitive basis. Decisions regarding the selection of the specific demonstration projects, as well as the subcontractors undertaking these activities, will be made in coordination with the GOI. **These arrangements should be structured in a form so that private sector recipients of these project-funded services will have an obligation to reimburse the project in the event that the services provided result in a completed transaction.** For example, if the project finances a feasibility study as an incentive to a potential private sector investor or service supplier and, subsequently, the investor or contractor concludes a deal related to the study, the investor/contractor should pay an up-front agreed fee for the service.

4.2 Training and Communications

The PURSE project is part of an ambitious agenda: to change the structure of three important sectors of economic activity. Because water supply, wastewater treatment and solid waste management are currently implemented by the GOI, increasing private participation will require changes in the attitudes of civil servants toward their own jobs, responsibilities and authority. The PURSE project must help create a foundation for positive and productive relationships between civil servants and private entrepreneurs. Such changes do not happen quickly. Participants in both the public and private sectors must learn new skills and receive new information. More importantly, they must adjust prevailing attitudes about themselves and about each other.

The Training and Communications component of the PURSE project will address all three of these dimensions of change: improving skills, conveying information, and changing attitudes. The program is designed to achieve thirteen specific training objectives, or outcomes, which are detailed in the following figure. The program will consist of the following related initiatives, which will be implemented in close cooperation with the Chair of the Steering Committee at Deputy V for Regional Affairs, BAPPENAS.

A Public/Private Forum will promote regular and effective communication between government officials and private entrepreneurs. Meetings will address a wide range of policy and technical topics that are central to building a working relationship between the public and private sector, including procedures for project identification and development, announcements of specific projects in which the GOI is soliciting private participation, terms and conditions of public/private agreements, mechanisms for government oversight and regulation of private activity, and lessons learned from the demonstration projects.

An In-country Training Program will improve the skills of, and convey information to, participants from both the public and private sectors. Workshops and short courses will

address many of the same topics as in the Public/Private Forum, but in greater detail and with a focus on teaching participants how to develop public/private partnerships. Training materials will be developed using PURSE project funds. Training topics will include procedures for developing projects and for analyzing their commercial and technical feasibility; how to use model contracts and negotiate terms specific to individual projects; technical standards and mechanisms for government oversight; and procedures for setting and revising prices for services.

A Formal Overseas Training Program will include both short and long term study. Short term training opportunities will be given to GOI senior, mid and junior level staff, and to potential private sector investors, owners or managers of urban services and infrastructure to participate in short courses and policy seminars (two-six weeks in duration) outside of Indonesia. Approximately 84 short-term participants are anticipated over the life of this project. Six Master's degree programs, in urban planning and/or business management, for mid-level GOI officials will be funded by the project.

A Research and Evaluation Program will ensure that GOI officials are actively involved in evaluating the PURSE demonstration projects and drawing lessons learned. Evaluations will include rigorous and quantitative reviews of construction and service quality, private project costs and profitability, benefits to consumers in terms of efficiency gains and to GOI in terms of costs avoided, and the success or failure of contractual terms and oversight mechanisms.

Figure 3: Desired Outcomes from PURSE Training and Communications

1. GOI officials and managers of government enterprises see private sector participation as a solution to their important problems and as a change that will expand their responsibilities and enhance their stature.

2. GOI officials and managers of government enterprises recognize opportunities to use private sector mechanisms to enhance urban services; managers have more autonomy and authority to take advantage of such opportunities.

3. Private entrepreneurs can work with GOI officials and managers of government enterprises to calculate a tariff that will return all of a firm's costs plus a reasonable profit; government policy and procedures allow different tariffs in different areas, based on true costs.

4. GOI officials and civil servants understand the government and public interests they are obliged to protect, and feel that they can protect these interests using regulatory oversight and enforceable contracts.

5. Regional and local officials provide necessary oversight of private firms without undue interference; oversight includes monitoring the firm's compliance with contract terms, design specifications and regulatory standards, fair and competent review of private partner costs to support price adjustments. Government entities establish and abide by a clear delegation of authority for oversight activities.

6. The process by which GOI entities identify, develop and tender projects for private sector involvement operates smoothly.

7. Urban services projects tendered by GOI entities attract qualified Indonesian investors and contractors.

8. Private firms build and operate new facilities that perform according to design specifications.

9. Private firms provide competent and effective services under contract to government entities.

10. Small and medium-sized Indonesian investors feel comfortable negotiating and concluding contracts with GOI entities.

11. Private Indonesian consulting firms are capable of supporting the full range of activities involved in identifying, developing, and packaging projects in a manner that will satisfy private sector needs for complete and reliable information.

12. Domestic banks are prepared to make loans to domestic investors to support construction projects in urban services.

13. Public and private partners conduct careful financial, economic and regulatory evaluations to demonstrate that private investment and service contracts are more cost-effective than public provision of urban services, in terms of cost to the consumer, quality of product, and reliability of service. Evaluations identify successes to be replicated and problems to be solved.

4.3 Demonstration Projects

The PURSE project will seek to develop a minimum of five BOTs and/or BOOs and six service or management contracts in order to demonstrate the ability of the private sector, in partnership with government entities, to implement water, wastewater and solid waste projects; test technology and methodology; examine legal, financial and organization framework; and measure comparative efficiencies. For implementing demonstration projects, the PURSE team will work with the GOI to identify locations at which private firms may construct, own and operate new facilities and opportunities for private firms to improve the operation and maintenance of existing facilities through service contracts. The team, in close coordination with GOI, will be involved in identifying potential projects; analyzing their technical feasibility and commercial viability; identifying potential contractors/investors; and using lessons learned from the projects to help the GOI develop new policies, regulations, guidance and model contracts. The projects will be directed at private participation of both foreign and domestic investors large and small. The final selection of the specific projects will be determined in the early stages of the PURSE project by the TA team and the GOI implementing ministries (Public Works and Home Affairs). Since the demonstration projects will specifically identify and surface policy and institutional shortcomings, training needs and required technical assistance, it is important that the projects have an early and vigorous start.

The key element in initiating a project and its successful implementation is for both sides - the government and private investor - to gain benefits, but not at each other's expense. It is a public/private partnership in the sense that the contractual relationship gives the public sector, which has the obligation and responsibility to provide urban services, the opportunity to provide those services earlier, in larger quantities, and at lower costs than were otherwise possible, and eventually obtain ownership and management of the service. The contract calls for the private sector to design, construct, finance, own and operate the works and/or system for the public sector under a service contract and transfer ownership at some future stipulated time. The private provider in return receives a reasonable profit and a fair return on its investment.

The responsible government body and management must feel that it has not given up authority or responsibility to the private provider but has added capacity to deliver services to its constituency.

4.3.1 Selection Criteria for Demonstration Projects

The emphasis will vary in the selection of specific projects, but in general, the criteria will encompass the following guidelines

- Each project should provide the means to develop an urban service that will answer an urgent and recognized local need.

- The proposed project should be immediately commercially viable.

- The project, when possible, should introduce new management and technological developments.

- The projects, particularly water supply and wastewater treatment, should bring additionality to the sector that fills an apparent funding gap under current fiscal constraints.

- Some projects, particularly in solid waste management, should introduce an avenue for small local private enterprises to provide contract services.

- The project would be presented to the private sector on a "prepackaged approach" with schematic designs, feasibility analysis and established contractual conditions.

- The project should provide opportunity to demonstrate, analyze, and disseminate information regarding opportunities and constraints to private sector participation.

4.3.2 Composition of the Demonstration Projects

An overriding concern in project selection is its implementation potential. Only if the pilot project is successfully implemented will it demonstrate the positive outcomes of private provision.

There should also be an emphasis on the speed of implementation. The various benefits and requirements of the staffing of the technical assistance should be identified quickly and accurately, thus making the PURSE project efficient and cost effective. Furthermore, if the demonstration projects require exceptions in present policy or regulations, only a few selected exemptions will be readily received and approved.

WATER: Two B.O.T. projects
Two Service Contracts (SC)

B.O.T.(1): The introductory project should be relatively easy to implement, that is, a concise smaller project that is commercially viable. The contract would be with a PDAM or equivalent to sell water either in bulk or delivered to the user.

B.O.T.(2): The second project might be more comprehensive and provide water to a full range of users. In an urban area, the contract might include supply, distribution and management.

SC (1&2): Contracts could be undertaken for maintenance, or for billing and collection. A full management contract might be considered for an enclave development.

Potential Projects
Serpong water treatment and distribution
Pontianak water supply
Bandung Raya water supply and distribution
Bekasi water distribution
Ujung Pandang water supply
Dumai water supply

WASTE WATER: Two B.O.T. Projects
One Domestic Investor Service Contract (DISC) project.

B.O.T.(1): The first project would be, as the water project, a concise, well defined project that is commercially viable and relatively easy to implement. It might consist of a treatment plant and effluent control.

B.O.T.(2): A second more comprehensive project might include a complete system of collection and treatment in an un-serviced area.

DISC (1): A domestic investor might invest in a septic tank collection business. The DISC would purchase trucks and contract with households, business and industrial concerns to empty septic tanks and dispose of the waste under an arrangement with the municipal PDAL.

Potential Projects
Surakarta collection and treatment
Ujung Pandang collection and treatment
Malang collection and treatment
Ambon collection and treatment
Yogyakarta sewerage system rehabilitation
Padang sewer collection rehabilitation and new treatment facility

SOLID WASTE: Two Domestic investor service contract (DISC) projects.
One Service contract (S.C.) project

DISC (1): A project might consist of a local or regional garbage collection company that either provides transportation from transfer collection points or from individual households, businesses or industries. The disposition of the waste could be to private, but licensed land fills.

DISC (2): A second project might be to organize a landfill business (DISC) which received solid waste. There could than be several ways of disposition such as compost, recycling, energy generation, or burial.

S.C. (1): This could be purely services rendered with no capital investment. The service could include garbage collection in neighborhoods or organizing a land fill operation.

Potential Projects
Transfer, Disposal, Transportation in Bandung; Medan; Bogor; Surabaya; Semarang; Malang
Jakarta - container vehicle transfer

COMPREHENSIVE URBAN SERVICE DISTRICT

A private water, waste water and solid waste company formation project.

A project may be formulated to provide all of the above urban services for a municipality or enclave development. This would include water supply and distribution, waste water collection and treatment, and solid waste collection and disposal.

This demonstration project would be formulated out of the experience and policy formulation of the other projects. It would demonstrate the ability of private investors to construct, and operate under new policies and regulations, as well as point to greater efficiencies in constructions and operations. The emphasis would be directed to implementing the project with domestic expertise and efforts.

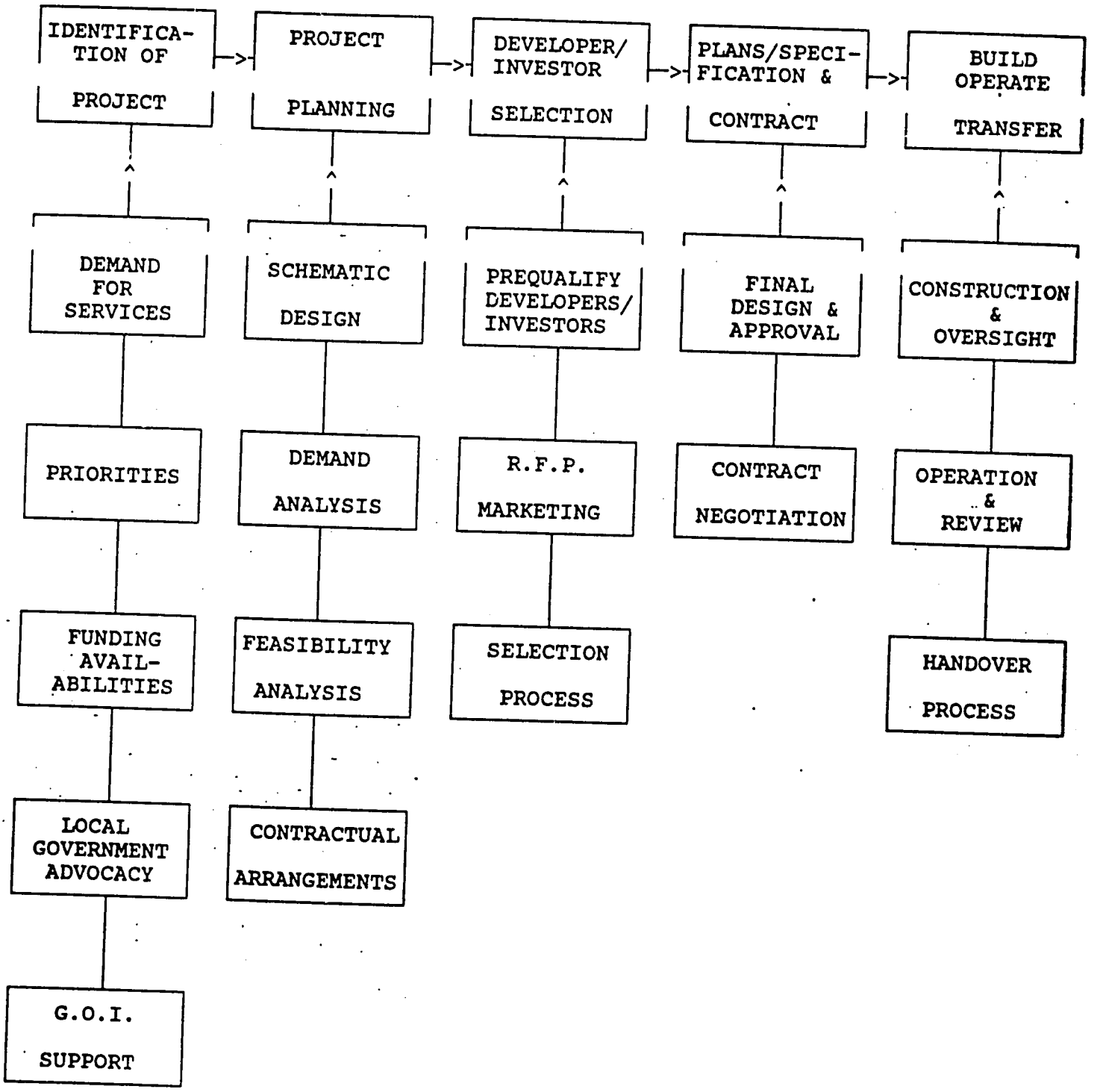
Potential Projects
East Bandung; Padang; Serpong; Bekasi

4.3.3 Demonstration Project Implementation Process

The implementation of the projects includes identification, analysis, formulation of the project plan, selection of the private investor, contract negotiations, construction and operation. While these steps outline the process for the pilot projects, the methodology is applicable on a continuing basis and offers a demonstration in itself. A flow chart (Figure 4) outlines the process:

FIGURE 4

A FLOW CHART OF THE IMPLEMENTATION OF PRIVATE/PUBLIC BOT DEMONSTRATION PROJECT



The Project Proposal

The presentation of the proposal to prospective bidders or terms of reference (TOR) will include the scope of the physical works, market demand, feasibility analysis and the proposed contractual relationship between the investor and the government unit.

The selection and contracting process will identify potential private developers/investors, pre-qualify firms, market the projects among the list of qualified firms, solicit proposals, select the investor and negotiate the contract.

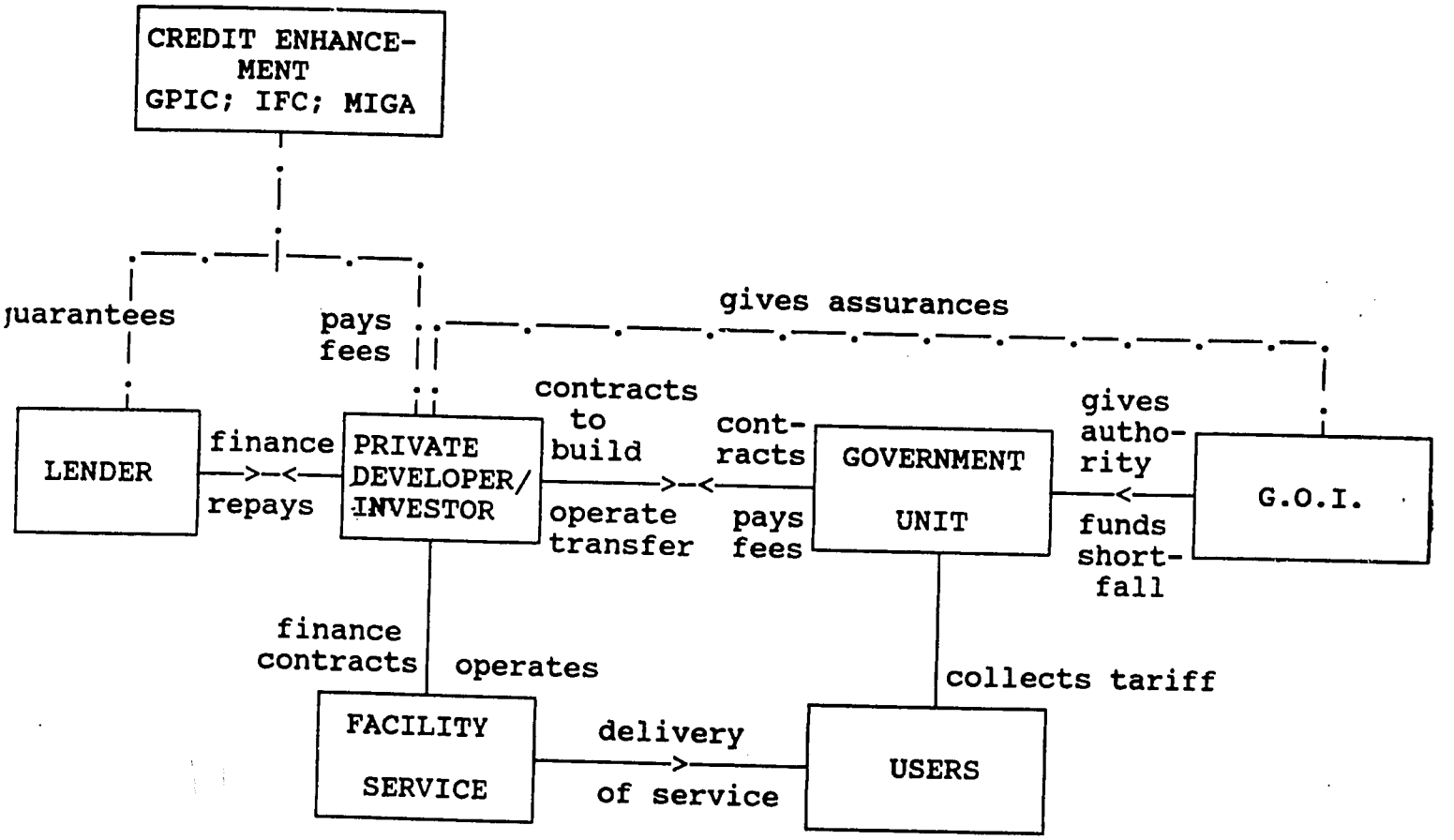
4.3.4 Framework of Contractual Relationships for Demonstration Projects

The success of the demonstration projects is to a large degree based on developing contractual agreements that provide a reliable source of income flow; a finance mechanism that allows the majority of the project costs to be borrowed, debt amortization generated from project cash flows and the assurances of the contractual integrity of all parties.

The contracted rate of return will depend on the associated risks, but based on present expectations and opportunity cost of capital. A minimum rate of return (IRR) of 16% to 18% may be acceptable if there is a potential of perhaps 9 percentage points or more to be gained from increases in income over the life of the contract. If there is no upside potential, the rate of return may need to exceed 20 to 22%. The attached diagram (Figure 5) outlines the contractual relationship.

FIGURE 5

CONTRACTUAL RELATIONSHIP IN A B.O.T.



4.3.5 Demonstration Project Cost Estimates

Two BOT projects (possibly BOO) will be developed in the early stages of the PURSE Project. The PURSE Project will take on the costs of pre-packaging a water project and a waste water project. This will include schematic designs; market analysis and feasibility studies; a project contract proposal; investor solicitation efforts; investor selection; and contract negotiation. All these costs will be paid by the PURSE Project. It is planned however, that those expenditures that are applicable to the proposed project and are costs that would normally be incurred by an investor in such a project would be repaid to the PURSE Project by the successful bidder and capitalized as part of the demonstration project. The estimated recoverable costs are based on two assumptions: (1) costs are reimbursable only from the BOT/BOO projects; (2) only expatriate assistance is reimbursable, at a rate of 50 percent for long-term TA and 75 percent for short-term TA.

TABLE 4

DEMONSTRATION PROJECT COST ESTIMATES
(in $000)

Projects	1	2	3	4	5	Small Scale	Total
Tech Ass't (expat)	450	450	250	200	200	450	2000
Tech Ass't (local)			15	25	35	70	145
Design Development	200	200	250	175	250	30	1105
Pack/Mart/Negotiate	50	50	75	75	100	130	480
Oversight	50	50	65	70	75	15	325
Total	750	750	655	545	660	695	4055
Rec.Costs	450	450	350	290	340	-	1880
Net Costs	300	300	305	255	320	695	2175
Net Cost BOT					1480		

4.4 Implementation Schedule

4.4.1 Bridging Technical Assistance

From project inception, planned for October 1991, to the beginning of the long-term technical assistance contract, it is important to initiate activities related to the demonstration projects because of the long gestation period required for these activities. Buy-ins and IQCs will be used to provide important expatriate and Indonesian technical assistance inputs and other support to demonstration project initiation.

FIGURE 6

BRIDGING TECHNCIAL ASSISTANCE

Task	TA Required	LOE
1.A Identification of demonstration project sites and potential investors - solid waste management project (domestic investment service contract) - water supply project (foreign investment BOT) 1.B Development of list of potential waste-water treatment project sites (foreign investment - BOT) 1.C Identification of government contracting entities and analysis of the institutional framework and constraints	1 Expat urban infrastructure privatization specialist 1 Expat urban policy specialist for institutional/ policy analysis 1 local-hire municipal services specialists for site visits 1 local hire business/financial consultant	2 person months (STA Expat) 1 person month (STA Expat) 2 person months (local hire) 2 person months (local hire)
2. Organization, set-up and implementation plan development for two initial demo projects (one in solid waste collection and one in water supply)	2 Expats (one urban infrastructure privatization specialist and one urban policy specialist)	2 person months (STA expat)
3. Communicate and solicit interest among potential BOT investors in U.S.	1 Expat urban infrastructure privatization specialist	1 person months (STA Expat)
4. Arrange workshop and meetings with potential private sector contractors for solid waste collection service contract opportunities	2 Expats (as in #2 above) 2 local-hires (one municipal services specialist; one business/financial specialist)	1 person month (STA expat) 4 person months (local hire)

4.4.2 Long Term A.I.D. Direct Contract Period

Over the assumed six year life of project after the initiation of the AID direct contract, implementation activities are best specified in terms of three categories of ongoing project activities, each described in detail in this Project Paper: (1) policy research and dialogue, (2) demonstration projects, and (3) training and communications. The charts below are illustrative of the allocation of all the long-term technical assistance and approximately 80 percent of the short term technical assistance.

Major policy activities are described below. These activities are keyed to the policy agenda described in Section 3.3 and in Annex A-3C.

FIGURE 7

LEVEL OF EFFORT SUMMARY FOR POLICY AGENDA

Task	TA Required	LOE
1. Assist in the development of a policy statement, or a compilation and publication of existing policy statements, regulations and statutes, clarifying GOI interest in and sanction of private participation in various forms of capital works and operating contracts for water, wastewater and solid waste services.	1 Municipal Services Advisor 1 Senior Urban Services Advisor	6 person months (LTA expat) 4 person months (LTA expat)
2. Policy Study and Review of Capital and Operating Costs for Water	1 Urban Environmental Specialist	6 person month (LTA expat)
A. Select five PDAMs for whom capital costs associated with source development, treatment works, and distribution system information is available and develop financial balance sheets and other accounting statements reflecting the capital costs for the three system components.	1 Senior Urban Services Advisor 1 Proj. Dev./Financial Specialist	6 person months (LTA expat) 4 person months (LTA local)
B. Review with PDAM staff operating costs including any labor or other resources provided by local government (kabupaten or kotamadya) and establish an operating account that includes current operations and maintenance costs and provision for capital cost recovery (2.A.) over a 20 year period.	1 Expat water sector financial analyst/tariff specialist to participate in study design and analysis 1 Proj. Dev./Financial Specialist	3 person months (STA expat) 4 person months (LTA local)
C. Develop with PDAM staff, Ministry of Home Affairs (DG BANGDA) and Ministry of Public Works (DG CIPTA KARYA) a hypothetical tariff structure that would generate a revenue stream sufficient for both operating costs and capital cost recovery.	1 Proj. Dev./Financial Specialist 2 local-hire specialists, in public sector accounting or financial analysis, for field visits, data collection and analysis, and report preparation.	4 person months (LTA local) 6 person months (STA Local)

3. Policy Discussions on Cost Recovery A. Using task 2 study as the basis, begin dialogue with Home Affairs on the extent to which PDAMs can establish tariffs that will recover both capital and operating costs.	1 Urban Environmental Specialist and 1 Senior Urban Services Advisor for intermittent policy discussions 1 Proj. Dev./Financial Specialist	8 person months (LTA expat) 2 person months (LTA local)
B. Review willingness to pay studies in Indonesia in the water sector to determine if sufficient evidence exists on effective water demand, and if insufficient, conduct willingness to pay studies in the 5 PDAM service areas involved in Task 2.	1 Urban Environmental Specialist to review existing work. 1 Proj. Dev./Financial Specialist to supervise study. 2 Expat Economic and Financial Analysts, 2 Local Hire Data Collection, 1 Local Hire Economic and Financial Analysis for implementation of study.	1 person month (LTA expat 4 person months (LTA local) 6 person months (STA expat) 6 person months (STA Local)
C. Expand policy discussions to include Ministries of Finance, Public Works and BAPPENAS to establish GOI consensus on water tariff policy (proportion of total costs expected to be recovered from beneficiaries through pricing and acceptable sources of annual revenues to cover any gap between full costs and user charges).	1 Senior Urban Services Advisor and 1 Urban Environmental Specialist for intermittent policy discussions	8 person months (LTA expat) 2 person months (LTA local)
4. Assist in Development of SOPs, Guidelines for Municipal Services Contracting	1 Municipal Services Advisor 1 Municipal Services Specialist	12 person months (LTA expat) 8 person months (LTA local)
A. Solid Waste collection, transfer and disposal contracting	1 Expat operating services contracting expert	5 person months (STA expat)
B. Water and Wastewater BOT and BOO contracting	1 Expat private sector capital projects specialists	5 person months (STA expat)
C. Water and Wastewater operating services (accounting, billings, collections, maintenance, repairs, etc.) contracting		

5. Assist in Development of Policy on Water Source Depletion	2 Expat environmental management/water resource economics specialists 1 Proj. Dev/Financial Specialist 1 Local hire environmental engineer/water resource economics specialist	5 person months (LTA expat) 3 person months (STA expat) 2 person months (LTA local) 2 person months (STA Local)
6. Assist in Development of Policy on Environmental Management of Wastewater (economic incentives to improve management of wastewater such as discharge permits, pollution permits, etc.)	2 Expat environmental management/wastewater management specialists 1 Proj. Dev./Financial Specialist 1 Local hire environmental engineer	5 person months (LTA expat) 3 person months (STA expat) 2 person months (LTA local) 3 person months (STA Local)
7. Assist in Development of Policy on Regulation of Alternative Methods of Solid Waste Disposal and Pricing Strategies (economic incentives to control solid waste handling and disposal)	2 Expat environmental management/solid waste treatment management (economics) specialists 1 Municipal Services specialist 1 Local hire environmental engineer	5 person months (LTA expat) 3 person months (STA expat) 4 person months (LTA local) 3 person months (STA Local)

FIGURE 8

LEVEL OF EFFORT SUMMARY FOR DEMONSTRATION PROJECTS

Task	TA Required	LOE
1st Project Project Schematic and Design	1 Expat engineer	6 person months (STA expat)
Market and Feasibility Study	1 Expat economist/financial analyst	6 person months (STA expat)
Project Management	Senior Urban Services Advisor and Demonstration Project Manager	18 person months (LTA expat)
2nd Project Project Schematic and Design	1 Expat engineer	6 person months (STA expat)
Market and Feasibility Study	1 Expat economist/financial analyst	6 person months (STA expat)
Project Management	Demonstration Project Manager	18 person months (LTA expat)
3rd Project Project Design	Expat engineering assistance.	10 person months (STA expat)
	Local engineering consulting.	10 person months (STA local)
Market and Feasibility Study	Expat economic/financial analysis.	3 person months (LTA expat)
	Local economic/financial analysis	6 person months (STA local)
Project Management	Expat financial management, project development/evaluation assistance.	10 person months (LTA expat)
	1 Local financial management, project development/evaluation assistance.	4 person months (STA local)
4th Project Project Design	Expat engineering assistance.	7 person months (STA expat)
	Local engineering consulting.	10 person months (STA local)
Market and Feasibility Study	Expat economic/financial analysis.	3 person months (LTA expat)
	Local economic/financial analysis.	7 person months (STA local)
Project Management	Expat financial management, project development/evaluation assistance.	8 person months (LTA expat)
	1 Proj. Dev./Financial specialist.	6 person months (LTA local)

<u>5th Project</u> Project Design Market and Feasibility Study Project Management	Expat engineering assistance. Local engineering consulting. Expat economic/financial analysis. Local economic/financial analysis. Expat financial management, project development/evaluation assistance. 1 Proj. Dev./Financial Specialist.	10 person months (STA expat) 14 person months (STA local) 4 person months (LTA expat) 6 person months (STA local) 8 person months (LTA expat) 6 person months (LTA local) 3 person months (STA local)
<u>6 Small Scale Demonstration Projects</u> (Limited capital investment, primarily service contracts in solid waste management)	1 Municipal Services Advisor 1 Municipal Services Specialist Local engineering consulting. Local financial/business management assistance.	18 person months (LTA expat) 18 person months (LTA local) 12 person months (STA local) 32 person months (STA local)

FIGURE 9

LEVEL OF EFFORT SUMMARY FOR TRAINING AND COMMUNICATIONS

Task	TA Required	LOE
Public/Private Forum Forty local meetings and five annual conferences for public officials and private entrepreneurs over six years. Meetings planned and organized by PURSE staff; run by public or private participants. The annual conference may require travel.	Assume meetings will use material prepared for briefings and workshops, so minimal cost for materials preparation. Preparing for each meeting requires 1 week of time, and each conference requires 1 month of time from both the Municipal Services Advisor and Specialist.	15 person months (LTA expat) 15 person months (LTA local)
Training: Guidance for Public/Private Partnerships Prepare and deliver forty workshops on five topics for public and private participants. Workshops will address procedures for establishing partnerships and aspects of the relationship between public and private actors.	Assume preparation of 5 workshops; workshops will meet for 2 to 5 days; 40 workshops will be held. Developing each workshop will require 3 months from a STA expat. Delivering each workshop will require 3 weeks of time from the appropriate LTA expat and 2 weeks of time from one of the local technical assistants.	30 person months (LTA expat) 20 person months (LTA local) 18 person months (STA expat) Travel and per diem for instructors only.

Training: Technical and Managerial Skills Facilitate participation of private sector personnel in existing workshops and courses to teach specific technical, managerial and administrative skills needed to deliver urban services and sustain a viable small or mid-size business. Assume no preparation of original training materials; the project should provide support to public and private training institutions to modify existing courses.	Identifying sources of existing training and arranging for cooperation with PURSE will require 1 month per year from the Municipal Services Advisor and Specialist. Assume a tuition cost of 2.0 M Rp per student, no payments for travel and per diem, 20 students in each of 5 years (beginning in second year of project).	5 person months (LTA expat) 5 person months (LTA local) Tuition fund of Rp. 200 million
Formal Overseas Training Program Six long- and 84 short-term training opportunities will be provided to GOI staff and private sector investors, owners, or managers of urban services and infrastructure. Programs which combine urban planning with business administration will be promoted.	Identifying appropriate master's programs and short courses for candidates selected will require 1 month per year from Senior Urban Services Advisor. Local technical staff and Project Administrator will assist in processing trainees.	5 months LTA expat 5 person months (LTA local)
Research and Evaluation Establish a continuing program, involving GOI and private sector, to perform financial, economic, and regulatory analyses of demonstration projects. Incorporate results of evaluations into existing project development procedures, model contracts, and workshops.	Senior Urban Services Advisor will manage evaluations. Short term expat assistance in designing and supervising evaluations. Local hire economists, attorneys and engineers to conduct evaluations under subcontract. Assume 12 evaluations over life of project.	5 person months (LTA expat) 18 person months (STA expat) 36 person months (STA local)

FIGURE 10

ILLUSTRATIVE IMPLEMENTATION SCHEDULE

NO	ACTION	TARGET DATES
1.	Project Agreement signed	Sept. 91
2.	GOI Project staff designated and initial PILs issued	1st Qtr-FY92
3.	Finalize TA bridging requirement and scopes of work	,, ,,
4.	Short-term bridging TA begins	,, ,,
5.	Issue the RFP for the long-term TA contract	2nd Qtr-FY92
6.	Public/Private forum initiated.	,, ,,
7.	Annual Work Plan prepared	3rd Qtr-FY92
8.	Review Technical Assistance contractor proposals	,, ,,
9.	Award the long-term TA contract.	,, ,,
10.	Conduct First Annual Review	4th Qtr-FY92
11.	The long-term TA contractor mobilized in the field	,, ,,
12.	Initiate demonstration projects (water/wastewater)	1st Qtr-FY93
13.	The training program begins	,, ,,
14.	Begin Policy review on Private Participation in Urban Services	2nd Qtr-FY93
15.	First long-term overseas trainee depart	,, ,,
16.	Begin Public-Private Workshop & develop SOP for contracting for Solid Waste	3th Qtr-FY93
17.	Begin Capital Operating Costs Study	3th Qtr-FY93
18.	Initial Annual Public/Private Conference	4th Qtr-FY93
19.	Second Annual Review	,, ,,
20.	Draft SOP for water and wastewater	1st Qtr-FY94
21.	Finalized draft contracting SOP solid waste/regulation adopted	2nd Qtr-FY94
22.	Third Annual Review	4th Qtr-FY94
23.	Mid-term Evaluation	4th Qtr-FY94
24.	Fourth Annual Review	4th Qtr-FY95
25.	Fifth Annual Review	4th Qtr-FY96
26.	Sixth Annual Review	4th Qtr-FY97
27.	Final Evaluation	4th Qtr-FY98
28.	PACD	Sept. 30, 1998

5. MONITORING AND EVALUATION

An important initial task of the long-term technical assistance team will be to establish mechanisms for monitoring and reporting on project activities. An essential aspect of this task will be establishing baseline data and developing systems to regularly update such data for planning and reporting purposes. The focus of the monitoring will be on progress made toward the end-of-project status and related outcomes as defined in this Project Paper. Project monitoring and reporting will consist of three major activities:

- regular updating by project personnel of established project information systems and financial records,
- quarterly reporting, and
- annual reporting.

The long-term contractor team, specifically the Senior Urban Services Advisor, will have primary responsibility for quarterly and annual reports, and will assist GOI organizations in preparing annual plans with inputs from other participating private and public agencies.

Long-term advisors working with the various project coordinating and implementing agencies as well as with the private sector on demonstration projects will provide needed inputs for quarterly and annual reporting to the local-hire Project Administrator who will coordinate such reports under the supervision of the Senior Urban Services Advisor. The Senior Urban Services Advisor will be responsible for submitting these reports to USAID and to BAPPENAS.

Quarterly reports will be used by the Steering Committee and USAID as the basis for periodic progress reviews against annual work plan objectives with the contractors and the GOI organizations receiving assistance. Annual performance reports will be the topic of review at annual meetings to monitor progress and consider reprogramming actions as necessary. Quarterly and annual reports will include data on the entire range of project activities and progress against annual planning targets. Financial data will be provided in detail. Such data will be used for USAID Quarterly Implementation Reviews.

The long-term team will also have responsibility for monitoring GOI and private sector contributions to the project, including Project-generated funds, and reporting on such contributions to USAID. All Project-generated funds will be recycled for use in the Project, for example, payments by private sector firms for engineering, feasibility, or other studies.

An important aspect of implementation, monitoring, and evaluation is ensuring and assessing project sustainability. Sustainability can be defined as the ability of a project to so influence the development context within which it operates that the system will produce sufficient inputs to continue the benefit stream beyond LOP, with widely replicable long term impacts. Addressing sustainability has two critical implications: the public policy environment and private sector capacity. Especially significant to addressing sustainability in the PURSE project is identification and dissemination of the replicable elements of demonstration projects. Terms and conditions of financial viability as well as information on how uncertainties of public policy were sufficiently resolved to induce private investment, must be identified, clearly documented, and explicitly incorporated as part of training and communication activities to enhance project sustainability.

Mid-term and end-of-project evaluations will be conducted. These evaluations will be facilitated by the availability of monitoring data collected by contractor teams over the life of the project and will be keyed to the indicators and means of verification in the project logical framework matrix. Briefly, the two evaluations will be as follows:

The Mid-Term Performance Evaluation will assess the continuing validity and relevance of the Project in supporting private sector participation in urban services. It will explore in particular project sustainability as evidenced by: (1) the commitment of the GOI to support private participation (2) the readiness of the private sector to respond to project-generated opportunities, and (3) the validity of project assumptions underlying output-purpose-goal linkages. Findings will be used to help determine the need for any revision of Project objectives, institutional arrangements, and funding. The mid-term evaluation will also be an important input into decisions regarding programming long term technical assistance after the first three years of the implementation contract. This evaluation should be conducted near the end of FY 1994.

The End-of-Project Impact Evaluation will determine whether required actions have been carried out, whether performance over the life of the Project has been consistent with project expectations, and whether additional actions are necessary to ensure sustainability of Project accomplishments. A particular focus of the evaluation will be on whether the project has served as a catalyst for public-private partnerships in urban service delivery as measured by the amount of private capital mobilized and the number of investments or contracts effected as a result. This evaluation will be keyed to Project Outputs, Purpose, and Goal as described in this Project Paper. It will draw lessons learned of value to the GOI, the mission, and to the broader development community regarding private participation in urban services delivery.

6. FUNDING AND RESOURCE REQUIREMENTS

6.1 Cost Estimates

The estimated total cost of the Private Participation in Urban Services Project is US$20.4 million, which includes USAID, GOI and private sector contributions. $15 million will be provided by USAID; $3.4 million by the GOI; and an estimated $2 million by the private sector. USAID resources will be used to fund all foreign exchange costs for technical assistance, training and commodities. Local currency costs will be borne jointly by USAID and the GOI. The foreign exchange and local currency costs for and the expenditure projections for the Project, by Indonesian Fiscal Year (April 1 - March 31), will be detailed in the first project implementation letter.

A summary of the estimated resource requirements appears in the figures which follow.

6.2 Government of Indonesia Contributions

The GOI contribution, totalling $3.4 million, will include financing for local support for the long-term technical assistance teams, including office space for the advisors assigned to specific ministries and space for project-supplied equipment and training activities; salaries of all GOI staff assigned to work on this project; space for GOI staff working on this project; in-country costs for training, including salaries, travel, per diem and honoraria; partial funding of local demonstration projects; and round-trip airfares to the U.S. west coast for the six projected long-term trainees and approximately 84 short-term training participants.

Additional details regarding the anticipated levels of GOI contributions will be provided in a project implementation letter. During project implementation, the annual workplans and budgets prepared will contain detailed breakdowns of required USAID and GOI contributions and GOI contributions will be included in the annual DIPs.

6.3 USAID Contributions

USAID contributions will include: short- and long-term technical assistance; short- and long-term training, both in-country and overseas; per diem for short- and long-term overseas training and airfares from the west coast of the U.S. to the point of training; facilities costs for in-country workshops and seminars; administrative support staff under the contract; office rental for the PURSE Project team; commodities, including vehicles and computers; audits; and evaluations. The subcontracting to domestic Indonesian suppliers of technical assistance in support of demonstration project activities will also be funded by USAID under the contract, however this is a cost which is included under the short-term technical assistance budget line item in the Financial Plan.

Additional details regarding anticipated levels of USAID contributions for each specific activity will be given in the first project implementation letter. During project implementation, the annual workplans and budgets will contain detailed breakdowns of these costs.

6.4 Private Sector Contributions

The private sector is expected to contribute approximately $2.0 million to this project. This amount includes funding for co-financing of in-country workshops, and repayment of costs incurred for demonstration project feasibility studies when the demonstration projects are implemented. All these demonstration project-generated funds will be recycled for additional uses within the Project, including the funding of additional demonstration projects at later stages of the project.

6.5 Disbursements

Disbursement will be handled in compliance with the intent of the Joint Decree of the Minister of Finance and the Minister of State for National Development Planning/Chair of BAPPENAS No. 48/KMK.012/1987/Kep. 004/Ket/I/1987, dated January 27, 1987, based on details to be determined between USAID and the GOI. Disbursement procedures for various project activities, consistent with the details determined between USAID and the GOI above, will be agreed upon by project implementation letter.

6.6 Project Financing Procedures

The Project will finance activities using three methods: i) direct payment by USAID; ii) direct payment by the GOI; and iii) pre-financing by the GOI with reimbursement from USAID.

USAID will contract for all technical advisory assistance. All long-term and most short-term training will be included in the long-term technical assistance contract. The long-term contract will also provide funding for short-term advisors and the required materials and facilities for the in-country training, forums and workshops. Office rental, vehicles, computers and related hardware and software will be procured under the long-term contract or under a sub-contract to the long-term contract.

A limited amount of funding will be available outside of the long-term contract to be used for special training requirements, short-term technical assistance, project implementation support or other contingencies. It is anticipated that USAID will contract for any required services.

For any pre-financing of activities by the GOI, the GOI will seek reimbursement by USAID pursuant to PILs which will commit funds for these specific purposes. Pre-financing will follow the procedures described in SKB-48.

Evaluations and audits will be funded directly by USAID, through IQCs, buy-ins to centrally- funded projects, or through A.I.D. direct contracts.

A.I.D. encourages the participation to the maximum extent possible of small, disadvantaged, and women-owned small business concerns in this activity in accordance with Part 19 of the FAR and Gray Amendment. It is anticipated that the prime contractors will utilize such business concerns for at least 15% of the total contract value, including bridging technical assistance activities.

6.7 Local Source Procurement

Local source procurement is authorized for financing: (1) locally required technical assistance, local costs of training, seminars and workshops, policy studies, and local administrative and logistic services; (2) local procurement of other commodities and services as listed in paragraph 18A1c, Chapter 18, AID Handbook 1, Supplement B; and (3) such other locally required goods and services as may be agreed to by AID in project implementation letters.

FIGURE 11

PRIVATE SECTOR PARTICIPATION IN URBAN SERVICES
ESTIMATED RESOURCE REQUIREMENT
($000)

PROJECT INPUT	Description of Input		USAID Funding	GOI Funding			Private Sector	Total Project
	Qty.	Cost/Unit		Cash	In-Kind	Total		
PERSONNEL								
a. Long-term Technical Assistance.								
- Senior Urban Services Advisor	6 py	300	1800					1800
- Municipal Services Advisor	6 py	300	1800					1800
- Urban Environmental Specialist	4 py	300	1200					1200
- Demonstration Projects Mgmnt	4 py	300	1200					1200
- Contract Management Specialist	2 py	300	600					600
- Administrative staff	6 py	48	288					288
- Municipal Services Specialist	5 py	48	240					240
- Project Dev/Financial Specialist	4 py	48	192					192
b. Short-term Technical Assistance.								
- Policy Regulatory: - Expat	28 pm	25	700					700
- Local	20 pm	4	80					80
- Demonstration projects: - Expat	51 pm	25	1275					1275
- Local	104 pm	4	416					416
* Equity investment							1750	1750
- Training/Communication:- Expat	30 pm	25	900					900
- Local	36 pm	4	144					144
- Un-allocated: - Expat	30 pm	25	750					750
- Local	60 pm	4	240					240
c. In-country travel			300					300
d. GOI Personnel					2050	2050		2050
e. GOI Office Space					400	400		400
Sub-total			12125		2450	2450	1750	16325
TRAINING								
a. Overseas Training								
- Long-term	6 particpt	40	240	20		20		260
- Short-term	84 particpt	5	420	245		245		665
b. In-country Training								
- Public/Private forum	40	2	80	40	40	80	40	200
- Public/Private conference	5	40	200	50	50	100	100	400
- Workshops	40	10	400	200	90	290	100	790
- Skill courses	20 particpt	5	100	45	20	65	10	175
Sub-total			1440	600	200	800	250	2490
COMMODITIES								
- PCs, office eqmnt and transportation		285	285		50	50		335
- Office lease		300	300					300
Sub-total			585		50	50		635
OTHER COST								
- Evaluation and Audit			150		100	100		250
- Contingency and Inflation			700					700
Sub-total			850		100	100		950
Project Total			15000	600	2800	3400	2000	20400

FIGURE 12

ESTIMATED EXPENDITURE BY FISCAL YEAR
($000)

PROJECT INPUT	ESTIMATED EXPENDITURE							TOTAL
	FY92	FY93	FY94	FY95	FY96	FY97	FY98	
1. PERSONNEL								
a. Long-term T.A.								
-Senior Urban Advisor	-	300	300	300	300	300	300	1800
-Municipal Serv. Advisor	-	300	300	300	300	300	300	1800
-Urban Env. Specialist	-	-	300	300	300	300	-	1200
-Demo Proj. Specialist	-	300	300	300	300	-	-	1200
-Contract Mangmnt Spec.	-	-	300	300	-	-	-	600
-Administrative Mgr.	-	48	48	48	48	48	48	288
-Municipal Serv. Specs.	-	48	48	48	48	48	-	240
-Proj Dev./Fin. Specs.	-	-	48	48	48	48	-	192
b. Short-term T.A								
-Policy/Regulatory								
Expat	100	100	100	100	100	100	100	700
Local	8	16	16	16	8	8	8	80
-Demo Project dev.								
Expat	150	250	250	250	125	125	125	1275
Local	48	80	80	80	48	40	40	416
-Training/Communication								
Expat	75	150	150	150	150	150	75	900
Local	20	24	24	24	20	20	12	144
-Un-allocated								
Expat	-	125	125	125	125	125	125	750
Local	-	40	40	40	40	40	40	240
c. In-country travel	20	50	50	50	50	40	40	300
2. TRAINING								
-Overseas training	-	90	150	150	120	100	50	660
-In-country training, workhops and seminars	30	100	150	150	150	100	100	780
3. COMMODITIES								
-PCs & supplies and transport	-	50	50	50	50	45	40	285
-Office lease	-	50	50	50	50	50	50	300
4. OTHER COST								
-Evaluation	-	-	-	75	-	-	75	150
-Contingency	-	150	150	100	100	100	100	700
Total Expenditure	451	2271	3029	3054	2480	2087	1628	15000

FIGURE 13

ESTIMATED EXPENDITURE OF GOI CONTRIBUTIONS BY FISCAL YEAR ($000)

PROJECT INPUT	ESTIMATED EXPENDITURE																TOTAL
	IFY 91/92		IFY 92/93		IFY 93/94		IFY 94/95		IFY 95/96		IFY 96/97		IFY 97/98		IFY 98/99		
	Cash	In-Kind	Cash	In-Kind	Cash	In-Kind	Cash	In-Kind	Cash	In-Kind	Cash	In-Kind	Cash	In-Kind	Cash	In-Kind	
1. PERSONNEL																	
a. Long-term Advisors	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
- expat																	
- local																	
b. Short-term Advisors	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
- expat																	
- local																	
c. In-country travel	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
d. GOI Personnel	-	125	-	300	-	300	-	300	-	300	-	300	-	300	-	125	2050
e. Office Space	-	-	-	60	-	60	-	60	-	60	-	60	-	60	-	40	400
2. TRAINING																	
a. Overseas training	-	-	30	-	50	-	50	-	50	-	35	-	25	-	25	-	265
b. In-country training, workshop and seminars	5	5	50	30	50	30	50	30	50	30	50	30	50	30	50	15	535
3. COMMODITIES																	
a. PCs/Office supplies/ transport	-	-	-	10	-	10	-	10	-	5	-	5	-	5	-	5	50
b. Office lease	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
4. OTHER COST																	
a. Evaluation & Audit	-	-	-	-	-	-	-	50	-	-	-	-	-	-	-	50	100
b. Contingency	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Expenditure	5	130	80	400	100	400	100	450	100	395	85	395	75	395	55	235	3400

FIGURE 14

PRIVATE SECTOR PARTICIPATION IN URBAN SERVICES
PROCUREMENT PLAN AND METHOD OF FINANCING
($000)

PROJECT INPUT	Qty	Financing ($000)				Exec. Agency	Proc. Method	Documentation		Remarks
		AID	GOI	Priv. Sect.	Type			E/Mark	Commit	
PERSONNEL										
a. Long–term: –expat	22 py	6600			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
–local	15 py	720			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
b. Short–term: –expat	87 pm	2175			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
	58 pm	1450			DP	AID	Buy–in	PIO/T	C	Including bridging TA (7 pm)
–local	120 pm	480			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
	100 pm	400			DP	AID	DC	PIO/T	C	Including bridging TA (8 pm)
c. Equity Investment				1750						
d. In–country travel		300			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
e. GOI Personnel			2050		In–Kind	GOI				
f. Office Space			400		In–Kind	GOI				
TRAINING										
a. Overseas Training										
– Long–term	6 particpt	240			DP	AID	DC	PIO/P	C	
			20		Cash	GOI	DIP			
– Short–term	84 particpt	420			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
			245		Cash	GOI	DIP			
b. In–country Training										
– Public/Private forum	40	80			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
			40		Cash	GOI	DIP			
			40		In–Kind	GOI				
				40		Cash				
– Public/Private Conferen	5	200			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
			50		Cash	GOI	DIP			
			50		In–Kind	GOI				
				100		Cash				
– Workshops	40	400			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
			200		Cash	GOI	DIP			
			90		In–Kind	GOI				
				100		Cash				
– Skill Course	20 particpt	100			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
			45		Cash	GOI	DIP			
			20		In–Kind	GOI				
				10		Cash				
COMMODITIES										
–PCs and Office eqmnt.		285			DP	AID	DC	PIO/T	UC	Supplied under L/T Contract
			50		In–Kind	GOI				
–Office rental		300			DP	AID	DC	PIO/T	UC.	Supplied under L/T Contract
OTHER COST										
–Evaluation and Audit		150			DP	AID	DC	PIO/T	C	
				100	In–Kind	GOI				

Note: DP = Direct Payment; DC = Direct Contract; DIP = GOI Project Fund; C = Contract; UC = Umbrella Contract

7. SUMMARY OF ANALYSES

7.1 Economic Analysis (see Annex A-2)

The economic analysis for the PURSE project reviews private sector participation in urban services in three aspects. First the paper makes explicit the investment gap that must be met by private sector funding given the stated GOI goals on water coverage targets and inadequate public sector resources. Second the paper reviews micro-economic considerations underlying the urban services sector and focuses attention on pricing polices and underlying market failures which result in inefficient use of resources. The final section looks a macro-economic aspects of private sector participation including the question of additionality and investment assurances.

The GOI's medium term development plans (Repelita IV and V) gave strong support to the infrastructure development of urban services. While coverage of services has increased, Indonesia's performance is still low by international standards. For example, only about 25% of urban residents use piped water for drinking and adequate sanitation coverage is low at 35%. In addition to public health considerations and environmental concerns due to insufficient water, wastewater and solid waste management, water is also an integral part of the production process of a number of industries. The shortage of clean water is curtailing industrial investments in selected areas.

Current estimates indicate that about 19 million consumers are served with piped water. Given growth estimates of urban population of over 5% per year, an 85% coverage rate by 2000 would represent another 60 million consumers to be served by the end of the decade. Project estimates indicate the achievement of this goal would require about $9 billion in infrastructure investment for water alone. Given current allocations under Repelita V of about $2 billion for urban water development and estimates under Repelita VI following a similar trend of $3.2 billion, allowing for some expenditures on rehabilitation, the project has estimated a financing gap of almost $5 billion that will need to be funded through the private sector sources.

Inefficiencies in the water sector stem in part from inadequate pricing policies. Piped water supply provided through GOI agencies, both the PDAMs and the BPAMs,is clearly subsidized. Though government policy is to pursue full cost recovery, the average tariff is set below the cost of production; in some cases by as much as 70%. The majority of groundwater users pay nothing for the use of the resource. It has been estimated that up to 75% of groundwater drilling and extraction is outside the official licensing and fee system. Ignoring the full cost of water in Indonesia has lead to undervaluing of the resource in terms of groundwater depletion, failing to invest at the appropriate time leading to decapitalization of water infrastructure, and it has cause mis-allocation of the resource between users by penalizing industrial use.

The macroeconomic consideration of private sector participation center around the concept of additionality of investment funds for the sector and the question of the cost of government assurances. Clearly a main benefit to private sector participation is the increase in available funding from private sector resources as well as efficiency gains from private sector access to management skill and access to technology.

7.2 Technical Analyses (see Annex A-3)

7.2.1 Piped Water Supply

Current estimates of piped water supply coverage for all urban areas is between 35% to 38%, which is comparatively low by Asian regional standards. The majority of urban residents obtain supplies from unregulated groundwater sources. Major urban areas are suffering from quality degradation because of a lack wastewater treatment and aquifer depletion due to uncontrolled extraction. The situation is exacerbated by the high urban growth rates of over 5% per year. By the turn of the century, projections suggest an urban population of 93 million, over 40% of the total population. Given a goal of 85% piped water coverage, this implies an increase of 60 million consumers over the current 19 million served.

The formal urban piped water supply sector is administered by public agencies either reporting directly to the Ministry of Public Works (BPAMs) or under the broad jurisdiction of the Ministry of Home Affairs (PDAMs). The PDAMs are autonomous local government enterprises responsible to the heads of local government. By 1994 it is intended that all BPAMs should have reached autonomous PDAM status. Groundwater resources exploration and monitoring is the responsibility of the Ministry of Mines and Energy, Directorate of Environmental Geology.

The PDAMs are intended to operate as commercial entities with a goal of full cost recovery from water sales, however they remain financially weak. As with most public infrastructure in Indonesia, they have relied heavily on central government direct construction of capital works and transfers and are unable to provide sufficient cash generation to cover capital expansion programs. Given the increasing demand for piped water supplies in urban areas, the GOI has made a deliberate recent effort to open the door to increased private sector investment. Indicative investments in water supply to achieve 85% coverage by 2000 are estimated at $9 billion; Government investment ceilings are estimated at about $4 billion leaving considerable scope for private investment of $5 billion. Areas envisioned for joint venture with the PDAMs include extraction, transmission, treatment and distribution of piped water.

Private sector participation is in its early stages and appears to fall into two investment types. These are large bulk water supply BOTs and "enclave" investments tied to particular large user groups such as a housing complexes, hotels, and industrial estates. A

large build, operate and transfer scheme is under negotiation which would sell bulk water to the City of Surabaya. A joint venture has been recently signed in Bali to provide treated water to a group of hotels. Considerable private sector investment activity appears to be underway outside the formal PDAM structure providing systems to industrial and housing estates in rapidly growing urban fringe areas. These unregulated piped systems rely for the most part on groundwater although some surface water systems are in place. These systems lack regulation and economies of scale. In addition to large BOT and BOO type investments, there is also considerable scope for private sector participation in the provision of management and other services through contracting mechanisms. Lack of administrative capacity and need for institutional strengthening of PDAMs is a recognized need.

Though policies are in place and the GOI has taken a positive position on private sector participation, activities appear to be taking place on an ad hoc basis. Opportunities so for have been identified by the private sector, and the GOI has not taken a proactive approach. In order to capture the current momentum and expand private participation, a number of issues need to be addressed. These include the lack of a regulatory framework which would provide the investor with a clear operating environment and consistent administrative procedures. There is also lack of effective regulation on groundwater resources which undermines effort in the provision of more economic piped water; surface and groundwater resources need to be managed conjunctively. The lack of autonomy of the PDAMs and their inability to respond in a fully commercial way makes reaching agreement with the private sector a hesitant process. The underlying weakness of the PDAMs financially and administratively make them unattractive partners. In this regard private sector investors will necessarily seek GOI assurances of the financial stability and soundness of PDAMs when entering into bulk water supply and other agreements.

7.2.2 Wastewater Treatment

The wastewater treatment sector in Indonesia is extremely underdeveloped. Despite recent construction of new systems in Jakarta, Medan, Bandung, Surabaya and Semarang, less than one percent of residents in large urban areas are served by operating sewer systems. Less than forty percent of urban residences have septic tanks with drainage fields, and most of the settled waste pumped from septic tanks is discharged without treatment to rivers and canals. Thus, the vast majority of human waste in Indonesia's cities is either discharged untreated to surface water or is deposited in unsanitary tanks and latrines that contaminate groundwater.

The World Bank, the Asian Development Bank, and other donors have shown great interest and support for extending sewerage in large urban areas. The majority of GOI funding for sanitation is devoted to providing on-site sanitation facilities in rural areas. The greatest opportunities for private sector investment in sewerage are in new residential developments, particularly in the more wealthy areas being developed around

Indonesia's largest cities. There are also opportunities for private firms to provide operations and management services under contract to GOI entities responsible for sewerage. Although this review did not address industrial wastewater treatment, it is clear that the private sector will have the principal role in building treatment facilities for sewage and industrial effluent from Indonesia's new industrial estates, as well as from existing industry.

Four issues must be addressed before there can be extensive private sector involvement in urban wastewater treatment. They are analogous to the issues affecting the water supply sector. First, there must be a regulatory framework that protects the quality of surface and groundwater resources and makes the use of individual septic systems less attractive. Second, PDAMs or other responsible local entities must have greater autonomy to enter agreements with private firms. Third, the GOI must establish model agreements and provide sufficient assurances of payment to private investors. Fourth, pricing of sewerage must gradually be revised to recover a greater proportion of the full long-term cost of providing services.

7.2.3 Solid Waste Management

Solid waste management (SWM) in Indonesia is highly decentralized. Initial collection is organized by neighborhoods while the municipality handles transport and disposal. Residents pay their community leader for daily removal of waste from their households, but only a fraction of receipts are channeled to the municipal cleansing agency (Dinas Kebersihan). For example, the Dinas Kebersihan in Jakarta received only Rp. 1 billion out of an estimated Rp. 100 billion collected in fees. Despite the financial potential of SWM, revenue shortfalls have negatively affected the Dinas Kebersihans' ability to provide adequate services. Dissatisfaction with the performance of municipal agencies has generated support for transferring SWM operations to regional enterprises (Perusahan Daerah Kebersihan). So far only two Dinas Kebersihans have been converted to PDKs - in Bandung and Medan - and preliminary evaluation indicates that the greater financial responsibility has stimulated successful fee collection strategies. Revenue streams assured, the PDKs can now turn their attention to cost control, which is where service contracts to the private sector can play an important role.

Contracting to private firms for waste transport and disposal has been implemented most extensively in Jakarta and Surabaya. In general, the record of private companies is no better than their public counterparts because the contracts are too short - usually one year - and the service areas too small to realize economies of scale. In order for both public and private actors to reap the benefits of service contracting, the Ministries of Home Affairs and Public Works must issue regulations and standard operating procedures which delineate the scope and form of private participation in SWM. The PDKs cost recovery mandate implies that they would be more effective partners with the private sector than Dinas Kebersihans. Consequently, the conversion of the latter should be expedited by the central government. The transfer of responsibilities between the two

entities provides a window of opportunity for the clarification of the institutional and regulatory framework surrounding SWM. Specifically, the PDKs require greater autonomy in the setting of solid waste tariffs, guidance on successful fee collection strategies, and model contracts for working with the private sector.

As the pace of development accelerates, the quantity and composition of the solid waste stream is changing. The increasing volume of waste will soon make the current collection system obsolete. Efficient removal of waste requires the construction of intermediate transfer stations, projects which have already secured commitments from private investors in Jakarta. Although extensive informal sector recycling exists in Indonesia, the increasing proportion of inorganic materials in the waste stream has heightened private interest in commercializing these activities. Several firms plan to establish recycling and composting enterprises at either transfer stations or landfills under BOO arrangements. Thus there are significant opportunities for the private sector not only in service contracts but in investment projects as well.

7.2.4 Land Use Issues

Although land use and zoning is not a focus of the PURSE project, location and ownership issues are an important part of the provision of urban services. For BOT projects, land and the actual water resource are included in the concession agreement, that is ownership never passes to the private sector. These resources are only managed by the private sector over the period of the concession. Land and existing infrastructure can be however valued and used as a part of the equity participation of the government agency in a joint venture agreement when setting up a BOT. BOOs would however have more complicated agreement if land ownership was a critical issues in the private contract. Long land leases may be an alternative.

At the present time it appears that a major concern in sewer and water supply infrastructure is that land use allocation needs to be more predicable in order to obtain the maximum value out of these urban development. Mistakes in changing use or zoning from say residential to commercial use can be costly.

In solid waste management the location issue of siting solid waste facilities is somewhat contention. Current experience indicates prolonged negotiations concerning the location of container sites, sanitary landfills and potential transfer stations. As the demand for appropriate solid waste management increases, these zoning issues will be exacerbated.

Over the course of the PURSE project, it is expected that concerns over land registration, titling, and zoning will be cataloged as one of the constraints that arise from the current institutional structure of the sector. These will be most apparent in the demonstration projects. The identification of these land use issues will be useful to the National Land Agency.

7.2.5 Conclusion

The success of private participation in the three urban sectors depends on the priority that Indonesian central ministries assign to water quality and wastewater treatment. When the President and other senior GOI officials state that Indonesia must develop its infrastructure to support continued development, they refer explicitly to telecommunications, transportation and power. Water supply, wastewater treatment, and solid waste are not included. The President has decided that the GOI must limit its public debt and also the private debt that Indonesian businesses and citizens incur. These limits will restrict the exposure that the GOI can incur under guarantee obligations on contracts between GOI entities and private companies. Private participation in urban services will grow only if such services can compete favorably with demands for GOI funds and guarantees to support other infrastructure sectors critical to Indonesia's economic development.

7.3 Institutional Analysis (see Annex A-4)

Institutional problems and constraints are a major factor impeding improvement of Indonesia's urban services delivery capacity. Among the problems described throughout this Project Paper are:

- the absence of an overall GOI strategy for the development of public-private partnership in the provision of urban services in Indonesia;
- the lack of a clear path for potential developers of private sector infrastructure projects to obtain the necessary approvals and define a framework of negotiation for their projects;
- weak, fragmented, and poorly staffed sector agencies at all levels involved in urban services planning and provision;
- inefficient and irregular procurement procedures; and
- a variety of legal and regulatory constraints hindering private sector participation in service delivery.

A number of Central Government agencies are involved in various aspects of urban and municipal services provision (and private participation therein) in water, wastewater, and solid waste management. The major players are the National Planning Board (BAPPENAS) the Ministry of Home Affairs (MOHA), the Ministry of Public Works (MOPW), and the Ministry of Finance (MOF). Other concerned agencies include the Ministry of State for Population and Environment, the Ministry of State for Housing, the National Investment Coordinating Board (BKPM), and the National Land Agency. Key

agencies for implementation of the PURSE project are represented on the Interagency Coordinating Team for Urban Development (TKPP) chaired by the Deputy V for Regional Affairs in BAPPENAS.

7.4 Social Soundness Analysis (see Annex A-5)

The project interventions do not focus on particular social groups in Indonesian society, but seek instead to alter the environment within which water, wastewater and urban services are provided to increase private sector participation. Lower income individuals and households may benefit from increased employment opportunities with private sector producers of urban services, but the main benefits to economically and socially marginal groups will be through improved provision of vital urban services of water, waste water and solid waste management.

Though coverage of urban services has improved significantly in Indonesia over the last two decades, it continues to be low by international standards. About three-quarter of the urban population do not use piped water for drinking. Much of the population still relies on shallow wells which are becoming increasingly polluted and less than 35% have access to adequate sanitation. Drainage is ineffective and the lack of adequate solid waste removal contributes significantly to serious urban environmental degradation which affect,in particular, the urban poor.

The GOI's poverty alleviation strategy includes two elements related to urban services. These are to ensure adequate provision of basic infrastructure and services and to improve targeting of public expenditures to meet the needs of the poor. The PURSE project will specifically support this strategy through first the promotion of private participation which will increase the overall level of supply of urban services, and secondly increased private participation will improve the efficiency of the market through increased competition and better use of natural resources, allowing the GOI to better target its scarce resources to low income areas.

7.5 U.S. Investment Analysis (see Annex A-6)

In a survey of U.S. companies, a consensus emerges indicating an interest in participating in private investment. It will be necessary, however, to provide complete information on opportunities, with a specific marketing program to attract U.S. firms to participate. The projects will need to be presented with the pre-engineering and feasibility analysis completed together with a clear statement of the contractual agreements set forth.

There is a widespread consensus that authoritative and highly convincing government commitment to well-defined objectives and priorities is of primary importance, and that

U.S. know-how could then help flesh out specific problems and solutions. In a particularly receptive environment, the large U.S. firms appear ready to engage in fairly extensive pre-feasibility and even policy advisory work for little or no immediate return, or to undertake small-scale demonstration projects on a fee-paid basis, provided that there is a strong prospect of follow-up business opportunities. A number of larger companies indicated that they would not provide significant access to their technology (e.g. by carrying out a detailed feasibility study) without a contractual agreement or strong understanding that they would be retained to develop a major project. Schematic planning and design activities typically are 2% to 4% of the total construction value of infrastructure projects.

The next greatest concern is whether a technically adequate and politically stable regulatory environment (beyond project-specific arrangements and guarantees) is in place that gives confidence there will be future business. In addition, if countries are not prepared to meet high enough standards, the larger firms may not be interested in devising and implementing intermediate, lower-cost solutions.

Another basic consideration is whether relevant government authorities have sufficient management capacity to meet their responsibilities in the development and supervision of given projects. Likewise, U.S. firms want to avoid situations where there is a significant risk that local operating entities would have insufficient operating funds or otherwise mismanage projects that the U.S. firm has sold and installed. Even if there is no continuing role, the potential negative impact on a firm's reputation seems to be an important consideration.

Transfer risk and exchange risk must be properly mitigated if the firm is to provide long-term financing and seek a long-term role and financial returns. Faced with serious foreign exchange transfer and debt service problems in one developing country, one large firm expressed a strong preference for local currency-denominated debt to local institutions, even if willing to have its U.S. entity guarantee it.

Most interviewees perceived USAID's strengths to be chiefly in funding technical assistance for public policy-makers, and in identifying the potential for and promoting U.S. private sector involvement. Its ability to provide project-specific financing and logistical support beyond the feasibility study stage was considered by some to be of secondary importance, particularly for larger projects.

7.6 Legal and Regulatory Analysis (see Annex A-7)

The legal and regulatory analysis deals generally with the laws and regulations applicable to private sector commercial activities in Indonesia, e.g., the Commercial Code and the Government of Indonesia's treatment of "facilitated" "domestic" investments. There is also a brief treatment of other laws and regulations that may be of interest to private

sector investors, e.g., taxes, customs tariffs, immigration, land ownership and use and environmental matters. More specifically, however, the paper examines the regulation of foreign investments in Indonesia by BKPM and Law No. 1 of 1967.

Specific legal issues with regard to private participation in water supply are reviewed within the context of the full legal history of Indonesia. This includes the types of laws and regulations in Indonesia which have legal authority and their place in the hierarchy of laws and regulations, the relevant offices and agencies of the Government which issue and implement laws and regulations, and practical aspects of implementation and enforcement, including a description of the judicial system. The organizational structure of BPAMs, PDAMs, and PDABs operate are included.

The legal authorization for private sector participation in public utilities under Indonesian laws and regulations is identified. Consideration is given to the award of service contracts - especially those awarded to the private sector water utilities. The regulations authorizing the award of such service contracts are examined in detail. The contents of those regulations, including a recitation of critically important elements which they do not contain, is given. Particular emphasis is also given to the authorizations for, and restrictions on, the participation of the private sector and PDAMs in joint ventures. Also considered are the means by which water tariffs are approved, with an examination of the specific language of the relevant regulations. The study also notes a number of variations which may be made - or which have been made in Indonesia - on the basic BOT format.

The analysis concludes that current laws and regulations lack clarity and precision. The result is a perception of unpredictability by the private sector which diminishes its interest in participation in the water supply field. Inadequate measures exist to assure that the private sector is subject to the rigors of competition or to protect the interests of consumers and Government were the private sector to participate in water supply services. Of particular importance is the absence of any law or regulation which would authorize or regulate BOTs in the water supply sector and the existence of water tariff making procedures which do not adequately assure the private sector of a reasonable return on investment through the application of fair and detailed standards by independent rate-making bodies.

The analysis concludes that Indonesian laws and regulations be made clearer and more precisely defined. It recommends that these laws and regulations be consistently applied and that the private sector be assured of its ability to enforce its rights provided under those laws and regulations. New or amended regulations should be issued that will clarify under what circumstances private sector participation is welcome and unwelcome in the water supply field and that will provide detailed terms for award of service contracts, entering into joint ventures, and administration of water tariffs.

7.7 Environmental Analysis (see Annex C)

USAID regulations require that all projects or project activities that have the potential for causing significant environmental harm be subjected to an environmental review. An environmental review generally includes an Initial Environmental Examination, followed in appropriate cases by a more extensive Environmental Assessment. An environmental review is not required for certain types of project activities. For other types of activities, an Environmental Assessment is mandated and the Initial Environmental Examination can be eliminated.

Indonesian law also prescribes environmental review procedures for projects that will have an impact on the environment. The GOI regulations correspond in large measure to USAID requirements; satisfying USAID requirements should generally produce sufficient information and documentation to satisfy GOI requirements. In some cases, additional information and analysis may be required under GOI procedures.

Three of the four inputs of the PURSE project are Technical Assistance and Training. These activities are eligible for a categorical exclusion from USAID environmental review requirements, because they are included among the types of activities that are presumed not to have significant environmental effects. The fourth input of the PURSE project is a set of demonstration projects in water supply, sewage treatment, and solid waste management. Some of the demonstration projects will involve construction of new facilities: water and sewage treatment plants, water distribution and sewage collection networks, and solid waste transfer stations and landfills. Other demonstration projects will merely involve service contracts under which private firms will provide operations, maintenance, and management support for government-owned facilities. Each of the demonstration projects may cause significant adverse environmental effects. Water and sewage treatment systems are among the class of activities that USAID has concluded "generally" have a significant effect on the environment. An EA is required for these activities, without the preliminary step of conducting an IEE.

Given the types of potential adverse environmental effects that may be associated with demonstration projects, USAID/Jakarta should anticipate that an EA will be required for each PURSE demonstration project that involves construction activities. Operation, maintenance, and management activities at water supply and sewage treatment facilities may also have significant environmental effects; thus, an IEE should be prepared for demonstration projects involving service contracts. Solid waste management facilities are not included among the list of projects presumed to have significant environmental effects, for which an EA is required. Thus, USAID should prepare an IEE for all demonstration projects in solid waste to determine whether an EA is needed.

The potential environmental impacts of a project, however, cannot be evaluated until a project or specific activity is sufficiently well-defined that its likely environmental impacts can be identified. For this reason, environmental reviews (IEEs and EAs) may be

delayed until after authorization of a project for those activities that are "unidentified at the time of authorization." When an environmental review is deferred, it must be completed prior to authorization of the specific activities at issue. The Environmental Analysis recommends that USAID/Jakarta should defer the environmental reviews of PURSE demonstration projects until after the demonstration projects are sufficiently developed that likely impacts can be identified. Environmental reviews should be conducted at the earliest time during the planning for each demonstration project at which the review can be meaningful.

8. CONDITIONS AND COVENANTS

8.1 Conditions Precedent to Disbursement

8.1.1 Project Representatives

Prior to the disbursement of USAID funds, USAID will be provided with the names and specimen signatures of the Project representatives for the Government of Indonesia.

8.1.2 Establishment of Project Steering Committee

Prior to disbursement of USAID funds, USAID will receive evidence that the Project Steering Committee has been established and a list of names of the individuals assigned to this Steering Committee and the name of the designated Chair will have been sent to USAID.

8.2 Covenants

8.2.1 Annual Plans

For activities implemented after April 1, 1992, the GOI will furnish each year to USAID Annual Plans for the Project.

8.2.2 Project Evaluation

The GOI and USAID agree to establish an evaluation program as a part of the Project. This program will include: (a) identification of a set of indicators and a means to measure progress against such indicators; (b) evaluation of progress toward attainment of the objectives of the Project; (c) identification and evaluation of problem areas or constraints which may inhibit such attainment; (d) assessment of how such information may be used to help overcome such problems; and (e) evaluation, to the degree possible, of the overall developmental impact of the Project.

8.2.3 Equipment Maintenance

The GOI will agree to provide sufficient funds from its annual development (DIP) or routine budget to adequately and properly maintain all equipment financed under the Project.

8.2.4 Staffing

The GOI will agree to provide all staff required to implement the Project in a timely and effective manner.

PRIVATE PARTICIPATION IN URBAN SERVICES

ANNEXES

(PROJECT 497-0373)

UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

Jakarta, Indonesia

September, 1991

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ANNEX A - 1

LOG FRAME

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

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PRIVATE PARTICIPATION IN UTILITIES AND URBAN SERVICES (PURSE)

ANNEXES

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   2. Economic Analysis
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   7. Legal and Regulatory Analysis

B. Environmental Analysis
C. Statutory Checklist
D. AID/W Guidance: PID Approval and PP Delegation of Authority
E. GOI Request for Assistance
F. Gray Amendment Certification
G. Draft Scopes of Work for Expatriate Resident Advisors
H. List of Contacts
I. List of References

LOGICAL FRAMEWORK MATRIX

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS
Project Goal 1. Increase the stock of infrastructure essential for economic growth and improve access to efficiently delivered services that contribute to an improved urban environment.	*Measures of Goal Achievement* 1.1 Evident contribution to the availability of selected urban services in water supply, wastewater treatment, and solid waste management. 1.2 An increase in the total levels of public and private sector investment in selected urban services.
Project Purpose 2. Expand the participation of the private sector in the provision of selected urban services (water, wastewater, and solid waste) on a sustainable basis through direct investment or contracted participation in supply, delivery, or other operational functions.	*End of Project Status* 2.1 Increased foreign private investment in urban services provision in Indonesia. 2.2 An increase in the number of domestic private companies participating in urban services. 2.3 Public/private and private sector projects developed and expanded services delivery and financing options utilized.

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS
Project Outputs	*Output Targets*
3.1 Establishment of a legal and regulatory framework enabling and encouraging private sector participation in the production and financing of urban services (water, wastewater, and solid waste).	3.1.1. Decrees issued for water, wastewater and solid waste services that: (a) make explicit the GOI's interest in private entrepreneurs' participation in the production and financing of those services; (b) formalize the legal basis for private investment of capital and other resources to build and operate facilities and to contract with local governments and regional enterprises to provide services to public operators of facilities; and (c) define the nature and extend of GOI guarantees or assurances of the performance of regional institutions in fulfillng contract obligations with private producers of services. 3.1.2 Guidance and directives issues for Regional Governments that: (a) Specify the types of Regional Governments or list the specific Regional Governments that are authorized to enter into contracts with private organizations to provide all or some portions of the respective services; (b) Identify the respective services, the specific types of facilities, and activities that may be contracted between Regional Governments and private entrepreneurs; (c) Prescribe the procedures for announcing and issuing tender documents for competitive contracting for the construction and/or operations of facilities and provision of specified services; and (d) provide model contracting procedures and documents for use by Regional Governments.
3.2 Guidance issued to set pricing policy for urban services and encourage greater degreee of self-financing for water, wastewater and solid waste services.	3.2.1 Accounting procedures revised for local governments and regional enterprises that: (a) identify the full cost of capital works on an accepted accounting basis as well as annual operation and maintenance expenses and any transfers to other regional government accounts; and (b) identify as sources of income or revenues all financing including user fees, central government direct construction of capital works, and transfers from other central or regional sources.
3.3 GOI requirements issued that regulate indiscriminate access to, and impact on water resources and land.	3.3.1 Policies toward licensing for private wells, private intakes, private wastewater and solid waste systems are reviewed to clarify; private rights and public interest in environmental management and preservation of resources.

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS
3.4 Pilot/private demonstration projects are implemented that adapt, test and demonstrate technologies for improved urban service delivery and create models for institutional, contractual, and financial arrangements in support of sustainable private participation.	3.4.1 Urban service demonstration projects are initiated, involving 5 BOO or BOT schemes (2 water, 2 waste water, and 1 multi-service project) and 6 service and/or management performance contracts, primarily for solid waste. 3.4.2 GOI and local government issued SOPs, regulations and project development guidance.
3.5 Training and communications program implemented that expands public and private sector awareness of institutional, contractual and financial mechanisms that support private sector participation in urban services.	3.5.1 Promotional program to facilitate private investment in urban services, involving 5 conferences and 40 public /private forums. 3.5.2. People trained in the public and private sectors who are facilitating private investment in expanded infrastructure, including 6 public officials for long-term training, over 100 public and private participants in short-term courses, and over 1,000 attendees at various public/private forums and conferences.

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS		
Project Inputs	*Input Targets*		
4.1 Technical assistance to the public sector in analyzing, reformulating, and drafting policies, standards, and regulations pertaining to private participation in selected urban services.	Personnel		
	Long-term expat TA:	22 py	6,600,000
	Long-term local TA:	15 py	720,000
	Short-term expat TA:	145 pm	3,625,000
4.2 Tehnical assistance to strengthen private sector capacity to finance, delivery, and maintain selected urban services infrastructure.	Short-term local TA:	220 pm	880,000
	In-country travel:		300,000
	Training		
4.3 Training for public and private sector participants to develop their regulatory and service delivery capacity respectively.	Overseas Long-term:	6 person	240,000
	Overseas Short-term:	84 persons	420,000
	In-country skills courses:	20 courses	100,000
4.4. Formulation, and development of pilot/demonstration projects to provide information for the policy analysis/implementation process and to obtain practical private participation experience.	In-country meetings:	45 meetings	280,000
	In-country workshops:	40 workshops	400,000
	Commodities		
	Office space and equipment:		585,000
	TOTAL		14,150,000

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MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Goal Level 1.1 National budget allocation trends Development and routine budgets of level I and level II local governments BAPPENAS, and other Government data on prevalence and availability of selected urban services infrastructure. 1.2 Private investment coordinating board (BKPN) and PUOD data	*Goal Level Assumptions* Other factors in Indonesia, including economic and political stability, support a climate of economic development Urban services infrastructure development is a GOI priority. The improvement of the urban environment is a GOI priority. The GOI is committed to increasing the direct beneficiary share of the financial costs of urban services production.
Purpose Level 2.1 Investment and other economic/financial reports. 2.2 Private investment coordinating board (BKPM) and PUOD data. 2.3 Existence of published standards and terms of reference for urban services public private agreements.	Purpose Level Assumptions There is insufficient capacity in the public sector to provide adequate infrastructure in urban services. Private investment projects will lead to an expanded capacity to provide urban services. Private investment projects will lead to increased efficiency in the allocation of resources through better management, service options, and competition. The private sector is interested and able to expand its role in the provision of improved urban services. Private sector participation in urban services will provide additionality to the economy, not substitution for available public sector service provision. Increased claims on the debt servicing capacity of the government will be minimized.

MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Output Level 3.1 GOI issuance of regulations and procedures that encourage private sector investment and public/private partnership in urban services. 3.2 PUOD published guidelines on pricing policy for water, wastewater, and solid waste services. 3.3 GOI publications and officials documents 3.4 Site visits to and reports on specific projects. Project evaluation and monitoring data and reports. 3.5 Surveys of attitudes of government officials regarding their openness to and awareness of opportunities for private participation in urban services. Training records.	*Output Level Assumptions* The GOI continues to have a significant and growing interest in and commitment to securing private participation in the provision of public services. Consensus can be reached at the top levels of the GOI on objectives and modalities of policy formulation and implementation regarding private participation. The GOI is receptive to receiving necessary technical assistance and training.
Input Level - Project documentation - Periodic reports by technical assistance contractors. - Annual program reviews.	Qualified organizations and individuals can be identified and appropriate contracts negotiated. Technical and financial resources will be provided as planned from all sources.

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ANNEX A - 2

ECONOMIC ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

ECONOMIC ANALYSIS

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ANNEX A-2

ECONOMIC ANALYSIS

1. Introduction

The economic analysis for the PURSE project supports the goal of increasing the stock of infrastructure essential for Indonesia's economic growth and improving access to efficiently delivered urban services by expanding the participation of the private sector in three aspects. The first section makes explicit the investment gap that must be met by private sector funding given stated GOI goals and inadequate public sector resources. Given the indicative nature of this analysis and the availability of data, the main urban services sector covered in this analysis is water supply. The second section in this annex reviews microeconomic considerations and focuses attention on pricing policies and underlying market failures in the sector resulting in inefficient use of resources. The third section looks at macroeconomic aspects of the project including the question of additionality and investment assurances.

2. The Case for Private Sector Participation: The Investment Gap

2.1 Current Situation

Indonesia is experiencing rapid economic growth. Estimates indicate that GDP will increase at about 7% per year over the next decade. The country's rapid economic growth also is accompanied by rapid urbanization. The 1990 census indicated that urban population is about 55 million and is increasing at a rate of about 5.4% per year. Total urban population at the end of the decade is estimated at about 93 million or 43% of the entire population.

The rapid economic growth is putting an increasing strain on urban infrastructure and services. Power, telecommunications, transport and water are all important inputs to economic growth. All of these sectors are experiencing demands that existing capacity is unable to fulfill. The GOI has recognized that the private sector is an essential part of the development process and is actively promoting private sector participation, both direct investment and provision of contracted services, to help avert bottlenecks that will inevitably slow down economic growth.

Economic growth which increases the absolute demand for services and rapid urbanization exacerbates the public sector inability to keep pace with the urban demand

for water supply, waste water treatment, and solid waste management. Recent estimates indicate only about one-third of urban residents have access to piped water supplies, the remainder using private wells or vendors. Industrial and commercial uses for water are largely met by private sources as well, with 65% coming from groundwater and another 25% supplied by private extraction. Less than 35% of all urban residents have adequate sanitation infrastructure. Less than 1% are connected to waste water systems.

In addition to public health and welfare considerations and environmental concerns due to the lack of water, waste water infrastructure and provision for solid waste management, water is an integral part of the production process for a number of industries. It is used as a direct input in certain products such as food and beverage production, as a coolant in industrial processes such as iron and steel, and it is essential in cleaning and flushing process in important industries such as textile dying and paper production. The World Bank and others have noted that though the absolute quantity of water is not yet a constraint on industrial output, shortages of clean water are reducing investments in certain types of industrial developments. Surabaya is a case in point. Jakarta and Bandung also experience industrial water shortages.

2.2 Investment Sources and Demands

The GOI's medium term development plans (Repelita IV and V) gave strong support to infrastructure development in urban services. In fact, of Repelita V the GOI allocated almost two-thirds of urban infrastructure to social overhead expenditures in water supply, human and solid waste and drainage and the Kampung Improvement Program. Within this overall directive an estimated $400 million annually or about $2 billion over the Repelita V period is earmarked for expenditure to extend direct access to 80% of the urban population.

In order to define the indicative investment gap over the period of the PURSE project, estimates have been made for the provision of piped water supply to serve 85% of urban residents by the end of the century. This is below the GOI target for 1994 but still would involve a substantial investment program. By 1994 an additional 15 million urban residents would need to be served with piped water.

Given the current estimate of 35% served on piped water which represents about 19 million consumers and growth estimates of urban population of 93 million by 2000, at 85% coverage this would represent another 60 million consumers to be served by the end of the project period. Given an indicative estimate of $150 per capitá (World Bank) for provision of piped water, the cumulative cost of providing piped water over the next 10 years to achieve target coverage of 85% is nearly $9 billion. Repelita V is estimated to provide about $2 billion. If Repelita VI is assumed to increase at 7% along with GDP, then approximately another $3 billion will be available from public sources until the end of the century. Part of government allocation includes rehabilitation expenditure. If this is set conservatively at about 15% of allocations(actually 30% are planned for

operation and maintenance), it is assumed therefore on present trends that GOI allocations for new water supply will be about $4.2 billion, leaving a financing gap of almost $ 5billion. These estimates are set out in Table A.1 and shown graphicly in Schedule A.1.

Given the indicative nature of these figures and available data, the gap for water supply alone has been calculated. Adding waste water and solid waste would only increase the gap significantly. Currently environmental sanitation and drainage only account for just over 9% of government allocations for infrastructure under Repelita V or about $450 million in total for the period. Most of the sanitation interventions under this account are for on-site services.

In adding more perspective to the estimates, it appears that in 1990, though about $400 million was available for water supply investment less than half this sum, about $160m was spend. The slow drawdown of the funds are attributed to inadequate implementing capacity at the municipal level and a trend towards investment in distribution and rehabilitation, both usually smaller and more diverse spending patterns than large scale expansion of source works.

Overall, the investment profile for capital works in water supply development shows that expenditures for source development and raw water transmission typically account for about 25% of expenditures and treatment and distribution account for the remaining 75%. Using this rule of thumb, over the next decade the scope for total capital investment in source work developments would be about $2.25 billion with the remainder, almost $7 billion, for treatment and distribution.

Assuming investment flows are fungible between government source and private investments, the analysis exhibits considerable scope for BOW and BOO direct investments in source works as well as improved performance of the sector through service and management contracts. The latter aims at efficiency gains and the improvement in management of the PDAMs, a central factor in the slowdown of government source sector investments. Efficiency gains through private sector participation in management should not be underestimated.

2.3 Current Investment Strategy

GOI fiscal and monetary policies include objectives of slowing the rate of growth of total debt, including public and private and foreign and domestic, and controlling the growth of the public sector budget. These reflect in part a concern for the balance of payments, in part a concern for the high rate of inflation, currently about 10% per year, and in part a concern that public sector investments be targeted to achieving the highest priority goal of increasing exports. These factors contribute to an additional concern, the high cost of

capital. Annual interest rates currently for five to seven year commercial financing are 23% to 25%. The strategy of encouraging more direct private participation in the production and financing of urban services is consistent with these fiscal and monetary policy objectives to the extent that:

- it increases the supply of urban services without a corresponding increase in direct public sector investment (both Central and Regional budgets); and

- the production of these additional services is at economically more efficient prices."

TABLE A1: URBAN WATER COVERAGE PROJECTIONS AND INVESTMENT ESTIMATES 1990-2000, CONSTANT 1990 PRICES

DESCRIPTION	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	TOTAL
TOTAL POPULATION (million)	178	182	185	189	193	197	200	204	209	213	217	-
URBAN POPULATION (million)	55	58	61	65	68	72	75	80	84	88	93	-
URBAN PIPED WATER COVERAGE (MILLION)	19	22	26	29	34	39	45	52	59	68	79	-
URBAN PIPED WATER COVERAGE (percent)	35%	38%	42%	46%	50%	54%	59%	65%	71%	78%	85%	-
URBAN POPULATION TO SERVE (incremental) (MILLION)	0.0	2.9	3.4	3.9	4.4	5.1	5.9	6.8	7.8	9.0	10.3	60
TOTAL INVESTMENT $ Million	0	437	503	580	667	768	884	1017	1171	1347	1551	8925
TOTAL BUDGET REPELITA V&VI (urban water) $ Million	400	400	400	400	400	524	524	524	524	524	524	5144
INVESTMENT BUDGET REPELITA V&VI (urban water) $ Million	340	340	340	340	340	445	445	445	445	445	445	4372
GAP $ Million		97	163	240	327	322	438	572	725	902	1106	4893

ource: Consultant Estimates

otes: Assume $150 per capita for new capital investment in piped water supply Second Jabotabek Urban Development Project, World Bank, 1990

Assume Repelita VI Investment Increases at 7% per year over 5 years in line with GDP growth.

Average annual allocation assumed for 1995-1999. Year 2000 assumed as a constant.

Capital Budget assumes new investment at 85% of total budget.

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3. Microeconomic Considerations

As demonstrated in the calculation of the investment gap, public sector funds clearly will be inadequate to meet the pressing needs for urban infrastructure investment in water supply, wastewater treatment and solid waste management. The GOI 's primary objective in encouraging private sector participants is to increase the absolute level of investment at a reasonable level of cost. A key consideration of private sector participation is the cost issue and directly related pricing policies.

Piped water supply provided through GOI agencies is clearly subsidized in Indonesia. The tariff is set below the cost of production by as much as 70% in some systems. The majority of groundwater users pay nothing for the use of resource. It has been estimated that up to 75% of groundwater drilling and extraction is outside the official licensing and fee system.

3.1 Public and Private Goods and Market Failures

Classical economic theory of public and private goods gives a framework which should be considered when discussing market application of supply and demand and their consequences in the provision of urban infrastructure. The management of water resources is often confused because of its nature as both a private and public "open" access good. Piped water supplies are generally considered private goods that can be "owned" and used by consumers with benefits retained by the individual and use restricted through a formal regulation mechanism. Groundwater resources when available without enforced restriction, as appears to be the case in Indonesia, are classic "open" access public goods, ie. goods from which people cannot be excluded. Wastewater provision and solid waste management also fall into the public domain because of the externalities generated that affect a wider society than the immediate users.

As "private" good, market principles apply to piped water supply in "neo-classical" terms where first price equals value and second, the cost of the good, after allowing for all its factors of production, will equal the market price. Water supply (and wastewater treatment) however suffer from a number of market failures when the classical market model does not apply. Standard market failures that apply to water and wastewater (as adapted from Rogers, 1990) include:

Increasing returns to scale: Municipal water and waste water services are natural monopolies because of large economies of scale; over capacity is often inherent in the design which is usually a public cost. Competition is difficult.

Externalities in water and wastewater include both water quantity and water quality, common pool effects on groundwater and the export of pollution.

The classic market model assumes that there is optimal income distribution; this condition is violated in Indonesia

The economic role of government is to correct market failures by funding public goods and by subsidizing goods that generate externalities. Some argue (Birdsall and James, 1990) that the government should concentrate on funding public goods and encourage the market to do what it does best: fund and produce private goods. It is bringing the private sector into the "marketplace" for traditionally public funded goods that needs examination. The GOI will need to closely regulate private provision to minimize its negative externalities to other users, as is currently apparent in groundwater depletion.

3.2 Issues in Water Pricing

Water is underpriced

In Indonesia water has a tradition of being considered as a free good. In areas where water is abundant, there is no reason to price water. Individuals and enterprises incur a private cost of pumping and distributing water, and they use water up to the point where their marginal benefit equals their marginal cost. However, an individual's water use does reduce the availability or increase costs to other, then there is a case for imposing a "price" on consumption to compensate for this externality.

Pricing is the major tool used by the economy for efficient resource use. Pricing is much more than cost recovery and tariffs. It also should lead to correct allocation decisions. This is true for both public and private pricing regimes. As water distribution increases, the cost of this supply must be passed on to consumers, otherwise they will use more water than is economically optimal and will require constant subsides in order to cover losses.

In Indonesia, piped water is provided through government sponsored facilities, i.e. BPAMs or through semi-autonomous facilities, i.e. PDAMs. Currently these public water agencies do not price water at its full economic or even financial cost. These public sector agencies have been much to blame as the use of subsidies in water pricing abrogates the use of the pricing mechanism for efficient resource allocation. Subsidies often lead to sloppy performance of public water utilities and certainly give the wrong "use" water signals. The "free" groundwater supplies have led to the depletion of the aquifers below Jakarta which will never recover through natural recharge. Future water costs will go up dramatically as new and more difficult and inconvenient sources of

supply are brought on stream. In Jakarta's case the situation is exacerbated by the treatment requirements for heavy municipal and industrial pollution of the surface and groundwater water supplies.

The Cost of Water and the Price of Water

In any pricing policy the relationship between full cost of water production (taking into account the cost of obtaining the water plus opportunity and externality costs) and the price of water (the tariff) should be clearly established. Adding the opportunity cost of water to its marginal cost of supply and comparing this with its current price indicates how efficient water use is and how efficient it could be. It is impossible to "price" water without a clear idea of the full costs. Ignoring the full cost of water will undervalue the resource, lead to failures to invest at the appropriate time and cause serious mis-allocations of the resource between users. In principle the GOI has set out procedures that users should pay the full cost of water distribution as well as for externalities resulting from shortages through appropriate tariffs. In practice this does not happen.

For example, a recent detailed study on the financial evaluation of Indonesia water enterprises (McDonald, et al 1988) made it clear that the PDAM's did not know the full cost of water. It was evident that for the most part operations and maintenance costs were fully recorded, but capital costs were ambiguous. In the 11 largest PDAMs, representing the main urban conurbation in Indonesia, interest and depreciation was used to define a measure of "profitability", but it was not clear how realistically depreciation reflected real asset values. At present there is no standard requirement for a specific rate of return on assets to provide for internal cash generation to add to capital formation.

In general the GOI has transferred capital assets to the PDAMs without transferring the related amortization costs. As a rule PDAMs set average tariffs at a level high enough to recover only operation and maintenance costs. However, implicit in the recent McDonald report was the observation that operation and maintenance was a somewhat neglected area in the PDAM organization as well as a lack of capital management. This raises questions as to whether sufficient expenses have been allocated even for operation and maintenance to satisfactorily maintain the system. World Bank estimates indicate that O&M expenses should be up to 30% higher than budgeted. This will add considerably to the financial cost of water. Increases in maintenance costs also reduce amounts available for capital investment and redistribution to municipal government. The lack of O&M expenditure will result in deterioration in service and over time will increase capital expenditure because of premature replacement.

A main conclusion from the above analysis is that GOI has at the current time very little idea of what the cost of piped water is in the public sector, both in financial and economic terms. In financial terms the GOI is aware that PDAMs are becoming

decapitalized as they are not setting aside adequate replacement funds from their retained earnings. At present PDAM Jaya is participating in a large expansion program funded through the World Bank. Part of the process is to sharpen financial management so that costs and revenues in the water sector can be more transparent. Specific requirements introduced as to capital formation include that the PDAM must provide sufficient internal cash generation to achieve an annual average of 30% of retained earnings to be used for capital formation. In order to achieve this financially prudent goal, the 50% tax on profits that by law is required to be passed to the DKI Jakarta has been waved. In future this share of the net income will be retained within PDAM as DKI Jakarta equity. Previously these funds were distributed as staff bonuses, general reserves and pension funds. Specific financial undertakings include :

- adjustment every three years of ground-water abstraction fee to assure adequate compensation for aquifer mining. This will induce present and potential users to switch over to PDAM Jaya water supply.

- sufficient internal cash generation to achieve an annual average of not less than 30% contribution towards capital expenditure; ie. retained earnings of 30% of positive cash flow

- maximum debt is no more than 70% percent of total capitalization

For private sector companies who are financially driven, revenue streams are the main indicator of performance and decision making. These companies have a very detailed knowledge of the cost of water production including operation, maintenance and capital. These costs plus some profit will be reflected in water provision by the private sector. These investments should achieve a more realistic financial cost of water supply and act as a "benchmark" for public sector systems.

Optimal Pricing and Subsidies

It is clear that the public water enterprises (PDAMs) have taken a "backwards" accounting stance and allow costs of water and therefore pricing to be based only on average historical operating costs and revenues needed to meet these costs on an annual basis. An "average " tariff high enough to cover O&M plus amortization costs is insufficient to ensure economically optimal consumption patterns. This stance is also not appropriate in situations where the utilities are facing increasing marginal costs (all the best projects have been built and now it becomes increasingly difficult to supply the same amount of water at the historical costs). This is almost always true in water supply where most of the closest and easily accessible sources have been exploited. In Bangkok for example, the cost of water has risen from $.40 m3 to over $1.00 m3 due to the new aqueduct bringing water from 30 kilometers from outside the city. The existing groundwater resources in Bangkok have been fully exploited to a point where they are creating high cost externalities in terms of land subsidence. Jakarta may not be far behind.

Under these conditions a "forward" looking accounting stance is indicated where water should be pricing closer to its long run marginal cost (LRMC). Though estimates are indicative, a 1988 study estimated that average incremental cost of water was about $ .50 m3 and the average tariff was only about 30% of this or $.15 m3. The implicit average subsidy is about 70% of the real cost.

The use of water tariffs for income distribution through cross-subsidies is an important issue in the cost of water in Indonesia. Water tariffs appear to carry two types of subsidies. The first subsidy is directly between user groups, ie. between low volume users and high volume users on a graduated scale, and also between industrial users and domestic users.

The cost of provision to small users is subsidized as it is generally equal to higher than the cost of provision to large users. Nevertheless, most PDAMs in Indonesia charge large industrial users much more than small domestic users. Overall the average tariff paid by industrial users is two or three times the average tariff paid by domestic users. This structure, while intended to provide water to all users at a low cost, results in overconsumption of piped water by households and underconsumption of piped water by nondomestic users. High industrial users fees have driven some of these consumers to develop their own sources of supply, directly from rivers or most commonly from groundwater sources. Further, within the domestic tariff bands, subsidies are provided to consumers who seem well able to pay closer to the marginal cost. The degree of cross subsidy could be substantially reduced by making tariffs for all users closer the LRMC. The main exception might be a low "lifeline" rate for low consumption levels to ensure basic services for poorer households.

The second type of income distribution subsidy is more indirect, ie. the use of PDAM revenues as a revenue earner for local Government in the form of a tax on "profits". The PDAM Jaya (Jakarta) is typical in this respect. As permitted under existing laws, the government authority (DKI) that runs Jakarta has been withdrawing funds from the PDAM equivalent to 55% of the PDAM's "net income after taxes". This payment represents an addition to general municipal revues and is symptomatic of the "cash cow" phenomenon of revenue with no direct cost. Some municipalities have used these general revenues for street lighting, road paving, etc.

The water tariff,as currently designed in Indonesia, carries with it more than the cost of production. This raises many questions as to the use of the water tariff as the most efficient way to achieve wider goals of income distribution and sources of finance for local government. These additional uses of the tariff cloud the fundamental relationship between the cost of water and the price of water.

The Private Sector Role

The private sector has a major role in the provision of water supply in Indonesia. Given the estimate of 35% of urban population with piped water of about 19 million, the remaining 36 million are mainly served by the private sector. Further it appears that the private sector is expanding to meet the increasing needs of the population. However, these increases in service are unregulated and uneconomic. A number of ad hoc water supply schemes are being built apparently outside the jurisdiction of the PDAMs. These "enclave" developers are pricing water to fulfil their financial requirements, but they are not capturing economies of scale and may be creating negative externalities through the use of unregulated groundwater.

Given the highly subsidized formal water sector in Indonesia, the introduction of the private sector should bring more financial rigor to investment and direct subsidies will become more transparent and explicit. These companies have very detailed knowledge of the cost of water production including operation, maintenance and capital and these costs plus some profit must be reflected in the sale price of water. Private sector developments in water facilities will be totally dependent on its revenue stream provided by bulk water sales or directly by tariffs and connection fees. They will rely on their own management of cash and capital resources, and therefore it is expected that the private sector will bring management efficiencies, directly through their own investment or through contracting mechanisms.

4. Macroeconomic Issues

Three issues are discussed at the macroeconomic level. These include consideration of additionality, investment assurances and questions concerning debt service and foreign exchange risk.

4.1. The question of additionality

Given the likely constraints on public sector fiance, management skills, and access to technology, the main benefits to private sector participation in the urban services sector are (1) to provide needed infrastructure capacity that would not otherwise be provided and (2) to provide efficiency gains resulting in lower investment costs and operating costs of water and wastewater schemes and for solid waste management. Private sector investments must meet the test of "additionality" with respect to financing and efficiency.

It is important to establish the reasons why Build, Operate and Transfer (BOW) and Build, Operate and Own (BOO) are chosen as capital investment mechanisms. Traditionally in the water and wastewater sector and for other public infrastructure, these investments in Indonesia have been financed by direct government grants and sovereign lending through ESAs (external support agencies). The use of the BOW or BOO model is predicated on the premise that sovereign lending or government finance is not available and that the benefits foregone due to lack of infrastructure development will result in major social and economic costs.

With regard to BOW or BOO, any capital investment should use the least cost option principal for financing as well as for construction estimates. The actual construction costs on any optimized least cost alternative will be about the same; it is the financing package that will differ. BOW and BOO investments are often precipitated by "sponsor" agents with specific interest in developing water supply or another type of infrastructure. The ability for these "agents" to put together a specific deal for a specific project may make the comparison of the individual BOO or BOW over a range of projects difficult. Capital dedicated for a specific project as a result of supplier credits or perceived opportunity by the private sector investor may not be fungible across the sector or between projects in the sector. Real "additionality" may only be available for certain types or sizes of projects, say above $25 million for foreign investor packages.

Because of the relatively higher costs of equity and debt service for a privately held company versus sovereign borrowing and the profit element necessary in private sector investment, by its very nature the capital cost of a privatized facility tends to be higher than more traditionally funded facilities. However, increased efficiency gains in construction and operation and flexibility in management decision should compensate for this higher capital cost. BOO are already common in the sector and are apparent where the consumer base reflected can bear the true (higher) capital cost. The sector should

build on market principles and use BOTs and BOOs for commercially attractive and robust projects leaving less viable projects for concessional funding.

4.2. Financial Assurances

One issue common to both power and urban infrastructure sector with regard to private sector capital investment is the issue of increased financial exposure by the GOI in terms of assurances required for the Government entity charged with securing the revenue streams of the new investment or joint venture company. The classic example in water supply is bulk water agreements arranged on a traditional "take or pay" arrangement. In these examples, the PDAM on behalf of the municipality agrees to the price and volume contract and its obligations. Lenders and equity investors also require some type of assurances or comfort by the GOI for the public agency. These assurances are not intended to directly guarantee the project debt which is secured by the revenue streams of the enterprise itself. Government "comfort" is apparently necessary to ensure that the government agency, in the case of water the PDAM and for wastewater, the PDAL, perform adequately with regard to their payment obligations.

The cost of the assurances are a function of both the size of the investment and the financial robustness of the government agency undertaking the "pay and take" agreement. The amount of the increased exposure of government debt for "assurances" would of course cut into the additionality benefit of the investment. In water supply as compared with power, telecommunication and transport investments, the size of the project investment is not large. In the active phase of development there are about $250 million worth of private water sector development seeking joint ventures with PDAMs. If these project investments are predicated on robust revenue streams that can attract equity investor and lenders, then the risk should be relatively small as the project has proved "bankable". Consideration will be given however to the government entity that has to secure the revenue steams. As has been stressed in the forgoing section 2 of this paper, PDAMs are financially and managerially weak. PDALs are a new entity; only one is operating. The perceived risk of these agencies financial performance maybe significant.

4.3. Foreign Exchange Risks

Foreign exchange risks predominate in large private investments when foreign partners borrowing are denominated in foreign currencies and equity holders want their return in foreign exchange. The use of foreign private borrowing for any project provides considerable additionality given the currently constrained domestic markets for capital. Revenue streams to all urban services projects are necessarily in domestic currency and are not tied in any significant way to export earnings say as in some manufacturing or tourism projects. Given the assumption that the GOI will continue with its current

policy of full convertibility of the Rupiah, foreign exchange risk will mainly center on the foreign currency value of profits. The GOI may need to consider this on a case by case basis and it will probably be a function of the size of the foreign exchange risk exposure by the foreign investor, other offers available and the perceived benefits of the project given its foreign exchange risk trade-offs, e.g. tourist developments.

Overall in the water supply, waste water and solid waste management sector, average capital investment is expected to be smaller than say in power or transport and have less foreign exchange requirements in terms of imports. These two factors indicate water supply and waste water investments as well as solid waste are highly suitable for domestic ventures.

ANNEX A - 3

TECHNICAL ANALYSES

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

TECHNICAL ANALYSES A - 3

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URBAN SERVICES ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

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ANNEX A - 3 (A)

URBAN SERVICE SECTORS

1. Piped Water Supply

1.1 Current Situation

Physical Characteristics

Both surface water and groundwater supplies in Indonesia are plentiful, although extraction and transmission can be complicated by poor quality, distance from urban centers and seasonal variations in natural supply. Specific urban areas suffer from water quality degradation and aquifer depletion. Inadequate wastewater treatment threatens in the future the present, reasonably plentiful supply situation.

In 1980, water supply coverage in urban areas by safe supplies e.g. piped water or covered pumped wells was only about 39%, among the lowest in Asia. By 1987, the percentage of urban housing provided with water from these two methods had grown to 46%. The majority of the remaining urban population (about 44%) obtain drinking water from open unprotected wells and about 10% from vendors. Overall groundwater is the major source of water supplies in cities because it is convenient and cheap.

The growth in demand for water in urban areas is related to the growth of urban populations. The current urban population is estimated at 58 million. Projections suggest a 60% increase by early next century to about 93 million. The urban population is expected to be over 40 percent by the turn of the century. Against this, the GOI has established a piped water coverage target of 85 percent for urban areas by the year 2000. To meet this target it is estimated that water supply investment would have to increase at an annual rate of 10 percent.

Water and water-related issues pose very serious environmental challenges. They particularly affect urban areas and are most acute in the metropolitan centers because of the impact of dramatic population growth. The situation for the poorer population is becoming most severe as they are confined to shallow groundwater wells for most of their water use. Groundwater is increasingly contaminated by poor sanitation and lack of appropriate drainage. Groundwater levels are sinking, sometimes resulting in saline intrusion, due to uncontrolled extraction. Pollution of the downstream areas of almost all north coast rivers of Java has reduced the possibility of using surface water for municipal and industrial purposes.

Organization of the Sector

At the central level, the Ministries of Home affairs (MHA) and of Public Works (MPW) are the two key agencies in the provision of urban water supply. The MHA has overall responsibility through the provincial Governors for the supervision and development of provincial and local government. Specific responsibility for administrative guidance to the local water enterprises (PDAMs) comes under the Directorate of Regional Finance of the Directorate General of Public Administration and Local Autonomy (PUOD) within MHA.

The MPW is responsible for the oversight, planning and implementation of water supply infrastructure. Within MPW, the Directorate General for Human Settlements (DGCK -Cipta Karya) is responsible for city planning and for guiding the development of water supply as well as sewerage and sanitation, solid waste management and the KIP (Kampong Improvement Program). The Directorate General of Water Resource Development (DGWRD) is responsible for urban flood control and bulk water supply. The Ministry of Mines and Energy, Directorate of Environmental Geology (DEG) is responsible for groundwater resources.

At the provincial level, the main agencies involved in water supply are the Provincial Water Supply Project (PPSAB) and the Provincial Monitoring and Development Unit (PMDU). At the local Government level, the two agencies involved in actual provision of urban water supplies are the (1) local water enterprises (PDAMs) and (2) the interim water supply bodies (BPAMs). The PDAMs are autonomous local enterprises responsible to the heads of local government (Bupati/Walikota). Their main objective is to expand, operate and maintain piped water supply facilities for the community in an efficient manner. The PMDUs who assist the PDAMs have been recently established by a joint Ministerial decision of MHA and MPW. The BPAMs are temporary water supply agencies controlled by the MPW via the PPSAB. Figure 1 sets out the organizational structure of the water supply sector.

There are currently about 151 PDAMs in operation throughout Indonesia and approximately 140 BPAMs. By 1993 all BPAMs should have made the transition to PDAMs. With a few very exceptions, the PDAM/BPAM system provides all piped urban water supply; recent data indicates that the piped water coverage level for all urban dwellers is between 35 to 38%. The majority of the population obtain water from unregulated groundwater sources.

Table 1 sets out indicative estimates for drinking water coverage in the 11 largest urban conurbations in Indonesia. The average is 26% coverage for drinking water which is below the overall piped water coverage. The lower figure is explained partially by the poor quality of piped water which causes consumers to continue using well water or another source for drinking.

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TABLE A.1

Percentage Coverage of Drinking Water in Large Cities

CITY	POPULATION (1988) ('000)	OVERALL SERVICE LEVEL PIPED DRINKING WATER SUPPLY %
Bandung	2,300	31
Bogor	900	17
Jakarta	7,800	17
Malang	600	30
Medan	1,600	29
Palembang	1,100	40
Semarang	1,100	32
Surabaya	2,200	44
Surakarta	700	24
Ujung Pandang	950	35
Yogyakarta	500	26
Total	19,750	26

Source: Adapted from the MPW Support Study for Master Planning for Water Supply Subsector Policy, 1988

Financial Characteristics

Both government and donors have focused considerable attention on the financial viability of PDAMs and their ability to operate as commercial entities by both government and donors. Experience across the range of PDAMs differs, however for the most part they remain financially weak. Though a number of PDAMs are recovering operating costs, none achieve full capital cost recovery through allowances for depreciation and few are able to provide internal cash generation to cover capital expansion programs. PDAMs, as have most of local government entities, have relied heavily on a system of central government transfers and direct construction to provide infrastructure on grant terms or at very low interest rates.

Despite the current emphasis on financial viability, PDAMs are tasked through the tariff structure to achieve social policy objectives of income distribution. Tariffs are based loosely on the principle of cross-subsidies from the rich to the poor, i.e. tariff must be within the ability of all people served to pay. This substantial cross-subsidy of domestic consumers is

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financed to a large extent by high tariffs on industrial and commercial consumers, as well as the capital transfers as discussed above. Further the actual water charges resulting from the tariff structure are not always in line with the objectives envisaged. Subsidies appear to be provided to consumers who seem able to pay closer to the real cost of supply. Given inadequate demand and supply management, for example unaccounted for water is on average 40%, PDAMs are often unable to provide a reliable supply of clean water to customers. Many potential public systems users, industrial, commercial and higher income residential, rely primarily on groundwater sources through operation of wells and pumps. There are procedures for metering deep wells, which should act as an extraction premium and may serve as some deterrent to over consumption. However it is unclear how rigorously these regulations are enforced and fees collected.

The PDAMs also have some obligation to provide 55% of their net profits to the municipal government. It is unclear how rigorously this obligation is enforced, however it is clear that in some cases water tariffs are seen as a source of general municipal revenues as well as a source of payment for water supply.

1.2. Private Sector Involvement: Experience to Date

The GOI has made a deliberate recent effort to open the door to increased private sector participation in the water supply sector by removing water from the "restricted investment list" (Presidential Decree No. 21 of 1989) and taking a series of steps to make the water sector more attractive to private investors. For example, the GOI has prepared guidelines for private sector participation that envision joint public/private participation in water extraction, raw water transmission, clean water production and clean water distribution.

The development of formal private sector participation in the urban water supply sector is in its early stages. The comprehensive WASH study (Private Sector Participation in Urban Water Supplies: Issues for Investment in Indonesia, May 1991) found two main types of private "off government budget" investment in water supply: supply-led source development projects, and "enclave" water supply developments.

Developing the source of supply and bulk water treatment most likely involves firms with specific expertise or construction interest in water supply. The single nature of the product, potable water, and the usually large size of the civil works investment make development of water investments a rather specialized area. The traditional development of supply-led developments include contractors, design and management firms, suppliers of equipment, etc. forming a consortium to develop a water source which is marketable to the PDAM or direct to the consumer on a "take or pay" arrangement. The supply led developments are characterized by larger traditional "lumpy" capital investments,eg source works, dams, treatment plants, etc. A common financing mechanism for these types of projects is a build, operate and transfer "BOT" arrangement.

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"Enclave" water development projects are mainly aimed at fulfilling a specific water demand as part of a bigger package of infrastructure. These projects include a number of industrial estates, tourist developments and private housing complexes that are typical of current private sector investment in Indonesia.

At present examples of fully contracted formal water sector private investments on a large scale are limited. It appears that interest in water supply investment is growing. The current examples of joint venture projects include both foreign and local investors. The joint venture water supply project which will serve the rapidly growing tourist areas of Bali at Nusa Dua was signed in mid-May, 1991 and is now underway. Two private Indonesian firms will invest $15 million, while the PDAM will contribute about $9m. All parties will cooperate in construction and management of the water treatment works, and the assets will be transferred to the PDAM after the concession period.

Several other projects are at various stages in the negotiation process. Nearing agreement is the large bulk water supply BOT at Umbulan Springs, East Java. When complete this $125 millon project will provide raw water for distribution to the PDAMs of Surabaya, Gresik, Sidoarjo and Pasuruan. The project is lead by the Bromo Consortium. Foreign and local firms are considering investing in a $70 million water supply project in Lhok Seumawe, Northern Aceh. This project is aimed at increasing the capacity of the water supply system in Lhok Seumawe to service a number of big industries including a paper making facility and a fertilizer factory. A Singaporean company, the Salim group, the GOI and the Riau province administration have agreed to invest US$480 million for a water supply project on Bintan Islands. Under the joint venture agreement, Singapore's Public Utilities Board (PUB) will be the major shareholder in the dam construction, while Riau provinces Clean Water Company (PDAM) will be the major shareholder in water distribution. Most of the water from this project is intended for consumption by Singapore residents. Interest has also been expressed by the private sector to develop water supply projects at Semarang and Bogor.

It must be remembered that the majority of water provision in Indonesia is already in the private sector if ground water sources are considered. A number of industrial and commercial enterprises, most notably industrial estates and factories and hotels have developed their own ground water sources. There are some examples of private sector development of piped water supplies for specific housing and industrial developments, which are wholly owned by the end users or developers. These developments appear outside the current municipal water structure.

1.3. Scope for Further Private Sector Participation

As identified, the two main areas of private sector participation are (1) direct investment in municipal water supply through build, operate and transfer (BOTs) and build, operate and

own (BOOs) mechanisms and (2) in service and management contracts that include technical operational activities and management functions.

Figure 2 sets out the physical organization of the sector into three main component parts, which are: source development and maintenance, bulk water handling and treatment and distribution. The figure also specifies the main agencies that are responsible for each activity based on the current sector organization explained in detail above. It is clear that both the Ministries of Public Works and Home Affairs, through their regional water enterprises, the PDAMs, will play indispensable roles in actively involving the private sector in water delivery. The figure also specifies the type of private sector participation, direct investment and management and service contracts, that are possible within each component of the sector. Section E of this annex sets out specific opportunities in more detail as demonstration projects.

To date the GOI has been reactive to approaches by the private sector in terms of joint venture opportunities in water supply. Though several joint ventures are currently underway, there is some lack of confidence that these "supplier" driven models can or should be replicated. This points to the importance of the development of a proactive capability within the GOI to involve the private sector in ways that fit into the overall "game plan" of the sector. There is great interest in the initial efforts of private sector investment in water supply and active attention to establish "lessons learned" from these examples on behalf of the GOI. Overall the GOI appears to have adopted a healthy attitude to private sector participation, viewing it not as an end in itself but as part of a comprehensive set of programs which endeavor to improve and expand the urban water supply.

FIGURE 2

MUNICIPAL PIPED WATER SUPPLY FLOW CHART

Physical Structure	Responsible Agency	Form of Potential/Existing Private Sector Entry
Source Development * Capped Springs * River Intakes * Transmission mains	Development under control of Public Works; maintenance shared between PW/ PDAMs depending on extent and nature of works.	Build, operate and transfer BOT
* Dams/Reservoirs	Most design and all construction contracted out to domestic and foreign firms.	Service Contract, Management
Bulk Water Handling and Treatment * Transmission Mains * Pumping Stations * Treatment Plants	Planning under PW; maintenance and operation under PDAM/DGPUOD or BPAM/ PW.	Build,operate and transfer Build,operate and own
Distribution * Treated Water Transmission Pipelines * Primary and Secondary Mains * Tertiary Mains (pipelaying) * Residential Connections - Individual Households and standpipes	Except in very specific cases all work on distribution of urban water supply is undertaken by PDAMs; operation and maintenance is under PDAMs; end user delivery of water and collection of fees and enforcement of tariff under PDAMs.	Build, operate and transfer Service Contracts Build, operate and own
* Institutional, Commercial & Industrial Connections.[1]	Management of operations including administrative technical operations is under control of PDAM.	

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PW : Public Works
MRA : Ministry of Home Affairs
PDAM : Regional Enterprise Water Utility
PUOD : Gov. Affairs & Regional Autonomy
BPAM : Water Utility Management Agency
DGPUOD : Directorate General of Gov.Affairs & Regional Autonomy

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Contracting

Contracting out to private sector firms for the provision of certain services related to the supply of urban water is a common method of including the private sector within the framework of publicly owned and operated services. Studies have shown than the use of private services frequently results in lower costs and improved efficiency. These gains are often the result of improved incentive schemes and a more flexible approach . Efficiency gains in water supply often lead to increased capacity utilization of existing infrastructure delaying high cost capital construction. A recent study in the USA indicated for example that private participation in waste water treatment showed an expected savings range between 8 and 30%. (Clarkson and Fixler, 1987). To date there is very little contracting out of services of PDAMs to the private sector with the exception of the construction of buildings, pump housings, etc.

There are a number of arguments in favor and against contracting out public services. The most compelling argument for contracting out is that it provides competition and introduces the rigor of the market place into public enterprises and thereby increases efficiencies in operation. Contracting allows more flexibility in adjusting to the size of programs and permits more rapid responses to specific problems. Contracting provides scope for experimentation with new techniques to see if they are workable. A contract mechanism may often make visible and specific the costs of individual activities that are usually hidden within the government budget thereby encouraging greater financial management control.

If contracting opportunities in the PDAMs were opened up to private sector provision this would represent a huge and growing market for services. The classic type of technical services contracts include bill collection and meter reading, meter maintenance, leak detection and routine pipe maintenance programs. Further, it is expected a number of financial management activities currently undertaken directly by PDAM staff could also benefit from the infusion of private sector contracting and management techniques.

Though still in the planning stages, a survey of actual experiences with private participation in urban services has been outlined under USAID's Municipal Finance Project. The purpose of the survey is to identify the current areas and actual extent of private sector participation in urban areas and to identify promising opportunities and constraints to these developments. Ten cities have been identified as survey sites including Surabaya, Bandar Lampung, Medan, Jambi, Jakarta, Bandung, Serang, Yogyakarta, Balikpapan and Kupang. Any data generated from this activity will be extremely useful in the identification of suitable opportunities for private sector participation in investment but more specifically in contracting.

Investment

Suggestions have been made that the GOI develop a "plan" or generalized TORs for earmarking areas (geographical or subsectors, e.g. industrial estates, distribution etc.) that are appropriate for private water supply development. The recent WASH study specifically suggested a plan that would establish the types of projects in which investments are encouraged; the standards of coverage and quality assurances to be met; technical standards that are expected and an organizational road map to assist the private sector in its search for profitable investment opportunities. This plan approach is echoed in the US investors desire to have as clear and concise a description of the project requirements as possible. (Also see regulatory structure below.) The planning process could include the "feasibility study" approach on a more project by project basis or include the prospect of "water enterprize zones". The latter would try to harness the current ad hoc development of the private sector say around particular geographic growth points, Bekasi or fast growing suburbs are cases in point. They would include high and medium income housing demand and industrial demand. The private sector could be given authority to set their own tariff levels, etc. within a PDAM jurisdiction. This approach would most likely involve the adoption of the water supply systems by the public sector over time and require regulation and enforcement of planning regulations and flexibility on pricing policies.

Specific opportunities identified as demonstration projects include build operate and transfer and build operate and own projects for investment in source development, bulk water transfer and distribution as well as service and management contracts for operation of the water supply enterprise. These individual projects are discussed more fully in Section ___ of this annex.

1.4. Issues

A number of issues arising in private sector participation in urban water supply were set out in the comprehensive WASH study on the topic completed in May 1991. This paper builds on that study and a workshop held in May which focused discussion around the key finding of the study. The workshop succeeded in bringing together the representatives of the main groups whose involvement is critical to accelerated private participation. These include representatives of central and local government and public enterprise, investors, contractors, service operators and consultants from the private sector as well as members from the donor communities..

A main consideration in reviewing private public partnerships in the formal urban water supply sector is that activities are at the formative stage. The untested nature of the activity and its high expectations color the issues set out below. These are grouped under four main headings: lack of regulatory framework, autonomy of PDAMs, pricing policies, and macro economic issues.

Lack of a regulatory framework for investment and contracting

There are numerous laws and regulations at the national, provincial and local levels that will govern private sector participation in the urban water sector. These include the Constitution, laws that define the responsibilities of the water authorities (PDAMs and BPAMs), laws that govern domestic and foreign private sector investment, regulations dealing with taxes and tariffs, and laws and regulations that govern operation of public utilities.

Overall the laws and regulations regarding private sector participation in urban water supply are clear in encouraging participation. The GOI has made a deliberate effort to open the door to increased private sector participation by removing water supply from the restricted list (Presidential Decree Number 21 of 1989). There are however conflicting laws that would appear to restrict participation in some ways. Further the laws and regulations are far less clear on stating on what basis the private sector may participate in the water sector, what standards the GOI will apply in evaluating applications, and how the GOI will ensure that its public policy aims in the water sector are achieved in line with the commercial needs of the private sector.

Indonesian laws and regulations are sometimes imprecise and their coverage - particularly with regard to commercial activity - uneven and tend to be handled on an ad hoc basis. The contradictions and inconsistences in the current legal framework will tend to discourage private investment unless these are clarified. Examples include:

Apparent limitations on the authority of PDAMs to enter into a joint venture with a private party

Apparent inconsistency between the Basic Law of 1945 and private ownership of a water utility

Apparent limitations on foreign private sector investment

In some instances laws appear to be in conflict, particularly to a foreign investor. Although inconsistences and ad hoc decisions on a case by case basis permit greater administrative flexibility, they pose difficulties for the private investor who wants predictability and a clear legal framework in which to operate. The lack of a regulatory structure "defacto" raises the perceived level of risk to the private investor, who can be expected to seek a higher rate of return before investing capital. This, in turn, will increase costs to the consumer.

In an informal survey of prospective investors in the water supply sector, they stressed the importance of an operating environment with clear regulations, consistent administrative procedures, and mechanisms to ensure that agreements are enforced. Further there is no history of private involvement in public utilities in Indonesia, and therefore there is virtually no laws and regulations governing its oversight.

The requirement for regulation of private participation in the urban water supply has two main bases. First it is perceived by investors that there should be clear and consistently applied rules to ensure that private investor receive a reasonable rate of return to investments or operations, and second it is equally important that essential public policy goals are pursued and that the public interest is protected. This is particularly important for water supply as it is considered a natural monopoly.

Competition in day to day operation is not practical in natural monopoly goods such as water supply and public regulation and oversight is necessary. The more frequently competition can be introduced into the process, the less likely regulatory authority is needed. The presence of competition, which provides the incentive to maintain quality and minimize costs, is understood to be a prime condition underlying the efficiency of the private sector. The longer the time between periodic competition, the higher degree of regulation and oversite would be necessary. For example it is likely that BOT arrangements with the private sector in control for up to 15 years would need more regulation than say service contracts that are competed every 2 to 3 years.

Sector regulation: land use planning and groundwater regulation

The majority of industrial and commercial consumers as well as residential users rely primarily on groundwater through the development of individual wells and pumps. It is estimated about two-thirds of industrial water is from groundwater supplies. Over extraction of groundwater resources in many areas is leading to saline intrusion and land subsidence.

Effective demand management of potable water requires that surface and ground water be managed conjunctively. At present it appears that the GOI is unable to regulate satisfactorily the private provision of groundwater in a way that minimizes its negative externalities. The Ministry of Mines and Energy under the Directorate of Environmental Geology (DEG) have the responsibility for groundwater resources. Drilling and extraction of groundwater is in theory regulated to ensure that use does not exceed sustainable levels. Considerable authority in licensing is delegated to local governments to monitor limits made explicit in licenses. Meters are also in place on a number of deep wells and pumps which act as "extraction" premiums for groundwater. Neither system is however well enforced and appears to be leading to serious mining of aquifers.

Unless regulation is in place which takes into account the full externalities of this classic "open access" good, groundwater will continue to appear to be a low cost alternative to piped water. Further much of the development of groundwater resources is outside the formal sector. Even large developments involving substantial residential communities appear to be taking place on an ad hoc basis with regard to availability of groundwater.

Autonomy of PDAMs

A critical issue in increased private participation in urban water services is the role of the PDAMs and PDABs. Issues need to be made clear on the managerial autonomy of the PDAMs, the role of supervisory boards, and the extent to which local governments can intervene in the affairs of a PDAM. Because of the complicated institutional setting in which PDAMs function and the large number of stakeholders, many PDAMs lack effective real authority to make decisions and act in a commercial way. Decision authority needs to be made explicit, for example, for contracting services and for joint venture agreements, both for bulk water contracts and in expanding distribution.

The perceived direction and control of the PDAMs by the GOI make PDAMs eligible for a number of benefits such as donor technical assistance and training, subsidized loans, and grants that would be unavailable if PDAMs were in full control of the private sector. Trading these specific benefits for more generalized benefits such as greater efficiency may be judged too elusive or speculative to encourage active interest by PDAMs in some formal sector initiatives, specifically on the management side.

Private sector companies and investors in dealing with PDAMs may seek particularly specific assurances for example for "take or pay" agreements for bulk water supply because of the weak nature of PDAM financial management and the lack of ability to take decisions.

Introducing the contracting process into the PDAM organization for specific services such as billing and collection or maintenance would involve costs of contract supervision and management and the setting up of regulations, standard operating procedures and other regulatory mechanisms that are not available currently in the Indonesian water supply sector. Lessons learned from other sectors, for example, solid waste may be valuable. One specific problem identified is that the current annual budgeting process of the PDAMs makes contracting out for services more difficult as the private sector needs a 3 to 5 year period to cover possible investments and negotiation costs.

Pricing

As in the power sector, pricing is an important issue when involving private sector participation. Water pricing is a particularly difficult because of its "social" connotations and responsibility. At present in Indonesia the water tariff is supposedly set to recover the full cost of production (O&M and some measure of capital costs), provide for income distribution through a social tariff and provide for fiscal distribution to local authorities through a tax on "profits". Currently the PDAMs do not achieve these targets. Specifically they fail to pay any depreciation and do not provide for capital formation from retained earnings.

PDAMs are saddled with an unrealistic pricing policy that calls for full cost recovery and mandates equity consideration in that water must be pricing at a level that all can afford. This policy has resulted in a large cross-subsidy provided to connected households by high

surcharges on mainly commercial and industrial users. The situation is further complicated by the lack of provision within PDAM budgets for capital replacement through internal cash generation. In addition to undoubted decapitalization of PDAM assets there is some evidence that operation and maintenance expenditures are insufficient. In general PDAMs are financially weak and their long-term financial soundness is in some doubt.

Subsidy issues in water tariffs are complicated. Clearly the water tariff in Indonesia carries more than the cost of production. It raises questions as to whether the water tariff is the most efficient way to achieve income distribution and act as a revenue earner for local government. Clearly a private sector enterprise would set the tariff closer to the full cost of production. This issue is further clouded because of the "open access" to groundwater. A more realistic policy needed to be enforced with respect to groundwater depletion.

Macro-economic Issues:

One issue common to both the power and urban infrastructure sector with regard to private sector capital investment is the issue of increased financial exposure by the GOI in terms of assurances of the government entity charged with securing the revenue streams. It is clear that some type of GOI "comfort" or assurances appear to be required by lenders. The project debt is of course secured by the revenue streams of the project company. Government assurances are required to ensure that the public agency itself will perform with regard to its payment obligations. In the case of power this is PLN and for bulk water supply and / or distribution investments it would be the specific PDAM representing the municipality buying the water. Evidence to date shows that power projects under consideration are on a larger scale in terms of capital costs than bulk water supplies. Any indirect government obligations in terms of assurances therefore would also be less. PLN however is a large nationally based agency that has a larger financial base than the majority of PDAMs organized on municipal levels. The explicit trade off is between large assurances required but for a fairly well resourced institution (PLN) as opposed to smaller scale assurances for water but these are required for weaker municipal based agencies.

The amount of assurance that would obligate the GOI in terms of its overall debt obligations is not considered large for water supply projects. Overall it appears that the GOI wants to stabilize its current debt service obligation in terms of $55 billion in direct GOI debt and about $10 billion in its private debt. If project investments are predicated on robust revenue streams and can attract international equity and debt the initial investment, then the risk of having to support the government agency performance is small.

Foreign exchange consideration are also important in large private investments when foreign partners borrowing are nominated in foreign currencies and equity holders want their return in foreign exchange. Revenue streams to water supply projects are necessarily in domestic currency and are not tied in any significant way to export earnings say through manufacturing or tourism.

2 Wastewater Treatment

2.1 Current Situation

Existing and Planned Sewerage Capacity

The wastewater treatment sector in Indonesia is extremely underdeveloped. Indonesia has a population of 182 million, of which approximately 55 million live in urban areas with 20,000 or more residents. Despite recent construction of new systems in Jakarta, Bandung, Medan, Surabaya and Semarang, less than one percent of residents in urban areas are served by operating sewer systems. Sewer construction projects are apparently underway in 5 of Indonesia's 11 large cities with populations of over 1 million; however, smaller urban areas are receiving little attention.

Major sewer systems are under construction in Bandung and Jakarta, supported by loans from the Asian Development Bank and the World Bank, respectively. In Bandung, a collection network capable of serving 460,000 residents has been completed and treatment works are under construction; network extensions that can serve an additional 340,000 residents are also under construction. The population of Bandung is approximately 1.7 million; the project will provide sewer service to approximately 40% of the residents in the early 1990s. In Jakarta, a pilot project including a collection network and aeration ponds is partially completed and is operational. Although the network serves a central area of the city with a population exceeding 500,000, the size of the treatment ponds limits the capacity of the system to waste from 170,000 residents. Jakarta has a total population of 8 million people.

Approximately 35% to 40% of urban residents have access to sanitation facilities equipped with either a septic tank and drainage field or with a leaching pit. The remainder of urban residents use facilities that discharge directly to the surface drainage network, to septic tanks without a drainage field (which, therefore, overflow into surface drainage) or to deep pits.

There is virtually no treatment capacity for sludge pumped from septic tanks. Stabilization ponds for septic tank pumpage have been built in Surabaya and Jakarta. The majority of septic tank pumpage, however, is dumped directly from septic service tank trucks into rivers and drainage canals.

Given the lack of proper treatment for human waste, it is certain that rivers in and downstream from urban areas are extremely polluted. Reliable data on surface water contamination are not available for most areas; a national program to monitor water quality in rivers was established in 1990, along with a program to require permits for major wastewater dischargers. Data for the Sunter River above and below Jakarta may be indicative of conditions in other major urban centers. A study completed in 1990 involving fairly extensive data collection estimated that 70% of the total pollutant (biological oxygen demand, or BOD) load to the Sunter River study area was attributable to domestic

wastewater: 50% to graywater from bathing and washing, and 20% to sewage and septic overflow.

Institutional Organization

The wastewater sector is organized in similar but somewhat different ways in different cities. In Jakarta, two different authorities are responsible for water supply (the PDAM) and sewer (the PDAL); the PDAL will be officially established in September, 1991 and will be the only PDAL in Indonesia. In Bandung, a single authority (the PDAM) is responsible for both water supply and sewer. Discussions with interested officials indicate that the trend is toward the latter model, i.e. for the existing water authority (PDAM) to assume responsibility for sewer as it comes on line.

As is the case for water supply, the Ministry of Public Works is responsible for planning and building wastewater treatment infrastructure, including sewage collection networks and treatment works. The responsible officials are within the Directorate General of Human Settlements, Directorate of Environmental Sanitation. An interim authority (a BPAM or BPAL) that reports to both the Ministry of Public Works and to the provincial governor is responsible for managing new works until tariff collections are sufficient to cover operating and maintenance costs, at which time the system is considered to be "breaking even" and to be ready for transfer to the PDAM (or PDAL), an "autonomous" government enterprise.

The PDAM reports to the head of the local government (mayor) and is ultimately responsible, through the provincial governor, to the Ministry of Home Affairs. The PDAM is controlled by the local government, which has authority to set tariffs for water and sewer service and which receives a large portion of PDAM revenues. The local government also exercises effective control over decisions by the PDAM to expand or reduce its staff, and probably over a PDAM's decision to enter into an agreement with a private sector firm.

The different interests of the Ministry of Public Works and the Ministry of Home Affairs set up critical conflicts that the PURSE project must address to be successful.

- Because of their principal interest in the construction of new infrastructure facilities, officials in the Ministry of Public Works are supportive of greater private sector participation in urban services, as long as "participation" is in the form of investment and construction. The Ministry of Home Affairs, local governments and PDAMs, however, have interests that work against increasing private investment. Private investment can only be commercially viable if more revenue can be generated from tariffs on service; this requires increasing tariffs, or allowing PDAMs to retain more of the revenue they collect, or both. Increasing tariffs is politically unpopular, and allowing PDAMs to retain a greater share of their revenue reduces the amount of funds transferred to the local government.

- Local governments and probably PDAM managers also have interests that work against private sector participation in the form of service contracts. Local governments are interested in local employment, and PDAM managers--as all managers--are interested in maintaining the size of their staffs. Using service contracts to perform PDAM functions in operations, maintenance, and administration may supplant PDAM staff and direct employment to other geographic areas. One PDAM manager indicated that a tentative decision to contract out billing and tariff collection services was vetoed by the mayor because of concern that the decision would eliminate jobs held by city residents.

Financial Characteristics

The cost of building sewerage systems varies depending on the complexity of the treatment works and the degree of extra capacity built into the system for future use. The Jakarta pilot project has an estimated cost of 49 billion Rp to serve 170,000 people, indicating a unit cost of approximately 300,000 Rp per person served. The Jakarta system has a great deal of excess capacity in the transfer sewers, but includes less than 4,000 total connections; also, existing flood control ponds were modified to create the treatment facility, an aeration pond. A study of options for extending the Jakarta project estimated that unit costs for construction would be between 191,000 Rp and 511,000 Rp per person served, depending on how construction was phased.

As is the case for water supply, sewerage tariffs are calculated to recover only the operations and maintenance costs of sewer service and do not include original capital costs or capital replacement. Explicit cross-subsidies have been included in the official tariff schedule; revenues from commercial customers, especially large commercial buildings and hotels, are used to subsidize rates for residential customers.

There is presently no regulatory requirement (at least in Jakarta) that households or commercial buildings connect to the sewer once the network is established. Customers must pay to be connected to the system. However, this may be less of a disincentive to connecting than it first appears. In Jakarta, the cost for a residential connection is between 250,000 and 400,000 Rp. The PDAL will finance the connection charge by establishing the connection and adding a charge of 1,000 Rp to the residential customer's water bill each month. Under this arrangement, a customer would pay back a charge of 360,000 Rp over 30 years, at 0% interest. Given the uncertainty in recovering payments over thirty years, and the present value of the discounted stream of payments, the residential consumer will pay considerably less than the actual cost of the connection. Whether residents are acting as rational consumers or not, the current demand for connections is greater than the Jakarta PDAL can satisfy.

2. Private Sector Involvement

2.1 Experience to date.

Private firms do not now own or operate any municipal wastewater systems in Indonesia. GOI officials indicated that a consortium of Australian firms had expressed interest in investing in the extension of the Jakarta sewerage system; however, their interest has apparently waned. There are a number of examples of private investment in and ownership of sewer systems in the U.S. Despite their small number, these cases demonstrate that private investment in sewerage can be feasible under certain conditions.

Most of the services associated with septic tank construction, installation, maintenance and cleaning are currently provided by private companies. The local governments of Jakarta and Surabaya have established stabilization sites for tank sludge, and apparently charge private companies a nominal fee for discharging their tanks at the facility.

2.2 Opportunities

The commercial viability of any private sector project depends on the security of the anticipated stream of payments. As shown by experience in the U.S., private investment in urban sewerage systems can be profitable when a municipality and/or other system users will sign long-term agreements to pay for access to the treatment capacity of the system. Such projects are certainly possible in Indonesia, and will be pursued in the PURSE demonstration projects.

Three factors indicate that private sewer projects are more likely to be successful in new small- and medium-sized developments than in large cities. First, the World Bank and the Asian Development Bank, as well as certain bilateral donors, have shown a continuing willingness to support the design and construction of sewerage systems for Indonesia's largest cities. These cities are also the highest priority of the GOI, and thus the most likely areas to be addressed using development loans. Sewer development in new areas, on the other hand, is less likely to be supported with public funds or debt.

Second, there is less incentive for potential customers to connect to a sewer when they already have a septic tank, which is the situation in many urban areas. The relative costs of sewerage and septic tanks are much more favorable to sewerage for new residential developments.

Third, large cities have the highest concentration of the urban poor. Indonesia has a long-established policy of subsidizing services for poor communities; thus, reaching an agreement with the local government under which the private firm can recover its full costs plus a profit will be especially difficult for these areas. Many new areas, on the other hand, are attracting more wealthy residents. These residents are not only more able to bear the full cost of

sewerage; local governments are also more likely to insist that they do so. Private projects will be much more attractive to government entities where they can be self-financing.

Another important factor also indicates that private provision of sewerage is most likely to succeed in new residential developments. Officials in Public Works have indicated they are considering establishing a requirement that real estate developers install sewer systems in all new developments exceeding some size limit, possibly 200 hectares. This requirement, if established, would create an immediate market for firms interested in building, operating and owning small sewer systems. The potential size of this market and the opportunity to replicate small treatment system packages suggests the possibility of a "franchising" operation.

Although this review did not examine industrial wastewater treatment, the opportunities in this sector deserve at least to be mentioned. GOI Regulation 20 (1990) establishes a foundation for controlling water quality through the issuance and enforcement of discharge permits. The GOI Environmental Impact Management Agency (BAPEDAL) has also initiated a program (PROKASIH) to reduce industrial wastewater discharges. These two events, combined with the push to develop industrial estates, means that the demand for treatment of industrial effluents may increase rapidly. Investors who are interested in systems larger than those appropriate to small residential developments, and who have access to technical expertise in treating industrial effluents, may find a profitable market in building collection and treatment systems for industrial estates.

There may also be opportunities for private firms to provide operations, maintenance and management services under contract to PDAMs. There will certainly be a need for maintenance services: during a visit to a small treatment facility near Jakarta, electrical pumps were out of service and sludge had remained in stabilization areas long enough to support a healthy crop of weeds. Whether there will be a market for such services depends on how resistant local government officials and PDAM managers are to hiring contractors.

3. Issues

Four issues must be addressed before there can be extensive private sector involvement in urban wastewater treatment; they are analogous to the issues affecting the water supply sector.

First, there must be a regulatory framework that protects the quality of surface and groundwater resources and makes the use of individual septic systems less attractive. The 1990 regulation establishing a system for discharge permits and the potential regulation requiring sewer systems in new residential developments are positive steps in this direction.

Second, PDAMs or other entities responsible for sewer services must have greater autonomy. PDAM managers need to be able to charge unique, locally-determined tariffs based upon the costs of service in their own area. They also need to be able to make decisions without

interference regarding staffing and whether to purchase support services from a contractor. PDAMs will also need to have sufficient authority and autonomy to exercise effective oversight of private firms.

Third, the GOI must establish model agreements and provide sufficient assurances of payment to private investors. And fourth, tariffs for sewer service must gradually be revised to eliminate subsidies and to enable recovery of the full cost--original capital, operations, maintenance, administration, and capital replacement--of sewer services, plus a reasonable profit.

Another issue also deserves mention. During development of the sewer system in central Jakarta, collection pipes installed for residential service were made obsolete before they were ever used because developers purchased residential land and converted it to commercial and office buildings. Certainly, all modern urban areas are affected by unanticipated changes. Land use needs to be more predictable, however, in order to get maximum value out of investments in infrastructure. Although land use and zoning will not be a focus of the PURSE project, PURSE staff should be aware of the issue and look for opportunities to take advantage of other projects that might be more involved with the topic.

Whether these issues will be addressed depends on the priority that Indonesian central ministries assign to water quality and wastewater treatment. When the President and other senior GOI officials state that Indonesia must develop its infrastructure to support continued development, they refer explicitly to telecommunications, transportation and power; water supply, wastewater treatment, and solid waste are not included. The President has decided that the GOI must limit its public debt and also the private debt that Indonesian businesses and citizens incur. These limits will restrict the exposure that the GOI can incur under guarantee obligations on contracts between GOI entities and private companies. Private participation in urban services will grow only if such services can compete favorably with demands for GOI funds and guarantees to support other infrastructure sectors critical to Indonesia's economic development.exchange risk is an issue that will dominate foreign private sector involvement in large private water supply investments.

3. Solid Waste Management

3.1 Current Situation

Solid Waste Management (SWM) services in most Indonesian cities are seriously deficient and progressively deteriorating. Only 40 percent of the households in urban areas are currently served by some form of garbage collection. In Jakarta, and other cities with populations greater than one million, the proportion rises to 55 percent. Not only does SWM coverage increase with city size, but it varies with income as well: 70 percent of wealthy households received garbage collection services compared to 19 percent of the poor.

In Jakarta about 5,000 tons of garbage are produced on a daily basis, half of which is generated by households. Even though collection services are purportedly very high (85% in the protocol areas), on average only 75 percent of the waste is collected, of which 60 percent is actually disposed at a four landfill sites. Inadequate solid waste collection and disposal not only creates urban blight and offensive odors, but can disrupt the operation of drainage canals, block traffic where garbage overflows onto roads, and threaten public health by facilitating the spread of contagious diseases. Furthermore, solid waste disposal and management problems will be exacerbated as higher incomes lead to larger quantities of waste, of which average particle size and share of inorganic matter will also increase.

The Central Government has allocated $220 million for the improvement of solid waste management in approximately 508 cities under Repelita V. These expenditures are earmarked for expanding household coverage from 40 to 70 percent and achieving 100 percent collection of non-domestic refuge; however, experts estimate that $350 million is actually required to achieve this goal. During Repelita V, cities with a population of more than 100,000 will be weaned from central government assistance and forced to reach self-financing through user fees and greater involvement of the private sector.

Institutional Structure

The National policy on solid waste management is derived from Law No. 18/1953 "Duty and Responsibility of Local Government for Public Works", which tasked provision of this urban service to local governments. In reality, the municipal agency charged with SWM has less control over domestic waste disposal than the local community organization (RW/RT). Household collection is organized at the neighborhood level by the RW/RT. Residents pay a small fee, based on their income, to the RW/RT leader for garbage removal. Despite frequent attempts, the Dinas Kebersihans have been unsuccessful in supplanting the traditional SWM system. The temporary collection area demarcates the end of the RW/RT authority. After community workers deliver the refuse to this open dump, the Dinas Kebersihan is responsible for its transport to the final disposal site, which they also own and operate. It is the task of the city tax and

revenue department, Dispenda, to collect fees to cover the operation and maintenance costs of the Dinas Kebersihan.

Non-domestic waste is handled by other local agencies. The municipal market agency (Pasar Jaya) collects market wastes, the Department of Public Works cleans canals and rivers, and the Parks Department maintains the city's parks and gardens. Factories are supposed to manage their own refuge, but they frequently dump their wastes in rivers. The organization of solid waste management is therefore highly fragmented and difficult to coordinate at the local level. The division of the components of SWM among local agencies also varies by city. The only constant is that ultimate authority lies with the mayor. Although the Perusahaan Daerah Kebersihans (PDK) are supposedly autonomous SWM enterprises, the mayor is the chairman of their Board of Directors.

Given its highly decentralized character, national ministries have played a limited role in SWM. The Ministry of Home Affairs (MOHA) has not adequately supervised or upgraded the management capability of municipal waste agencies. In order to achieve both cost recovery and private sector participation, guidance is needed from MOHA. Likewise, the Directorate of Environmental Sanitation (PLP) at the Ministry of Public Works is charged with the provision of technical assistance, but the low levels of capital construction in the sector has limited their interest in the sector. The provincial PLP provides assistance in procurement of capital equipment. Future construction of transfer stations, sanitary landfills, and composting plants will require more substantial technical input from Public Works.

Financial Characteristics

The Dinas Kebersihan has had great difficulty in increasing revenues for garbage transport and disposal because most residents feel that the monthly fee they pay to the RW/RT covers this service. To the contrary, the Dinas Kebersihan claims that by law, the community payment is for transport from individual households to the temporary collection area, not from the latter to the final disposal site. Furthermore, fee collection is most often the responsibility of a separate agency, the Dispenda, which has no incentive to actively elicit payments from households.

Waste produced by shops, markets, hotels and factories generate much more substantial revenue than households. The Dispenda receives payment from businesses at a rate that approximates cost recovery. Since markets generate large volumes of refuse, fees and waste are collected on a daily basis. Revenues from commercial and market areas are used to cross-subsidize the handling of domestic waste.

Despite the success in collecting fees from businesses and markets, the failure to generate revenue from households causes the Dinas Kebersihan to bear heavy financial losses each year. Cost recovery in the SWM sector normally refers only to recoupment of operations and maintenance, not depreciation on capital equipment or debt servicing.

However, even using this generous definition, the average cost recovery rate in cities with a population over 100,000 was 28 percent. Full cost recovery probably lies as low as 5 to 10 percent (Cerverro 1991).

The Dinas Kebersihans' financial insolvency was the impetus behind the conversion of the agencies in Bandung and Medan to regional enterprises, or Perusahan Daerah Kebersihan (PDK). The Asian Development Bank initiated both actions by requiring improved cost recovery in exchange for substantial capital infusion through their Urban Development Programs. ADB officials felt that the PDKs' financial self-sufficiency would improve once their budget was separated from the local government account. The PDKs have greater financial autonomy, specifically they are responsible for fee collection rather than the Dispenda; but they are not free to set a solid waste tariff which matches their operational costs. These financial difficulties will be further addressed in the issues section of the annex.

3.2 Private Sector Involvement: Experience to Date

Collection and Transport

Service Contracts

Contracting to private firms for garbage collection and transport has been applied on a piecemeal basis in both Jakarta and Surabaya. After the successful demonstration cleaning of the Monas area in Jakarta by PT Sarana Organtama Resik (SOR) the city agreed to privatize 10 percent of its 261 sub-districts in 1988. The Dinas Kebersihan for DKI Jakarta has an inadequate supply of both manpower and equipment: they employ only 5,900 persons and own 685 trucks, despite an estimated need of 16,000 workers and 2,000 trucks. Thus, private coverage of twenty-seven sub-districts provides much needed additionality. Private firms bring 115 trucks manned by 2,000 people to the city's solid waste management system.

The privatization of solid waste collection and transport in Jakarta was not part of an articulated strategy. The impetus came from a dynamic and committed private firm (SOR), not the Dinas Kebersihan. Following the pilot project, five companies were awarded contracts for nine kelurahans by direct appointment in 1988. The bid process became more systematic and competitive in the next fiscal year: fourteen of the eighty-two firms which submitted tenders were awarded contracts after a review of their proposals and qualifications. The contract price is based on the cu. meter of waste hauled from residential areas, and per sq. meter for street sweeping services. The Dinas Kebersihan enjoys substantial savings - $100,000 per year - by utilizing private contractors in 27 kelurahans; however, further expansion of private coverage is constrained by insufficient funds.

In Surabaya, private firms transport 15 percent of domestic waste from temporary collection areas to final disposal sites. Three month contracts for transport have been directly awarded to six firms, at a payment rate of $.60 per cubic meter. Industrial and commercial enterprises, which generate over 2.5 cu.m. day of solid waste, are required to transport it directly to the disposal site. Street sweeping contracts, covering twenty percent of the total area, are currently given to 24 private companies by direct appointment. Local regulations limit the contracting period to only three months, but contractors with acceptable performance can expect regular extensions.

Leasing

Leasing is attractive to private firms because the high interest rates on loans and short contract periods severely limit their ability to make substantial investments in capital equipment. For the most part, the leasing of garbage collection and transport equipment has primarily occurred between private firms and the Dinas Kebersihan, not with truck companies. Government-owned equipment is leased to private firms in two Sumatran cities as well as in Jakarta. In turn these companies provide labor and are responsible for operations and maintenance. SOR is one of the few firms which has leased equipment directly from truck companies.

Transfer Stations

In cities where land shortages force the placement of the main disposal site on its outskirts, considerable inefficiencies arise in the transport of waste from the residential source to the final destination. The frequency of garbage removal from the temporary collection areas is limited by the distance trucks must haul the waste. The introduction of an intermediate transfer station would vastly improve the cost effectiveness of the physical system. The JICA master plan for Jakarta proposed the establishment of six transfer stations to consolidate the waste delivered by small trucks from surrounding districts into containers or silos which would then be transferred to the disposal site using container trucks or large trailers. So far, the Dinas Kebersihan has not been able to secure donor financing for the construction of the proposed transfer stations, but there are two private sector initiatives underway.

Sarana Organtama Transportasi (SOT) recently signed a ten year contract with the Governor of Jakarta to build a 1000 ton capacity transfer station in East Jakarta. The transfer station will receive waste from the districts managed by its sister company, SOR, but the remaining two-thirds capacity must be filled by the city. SOT plans to use a closed container system, with simple conveyor belts for sorting recyclable materials and labor intensive technology for converting the organic waste (70% of the total) into compost. SOT's director has secured a long-term loan from the International Finance Corporation for 70 percent of the $3 million investment, but does not have sufficient equity to begin construction.

A contract for a second transfer station is currently being negotiated between the city of Jakarta and PT Multi-Container. The firm proposes to introduce a hydraulic system in which waste would be compacted into silos and then transported to the final disposal site. The current design calls for 550 silos, with a capacity of 600-1,000 tons/day, which would require a total investment of US $4 million (including the purchase of land and other equipment). Unlike the SOT/SOR operations, Multi-Container will only provide transfer and final transport service, not neighborhood collection. In general, the container system is more appropriate than hydraulic compaction because of the wet consistency of the waste stream and the need to remove valuable recyclable materials.

Disposal

Informal Recycling

For the past five years the Center for Policy and Implementation Studies (CPIS) in Jakarta has conducted several studies of the city's extensive informal recycling business. On a daily basis scavengers collect 35 kg of recyclable materials - including plastics, glass, paper, and metals - from household bins and open dump site. They sell their recyclables to entrepreneurs, who run small sorting and cleaning operations, called lapaks, usually situated beside a temporary collection area. Entrepreneurs known as bandars specialize in sales of one material which they buy in bulk from lapaks, offices and factories, and transport to factory suppliers. Because of the tight quality control implemented at the lapak level, few materials have been rejected as unacceptable by the factories.

CPIS estimates that approximately 80 percent of the recyclables in the municipal solid waste are recycled by this informal network. The easiest entry into the system is through scavenging, for which the daily earnings are higher than the wages of at least one-third of Jakarta's formal sector employees. By forming allegiances with one or two lapak owners, scavengers also receive fringe benefits, such as advances, housing, and free use of hand carts. The small scale of operation and labor intensive tasks facilitate upward mobility; many of the 2,000 lapak owners were previously scavengers. Daily turnover at lapaks averaged about $100 in 1988, with net profits at $16 per day. The successful operation of this recycling system is predicated on the existence of open temporary collection areas, which are the site for extensive scavenging, sorting and cleaning of materials. A shift to container or compactor collection would force the relocation of recycling to either the intermediate or final disposal site, and thereby eliminating much of this informal employment, as well as increasing the total volume required to be transported.

Informal Composting Enterprises

Given the profits already realized in recycling, CPIS decided to investigate whether the organic component of the waste stream had any economic value. In November 1989,

they established an experimental Enterprise for Recycling and Compost Production (ECRP) in order to: develop a composting technique appropriate for Indonesia; study the costs of production; and provide the relevant training. The results of this pilot project are discussed in Section 3.3.3.

Commercial Compost Plants

Two private firms are pursuing plans to develop large scale composting plants in Jakarta. PT Tri Naga Terra has signed a fifteen year contract with the Governor to build a humic acid and compost production plant which would be capable of processing 400 tons of garbage daily. The terms of the contract allow the firm a three year grace period, followed by annual payments of $500,000 per year until year six, after which the firm must contribute 10 percent of its profit to the city. In addition to the composting, PT Tri Naga Terra plans to institute mechanical selection of glass, plastics and metals for recycling. The total investment required, including the purchase of twelve hectares of land at the major city dump, is US $20 million. Humic acid is currently being produced by a private firm, PT Tri Utama Jinawi, in Semarang but they are experiencing marketing difficulties. PT Tri Naga Terra obtained the know-how for humic acid processing from the latter firm, but they will not break ground on their own plant until a demand for the product has been established. Another firm in Jakarta plans to operate on an even larger scale: PT Arthaguna holds a contract to convert 1000 tons of waste into fertilizer. This project requires an investment of $54 million of which a substantial portion will be provided by German firms.

A private firm attempted to produce compost under a franchise agreement with the city of Surabaya. The firm failed to realize a profit because it employed a relatively capital intensive European composting system which was not cost competitive in Indonesia. Twenty thousand tons of compost were stockpiled and sold for years afterwards, although production ceased in 1985.

Incineration

It is widely acknowledged that incineration is inappropriate for the predominantly organic waste stream in developing countries. Despite the high moisture level and low energy content of Surabaya's waste, the Dinas Kebersihan recently purchased and installed an incinerator plant. The plant is now operating but has not been fully accepted from the contractor. The total cost of the incinerator (including plant, installation, start-up and a ten year management contract) is approximately US $18 million, more than the agency's total routine budget for the last fifteen years. The municipality is currently defraying costs by accepting bilge from oil ships which facilitates the combustion of the wet waste stream; a combination which produces extremely toxic fumes.

3.3 Scope for Further Private Sector Participation

Collection and Transport

- It is ironic that the Dinas Kebersihan in Jakarta, which has one of the worst cost recovery records, is one of the pioneers in contracting for garbage collection and transport. However, budget constraints prohibit the agency from expanding this effort. Regional enterprises (Perusahan Daerahs) are the best suited for the development of model service contracts as one PURSE demonstration project. The financial autonomy of the Perusahan Daerahs makes fee collection and cost control top priorities. Now that the recently converted regional enterprises in Bandung and Medan have considerably improved their revenue streams; they are ideal candidates for demonstrating the cost benefits of contracting to private sanitation firms.

The current practice of collecting and disposing waste at open dump sites, and transport by open dump trucks, is both environmentally unsafe and inefficient. Once the waste is accumulated at the temporary dump site, it is rifled through by scavengers, exposing them to hazards such as broken glass, metals, and disease spread by insects, vermin and rodents. Studies have shown that infant and child mortality and morbidity rates are extremely high among scavengers. Garbage workers are also exposed to these health risks through their manual loading and unloading of waste at the temporary and final dump sites. A closed container system would eliminate these environmental hazards. Furthermore, the unit costs of the manual/open dump truck system are considerably higher than those for a closed container system: $15/ton compared to $8.5/ton respectively (JUDP III Staff Appraisal Report 1990).

Solid waste management agencies/enterprises could shift to a closed container system by requiring the use of specific equipment in contracts with private firms. In order to encourage the private sector to invest in containerized transport, the contract period would have to match the economic life of the equipment, approximately 4-5 years. In cases where the private firms do not have the financial capability to invest in new equipment, they could lease the trucks from either the public agency or private transport companies. A second demonstration project in service contracts could promote this shift in collection/transport technology. Such an experiment would be most appropriate in Jakarta, where a private firm (SOR) has already expressed interest in investing in a container system and the Dinas Kebersihan has accumulated some experience in contracting.

Transfer Stations

Master plans for Indonesia's largest cities (population greater than 500,000) have promoted the establishment of intermediate transfer sites in order to improve the overall

efficiency of the solid waste system. These plans remain on the shelf because of the prohibitive capital investment required. In Jakarta, private construction of two of the recommended six transfer stations cannot begin until sufficient financing is secured. Private firms will recover their investment through take-or-pay contracts with the municipal agency. In addition, transfer stations are a potential site for recycling and composting activities. In order for recycling to be profitable, a closed container system must be in place so that recyclables cannot be easily removed at the temporary collection area by scavengers. Ideally, the company which ran the transfer station would also hold a contract for transport in the surrounding neighborhoods. This would encourage their investment in demonstration containers and trucks - a system which vastly improves efficiency and the quality of the urban environment.

Disposal

Compost

Although there is considerable private interest in composting at all levels of the solid waste system, the profitability of these ventures is uncertain. The demand for compost remains unknown because the agricultural community buys heavily subsidized fertilizers. The success of compost operations at one level in the system directly threatens the viability of composting at higher levels. On the one hand, compost processing at the temporary collection area, such as the existing ERCP, would reduce the organic waste transported to the transfer station. On the other hand, the use of a container system for transport of waste to the transfer station would eliminate any neighborhood enterprises. In Jakarta compost operations have already been established at the sub-district level, one is soon to follow at a transfer station, and lastly at the final disposal site. In this experimental stage, the Dinas Kebersihan could reduce competition between the small and medium sized businesses through zoning. For example, ERCPs should not be licensed in East Jakarta - site of the first proposed transfer station.

In general, the prospects for ERCPs are quite limited. Even the largest ERCP can only process 4.5 ton of refuse daily, less than 1 percent of the garbage generated. The CPIS determined that ERCPs could produce compost profitably at the current price in Jakarta; however, transportation costs were not included in the analysis. The impact of this oversight is minimal if there is a potential market for compost in the immediate locality; however, transportation from inner-city enterprises to outlying agricultural areas would be exorbitantly expensive. The CPIS has suggested that the ERCP be managed by a private firm responsible for garbage collection in the sub-district; but transport companies complain that economies of scale cannot be realized at this level. Thus one would tentatively conclude that an integrated transport-transfer station system which served several sub-districts would be the best candidate for compost operations. A medium sized business is also better positioned for financing the marketing campaign which is necessary to stimulate sufficient demand.

Landfill

In the long term, private firms may be interested in gas recovery from sanitary landfills. Presently, the Perusahan Daerah in Bandung operates the only sanitary landfill in the country. Open dumping is the most common final disposal method. This practice allows landfill gas to escape into the atmosphere and the soil, causing environmental problems as well as wasting a valuable resource. Most of the landfill gas systems in the U.S. have been developed under royalty contracts by private firms. The private developer builds and operates the system, and turns over a percentage of its gross revenues to the landfill owner, typically the municipality. A feasibility study should be done to estimate the potential for gas recovery as sanitary landfills are established in major cities. The study could also identify possible gas developers interested in the existing sanitary landfill in Bandung.

Incineration

There is some concern that Surabaya's recent receipt of the prestigious Adripura award for being the most beautiful and clean city - immediately following the opening of its new incinerator - will encourage other cities to commit the same folly. The project should make every effort to dissuade municipal agencies or regional enterprises from investing in such an inappropriate and expensive disposal technology.

3.4 Key Issues

Adhoc Contracts between Dinas Kebersihan and Private Firms

The experience of contracting garbage collection services to the private sector in Jakarta has been mixed. On the one hand, the majority of the firms which were awarded cleaning contracts had no previous experience in sanitation so it is not surprising that two firms have already been dismissed for inadequate collection. On the other hand, the firm whose exemplary pilot performance persuaded the Governor to implement minimal privatization in Jakarta, has continued to provide high quality services.

The reason for this disparity lies in the size and length of the concession. Most contracts awarded by the Dinas Kebersihan are for only one sub-district for one year. Under these terms private firms neither have an incentive nor the means to invest in the appropriate capital equipment. Banks will not approve loans for trucks because it takes at least three years to pay back and the firm has guaranteed revenue for only one year. It is not surprising then that most firms lease second hand dump trucks which are frequently inoperable. In addition, economies of scale cannot be realized in such small service areas. The financial survival of most firms is predicated on paying very low wages, which reduces labor productivity. Inadequate capital equipment and poorly motivated personnel could easily describe the operations of the Dinas Kebersihan. In

fact, the majority of private firms perform no better than the best public sector operations.

Although the record of private garbage collection companies is poor, the relative success of SOR suggests that the problem lies in the prevailing contractual arrangements. Unlike the other firms active in Jakarta, SOR received a five year contract for seven sub-districts after clearly demonstrating an expertise in sanitation. Because of its high profile in cleaning Blok M and Monas on pilot basis, followed by the management of protocol areas, SOR has a direct line to the Governor of Jakarta. This access has provided SOR with the security to make substantial investments in both physical and human capital. Furthermore, when costs have risen during the contract period, SOR has received payment increases through direct negotiation with the Governor. Despite its enviable position relative to other garbage collection firms, SOR is not reaping huge profits because of underutilization of equipment and staff. The company director maintains that SOR could double its service coverage - and profit - without significantly increasing its current capacity.

Clearly an overhaul of contractual procedures is warranted in order to best capture the efficiency benefits of private sector participation. First, pre-qualification for firms with an expertise in sanitation should replace the current arbitrary selection process. Second, the concession size must be larger and longer in order to attract firms which will provide high quality service. Contract periods of three-five years would encourage firms to invest in capital equipment, maintenance facilities, and training of personnel. Competitive bidding may only be possible in cities with a population of 500,000 plus, where the service area is large enough to achieve economies of scale. Third, contracts must include clear terms of reference and performance standards. The scope of work should include definition of the contract area, services to be performed, waste type and quantities to be collected and disposed. Firms would be evaluated on their use of appropriate equipment, frequency of collection, cleanliness in the contract area and along transport routes, and the level and reliability of service. Penalties for non-compliance would also be built into the contract. Lastly, contract prices should be based on a fixed sum plus a unit charge for waste actually disposed at the landfill. In order to assure private firms sufficient income to operate at profitable scale over the life of the contract, a mechanism for adjusting payment levels to cover rising costs must also be established.

The experience with contracts designed and administered by the municipal agencies suggests that clear guidance is required from the central government. The Ministry of Home Affairs should issue legislation which explicitly delineates the services eligible for contracting to the private sector; followed by the development and dissemination of model contracts - based on the guidelines set forth above - to the responsible agencies/enterprises.

Cost Recovery in Solid Waste Management
(See Cerverro 1991 for a full analysis of this issue).

Substantial recovery of operations and maintenance costs is directly linked to specific fee collection strategies rather than the financial autonomy of the responsible SWM institution. In general, Dinas Kebersihans have no reason to actively enforce payments of the solid waste tariff because their operations are heavily subsidized by the local government. The Dinas Kebersihan in Jakarta is one of the worst performers, they collected only Rp. 1.3 billion against a routine and development budget of Rp. 26 billion. The Dinas Kebersihans in Bogor and Surabaya are exceptions to the rule. Revenues in Bogor rival those of Jakarta, despite the significant difference in population - 600,000 vs. 8 million respectively. Likewise, Surabaya, a city of 3 million people, receives Rp. 4.5 billion annually. The success of these two municipal agencies in achieving respectable cost recovery rates lies in their fee collection strategy.

The Dinas Kebersihans in Bogor and Surabaya were the first cities to attach the solid waste tariff to the water bill. In one year, the recovery of O&M costs rose from 50 to 70 percent in Bogor, and even more dramatic - 6 to 55 percent in Surabaya. The cost recovery rate is 56 percent in those cities, such as Manado, Padang, and Balikpapan, which have linked payment to the water bill, compared to 29 percent for cities of the same population without PDAM cooperation. On the one hand, the advantage of this strategy is that SWM and water supply are both under the jurisdiction of local government which facilitates coordination. On the other hand, the disadvantage of linking payments for the two services is that the PDAM does not have as extensive a clientele as the Dinas Kebersihan.

The cost recovery rates of the Dinas Kebersihans in Bandung and Medan increased significantly after their conversion to Perusahan Daerahs. In two years, the coverage of O&M expenditures rose from approximately 20 percent in both cities to 55 percent in Medan and close to 100 percent in Bandung. Since the PDKs were weaned from municipal subsidies, they each vigorously pursued revenue generation - although through disparate means.

The Bandung PDK has informally linked the solid waste tariff to the electricity bill by stationing a PDK fee collector at the PLN payment point. Bogor, Tasikmalaya, Ambon, Banjarmasin, and Sukabumi have since adopted the same strategy. The advantage of this approach is that the vast majority of households receive electricity and pay their bills vigilantly. Although the PLN has provided the PDKs with their computerized customer lists, they are resistant to formally attaching the SWM tariff to the electricity bill. It remains unclear whether the PLN will disconnect power to households which have paid for its service but not waste disposal. The viability of the combined "payment point strategy" is threatened if there are no repercussions for failure to pay the SWM tariff.

The solid waste tariff, which is applied to either the water or electricity bill for waste transport and disposal, is in addition to the fees already charged by the village chief (lurah) for initial household collection. Instead of installing a second tariff structure on top of the traditional system, the PDK in Medan has entered into Memorandums of Understanding with the Lurah which specify monthly revenue targets to cover the costs of the entire SWM chain. The Lurah keeps ten percent of the target revenues, and any portion above that level. The rationale behind this approach is that the responsibility for collecting SWM fees falls on the most influential community leader. Preliminary results reveal a 92 percent target achievement rate for the pilot sub-districts, compared to an average of 34 percent for the entire city. Although it is premature to evaluate this innovative strategy, its promise lies in the simplicity of a single tariff structure and the use of community pressure.

The conversion of Dinas Kebersihans into Perusahan Daerahs in Bandung and Medan was the impetus for their intensive efforts to increase revenue generation; however, the experience in Surabaya and Bogor suggests that it is not the organizational structure which matters as much as the fee collection strategy. Nonetheless, the conversion of Dinas Kebersihans in the other nine cities with populations above 500,000 (including Surabaya and Bogor), should be expedited in order to stimulate cost recovery in the solid waste sector.

Before the Dinas Kebersihans are granted financial autonomy as PDKs, the Ministry of Home Affairs should be prepared to assist them in developing an appropriate fee collection strategy. The linkage of the solid waste fee to the water bill appears weak for the following reasons: one, a sewerage tariff may be added in the future; and two, the PDK serves far more households than are covered by the PDAM. The attachment of the solid waste tariff to the electricity bill has greater potential; however, its long term viability requires more formal cooperation with the PLN. Instead of individual PDKs approaching the state enterprise, a consistent nationwide policy should be developed by the Ministry of Home Affairs and PLN officials. If the revenue-sharing arrangements between the Lurahs and the PDK in Medan prove successful, the Ministry of Home Affairs could standardize the experimental Memorandums of Understanding for adoption in other locales. However, the influence of the lurahs dissipates in megacities like Jakarta. Overall, the Ministry of Home Affairs should develop guidelines - or even a national policy - for SWM fee collection, before granting financial autonomy to Dinas Kebersihans.

Autonomy of the Perusahan Daerah Kebersihans

Theoretically, regional enterprises have greater autonomy than municipal agencies. In reality, the PDKs have weak authority in setting solid waste tariff levels, recruiting suitable technical personnel, and defining their scope of work. Cost recovery is particularly difficult when the solid waste charges are not systematically linked to operational costs. The provincial government determines a rate per cubic meter of waste

disposed, and protracted negotiations are required for any modification. This has contributed to the PDKs' inability to interest private companies in garbage collection because they cannot profitably operate on an outdated flat rate set by the government. For example, in Bandung the average non-domestic solid waste fee of Rp. 4,650/cu.m was set in 1986, but costs have since doubled. In its early years, the Bandung PDK tried to displace the neighborhood system and collected waste and fees directly from households; however, this initiative failed because assessment of charges had to be based on the cross-subsidy principle.

One advantage of PDK status is that the enterprise has greater independence in receiving loans from donors and banks for investment in capital equipment. On the personnel side however, the PDK has little room for maneuver. The top managers of the PDK are civil servants, drawn with reluctance from the municipality. Because they are government employees, they cannot refuse their appointment to the PDK by the mayor. Furthermore, the general manager of the PDK does not have the authority to dismiss his assistant directors in finance and operations, regardless of their job performance. Neither the directors nor their staff have a background in sanitation and/or business management, and they are not allowed to independently recruit qualified personnel. The PDK director in Bandung takes on "trainees" until the municipality agrees to formally hire them. Although they recognize the need to provide management training to their staff, the investment in human capital is soon lost as freshly qualified personnel leave for higher salaries in the private sector. The ability to attract and retain skilled manpower is thus another incentive for the PDK to improve revenue generation.

Lastly, the PDKs autonomy from the municipal government is nominal rather than actual. The local government continues to expect free services from the PDK; for example, in Bandung, 20 percent of their expenditures were for the provision of such unprofitable services as drainage cleaning and street sweeping to the municipality. The municipality continues to subsidize part of the PDKs operations, but this will be phased out completely in the next four years. The PDK is concerned that after the subsidies have been eliminated the municipality may not pay for the current services it receives. In fact, the PDK fears that the management of sludge from wastewater treatment plants may also fall on its shoulders if regulation on industrial waste is not issued post haste. Zoning is another area of contention between the PDK and the local government: they have been involved in prolonged negotiations concerning the location of container sites, sanitary landfills and potential transfer stations.

In order for the PDKs to operate effectively the institutional responsibilities for various aspects of waste management must be firmly established by the Ministries of Home Affairs, Public Works and Environment/Population. Once their scope of work has been clearly defined, the autonomy of the PDKs must be strengthened particularly with regard to the setting of solid waste tariffs and personnel management.

ANNEX A - 3(B)

TRAINING AND COMMUNICATIONS ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

ANNEX A - 3(B)

TRAINING AND COMMUNICATIONS ANALYSIS

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ANNEX A - 3 (B)

TRAINING AND COMMUNICATIONS PLAN

I. Introduction

The PURSE project is designed to increase the participation of private sector companies in providing three types of urban services in Indonesia: water supply, wastewater treatment, and solid waste management. Today, each of these services is either exclusively or predominately provided by government. Water, in particular, is regarded as a public resource and must, under the Constitution, be "controlled by the State and shall be made use of for the people." There is a complex and extensive set of government institutions responsible for supplying potable water; this bureaucracy is gradually assuming responsibility for wastewater treatment, also. Although there is considerably more private involvement today in solid waste management than in the other two sectors, the solid waste sector is still dominated by government agencies.

Thus, the PURSE project is part of an ambitious agenda: to change the structure of three important sectors of economic activity; to change the attitudes of civil servants toward their own jobs, responsibilities and authority; and to help create a foundation for positive and productive relationships between civil servants and private entrepreneurs. Such changes do not happen quickly. Participants in both the public and private sectors must learn new skills and have new information. More importantly, they must reform existing attitudes about themselves and about each other. The Training and Communications component of the PURSE project will address all three of these dimensions of change: improving skills, conveying information, and changing attitudes.

The Training and Communications Program consists of four related parts.

A Public/Private Forum will promote regular and effective communication between government officials and private entrepreneurs. Meetings will address a wide range of policy and technical topics that are central to building a functional relationship between the public and private sectors, including procedures for project identification and development, announcements of specific projects in which the GOI is soliciting private participation, terms and conditions of public/private agreements, mechanisms for government oversight and regulation of private activity, and lessons learned from the PURSE demonstration projects.

An **In-Country Training Program** consisting of workshops and short courses will be directed to participants from both the public and private sectors. The Training Program will have two components:

> Guidance for Public/Private Partnerships will use workshops to teach participants how to form and operate public/private partnerships. Topics will include procedures for developing projects and for analyzing their commercial and technical feasibility; how to use model contracts and negotiate terms specific to individual projects; technical standards private parties must meet and mechanisms for government oversight; and procedures for setting and revising prices for services. The workshop curricula and materials will be developed using PURSE project resources.
>
> Technical and Managerial Skills will teach participants the technical skills needed to deliver urban environmental services, and the managerial and financial skills needed to sustain a viable business. Topics will be determined based on needs identified during the project. Existing sources of courses and course materials will be used to the extent possible for these training activities.

A **Formal Overseas Training Program** will include both short and long term study. Six Master Degree programs for GOI officials, and 84 short courses or seminars for both public and private participants will be provided under the project.

A **Research and Evaluation Program** will ensure that GOI officials and private entrepreneurs are actively involved in research to support the policy agenda and in evaluating the PURSE demonstration projects. The research program will address issues of pricing, subsidies, the investment gap, willingness to pay and the commercial viability of private investment in infrastructure. Evaluations of demonstration projects will include rigorous and quantitative assessments of construction and service quality, private project costs and profitability, benefits to consumers in terms of efficiency gains and to the GOI in terms of costs avoided, and the success or failure of contractual terms and oversight mechanisms. Results from research studies and project evaluations will be incorporated into programs of the Public/Private Forum and workshops offered in the Training Program.

The recommended Training and Communications Program has been developed based on a careful analysis of how current conditions differ from the desired outcomes of the PURSE project, and on the role that training workshops and public/private dialogue can play in promoting the desired outcomes. This analysis is presented below in Section II. Section III describes the three components of the recommended program and describes how training performed under the PURSE project should be coordinated with existing institutions to maximize the potential for sustaining these activities beyond the

II. Desired Outcomes, Current Conditions, and the Role of Training and Communications

This section presents the analysis of desired outcomes and current conditions that underlies the recommended Training and Communications Program. The analysis is displayed in a series of thirteen tables. The first entry in each table is a desired outcome of the PURSE project; each desired outcome has been derived from the end-of-project status indicators included in the PURSE logframe. The next entry is the current status of attitudes and skills that are relevant to the desired outcome. The remaining information in each table describes how the three training and communications components will support the desired outcomes. A fourth column in each table identifies how discussions held within the GOI as part of the policy agenda, technical assistance and demonstration projects will relate to the training and communications program.

In reading the material below on current conditions, readers should remember that civil servants and GOI ministries are not monolithic institutions; they include individuals with a broad range of skills and attitudes, some of whom will support the goal of the PURSE project and others who will resist it. The PURSE design team has conducted interviews with a reasonable number of senior officials; implementing the project, however, will undoubtedly require substantial involvement with a much larger number of GOI officials and civil servants. Although certain conditions and attitudes occur widely enough to warrant attention from the PURSE project, none of the conclusory statements about current conditions is universally true.

Desired Outcome No. 1:

GOI officials and managers of government enterprises see private sector participation in urban services as a solution to their important problems and as a change that will expand their responsibilities and enhance their stature.

Current Condition

Many officials and managers see private participation as a threat to their authority and stature, inappropriate for providing public services, and risky because private provision of urban services is not commercially viable.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Briefings for mixed public/ private audiences substantiate the potential role of the private sector with results from research program; meetings give private sector an opportunity to express its interest, helps GOI officials see private firms as potential partners with a genuine interest in expanding infrastructure and providing reliable services	Senior/central officials communicate to jr/regional officials that they can enhance their jurisdiction and stature by using private firms to build new facilities and improve services	More detailed workshops present the same results and teach officials the conceptual framework underlying the analyses, to generate greater confidence in the results	Develops more reliable estimates of the investment gap for each sector; determines how much private investment can be sustained with GOI assurances; determines the additional revenue a PDAM could generate by filling existing requests for water/sewer connections; estimates the gains in efficiency needed to justify use of private investments and service contracts.

Desired Outcome No. 2: GOI officials and managers of government enterprises recognize opportunities to use private sector mechanisms to enhance urban services; managers have more autonomy to take advantage of such opportunities.			
Current Condition: Few examples of organized private participation in water supply and wastewater treatment, so officials do not recognize opportunities; central ministries and local governments control decisions by manager of government enterprise; managers need guidance as well as more autonomy.			
Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Highlights examples from PURSE demonstration projects and other sources; private sector participants convey what opportunities and incentives must be present to warrant their interest	Highlights examples from PURSE demonstration projects and other sources	Workshops teach public officials and private entrepreneurs how to recognize situations in which private participation is appropriate	

Desired Outcome No. 3:

Private entrepreneurs can work with GOI officials and managers of government enterprises to calculate a tariff that will return all of a firm's costs plus a reasonable profit; government policy and procedures allow different tariffs in different areas, based on true costs.

Current Conditions:

GOI does not have information required to calculate the true cost of services provided by government enterprises; pricing procedures for enterprises formally include all cost elements, but some costs are not captured; present policy requires uniform pricing of services across areas with different costs and differing willingness to pay.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Discussions help GOI officials recognize costs that are now hidden, understand that private firms must recover all costs and a profit, and that costs differ among areas.	Senior/central officials communicate to jr/regional officials that the price of service from a private firm must reflect full costs and profit, and that this price is an acceptable cost to the government of the service being provided	Teach public and private participants how to calculate full cost of services provided; communicate results of research program re current costs and potential for paying profit out of productivity gains	Summarize current pricing practices in PDAMs and other gov't enterprises; estimate full costs of service being provided by government entities; determine the efficiency gains needed to pay a reasonable profit without increasing cost to the public

Desired Outcome No. 4:

GOI officials and civil servants understand the government and public interests they are obliged to protect, and feel they can protect these interests using regulatory oversight and enforceable contracts.

Current Conditions:

Many officials do not distinguish between GOI interests (e.g., maintaining status quo) and public interests (good service at reasonable price); the concept of "regulating" a private party is not understood; commercial law, including power to enforce contract, is poorly developed.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Discussions clarify what obligations and oversight mechanisms public officials need and private partners will accept, and the private sector need for certainty and established procedures; discussions should distinguish between government and public interests	Discussions result in clear and separate lists of public and government interests public officials feel they need to be able to protect	Workshops and courses teach both public and private participants how government can monitor technical operations, check compliance w/ standards, audit costs, and review customer complaints and service cutoffs	Examination of utility regulation schemes in other countries produces a list of obligations commonly assumed by private partners and the oversight mechanisms used by governments

Desired Outcome No. 5:

Regional and local officials provide necessary oversight of private firms without undue interference; oversight includes monitoring the firm's compliance with contract terms, design specifications and regulatory standards, fair and competent review of private partner costs to support price adjustments. Government entities establish and abide by a clear delegation of authority for oversight activities.

Current Condition:

Local government officials control/interfere with decisions by managers of government enterprises responsible for urban services; oversight includes only cost and tariff review, not compliance with contracts, specifications and regulations; delineation of authority is clear in principle but more complicated in practice.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Highlight examples of appropriate oversight and undue interference; discuss oversight relations and patterns that emerge in demonstration projects	Review oversight operations; identify appropriate and inappropriate oversight; establish and maintain clear delegation of authority for oversight	Repeat training on public interests and oversight mechanisms as needed; incorporate lessons learned from demonstration projects	Review experience of regional and local governments in oversight for demonstration projects to identify successes and problems

Desired Outcome No. 6: **The process by which GOI entities identify, develop and tender projects for private sector involvement operates smoothly.**			
Current Condition: Most GOI experience with tendering projects is in turn-key contracts for roads and power; the process for power is still being developed and tested.			
Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Clarifies what information private firms need to evaluate projects; public and private participants discuss problems in the process		Teaches civil servants and private consultants how to develop and package a project to meet needs of potential private investors	Examine processes the GOI uses in other sectors, use these as a basis for defining process to be used in urban services

Desired Outcome No. 7:

Urban services projects tendered by GOI entities attract qualified Indonesian investors and contractors.

Current Condition:

Many Indonesian firms are involved in the solid waste sector; banks have collected tariffs for water; contractors have been involved in large construction projects, but not in on-going operation. Trade associations are current network for arranging projects.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Identify qualified Indonesian firms and include them in the Forum; provide them with information on potential projects		Solicit and support participation by small and mid-size Indonesian firms in workshops on project development, technical and managerial skills	

Desired Outcome No. 8: **Private firms build and operate new facilities that perform according to design specifications.**			
Current Condition: Road construction contractors, especially in rural areas, have had trouble building roads that meet specifications; not clear what experience is in other types of projects.			
Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Public and private participants discuss nature and causes of problems in quality of construction and operations; help identify solutions	GOI officials share information across organizational levels on quality of construction and operations, based on oversight activities	Facilitate participation of private participants in existing courses on technical and managerial skills; revise curriculum to address problems identified in demonstration projects	Evaluations of demonstration projects assess quality of construction and operations, identify causes of poor performance

Desired Outcome No. 9: **Private firms provide competent and effective services under contract to government enterprises.**			
Current Condition: Government enterprises do not contract out for services; most managers of enterprises do not want to contract for services; when they do, local government officials resist their attempts to do so.			
Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Public and private participants discuss nature and causes of problems in quality of services, help identify solutions	GOI officials share information across organizational levels on quality of services from private partners	Project uses existing courses to teach private participants how to perform specific technical, administrative and managerial functions	Evaluations of demonstration projects assess quality services delivered, identify causes of poor performance

Desired Outcome No. 10:

Small and medium-sized Indonesian investors feel comfortable negotiating and concluding contracts with GOI entities.

Current Condition:

No models for contracts; small and mid-size businesses are at a disadvantage negotiating with the government because of expertise, access to information, and because terms may not be enforceable against the government.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Small and mid-size Indonesian firms participate in forum discussions, gain greater understanding of government's needs and procedures		Workshops teach public and private participants how to use model contracts and negotiate terms specific to individual contracts, and methods for government oversight	Evaluations of demonstration projects examine efforts made to involve small and mid-size Indonesian firms

Desired Outcome No. 11:

Private Indonesian consulting firms are capable of supporting the full range of activities involved in identifying, developing, and packaging projects in a manner that will satisfy private sector needs for complete and reliable information.

Current Condition:

GOI identifies potential projects based on need, not commercial viability; feasibility analyses by consulting firms have inadequate financial analysis; GOI does not develop and package projects sufficiently and uses aid donor funds to support development of large projects--local firms, therefore, have little experience in this.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
		Workshops teach public and private participants how to perform each step of the process; PURSE staff supervise analyses performed by local firms under subcontract	Determine whether providing services under subcontract to PURSE improved the ability of Indonesian consulting firms to support development of public/private partnerships

Desired Outcome No. 12: **Domestic banks are prepared to make loans to domestic investors to support construction projects in urban services.**			
Public/Private Forum	Intra-GOI Forum	Training Program	Research and Evaluation
Bank officials are invited to be regular members of the forum		Include bankers in workshops on the project development process, methods for analyzing commercial viability, and government assurances and oversight measures included in contracts	Estimate changes in the amount of capital being provided by domestic banks for private projects in urban services

Desired Outcome No. 13:

Public and private partners conduct careful financial, economic and regulatory evaluations to demonstrate that private investment and service contracts are more cost-effective than public provision of urban services, in terms of cost to the consumer, quality of product, and reliability of service. Evaluations identify successes to be replicated and problems to be solved.

Current Condition:

No history of joint public/private evaluations of projects; available information is insufficient for determining cost-efficiency of urban services provided by public entities, for purposes of comparison; local skills are inadequate in financial analysis; regulatory and contractual analyses may be new for participants.

Public/Private Forum	Intra-GOI Discussions	Training Program	Research and Evaluation
Use research results in forum discussions	Use research results in intra-GOI discussions	Convey results from evaluations and methods used in evaluations in workshops for public and private participants	Conduct technical, financial, economic, and legal/ regulatory evaluations of demonstration projects

III. Description of Program Components

A. The Public/Private Forum

One of the most difficult challenges to making public/private partnerships work in Indonesia is increasing the dialogue and degree of mutual understanding between people in the public and private sectors. A workshop held in Bali to discuss prospects for partnerships in water supply dramatically revealed the need for more extensive and more effective communication between private entrepreneurs and GOI officials. The meeting was an important opportunity for representatives of private firms to describe the changes they feel are needed in GOI procedures and regulations. For GOI officials, the meeting was an opportunity to learn what information and assurances must be provided to private firms to motivate their interest in projects. The meeting also revealed that a great deal of work will be needed to prepare GOI regional and local officials to change their perspective from that of direct service providers to regulators of private sector activity.

The Public/Private Forum will consist of local meetings and annual conferences to promote communication between GOI officials at various levels of government, including the managers of government enterprises, and private entrepreneurs.

- Local meetings will be one-day sessions involving 20-40 people. Forty meetings will be held in each of three locations (Jakarta and two other cities in which demonstration projects are conducted). Each meeting will be organized around a specific topic. PURSE project staff will develop materials for the meetings and identify persons to be invited; as much as possible, the programs will be lead by participants rather than by PURSE staff.

- An annual national conference will bring together Forum participants from the three local meeting locations. The conference will involve up to 100 people and will last two to four days. PURSE staff will develop the program and organize the meeting; public and private participants will be encouraged to play as great a role as possible in planning the conference as well as leading sessions during the conference.

Local meetings and annual conferences will address topics such as the following:

- GOI policy on private participation in urban services;
- procedures the GOI will use to identify, develop and tender new projects;
- information needed by private sector participants to evaluate new projects;
- announcements and descriptions of new projects GOI entities are offering for private participation (both investment and service contracts);
- results of studies conducted as part of the policy agenda on current costs of urban services and public willingness to pay;
- terms and conditions to be included in model contracts;

- procedures and contractual terms for setting initial prices, evaluating cost data, and revising pricing formulas as needed to reflect changes in costs to the private partner;
- procedures GOI entities should use for monitoring and regulating the activities of private partners; and
- lessons learned from PURSE demonstration projects.

To promote the long-term sustainability of both of these activities, responsibility for planning, organizing and leading the local meetings and the annual conference should gradually be shifted from PURSE project staff to public and private participants in the Forum. Informal or formal associations of participants may arise from Forum activities, and should be encouraged. If participants find the information and communication networks that arise from Forum activities to be valuable, they should eventually be willing to continue the activities using their own effort and funding.

The following table recommends the level of support the PURSE project should provide to Forum activities. The initiation of local meetings should be phased across the three locations, using approximately six months of lead time to identify participants and organize the meetings. This phasing and preparation will allow local meetings to start in Jakarta during the third quarter of the first project year, in Location 2 during the first quarter of the project year, and in Location 3 during the third quarter of the second project year. For the annual conference, the project should bear the full costs in the first two years and then require cost-sharing for an increasing percentage of costs, via direct funding from public and private organizations or attendance fees.

TABLE A

Forum Event	Type of Support	Year of Project					
		1	2	3	4	5	6
Local Meetings	number of meetings supported by project						
Jakarta		2	4	4	2	2	0
Location 2		0	4	4	4	2	0
Location 3		0	2	4	4	2	0
Annual Conference	percent of costs borne by project	100%	100%	75%	75%	50%	25%

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B. The In-Country Training Program

Because of the long history of GOI dominance in the urban services sectors, the government and its potential private partners do not have models for working together. Many aspects of the relationship involved in public/private partnerships need to be worked out; procedures need to be established to form and sustain partnerships; and people need to be trained to use these procedures. Furthermore, because private firms have not been involved in urban services (except the low-end of the solid waste sector), its personnel need training in technical and administrative skills relevant to urban services. The PURSE training program will use workshops and short courses to train public and private participants in the procedures needed for public/private partnerships and in the skills needed to deliver urban services efficiently.

The PURSE project design anticipates that procedures for establishing public/private partnerships, model contracts, and other related products will be developed during the course of demonstration projects, policy dialogue with the GOI, and Public/Private Forum. Under the general heading Guidance for Public/Private Partnerships, the PURSE training program will use these products to prepare and deliver workshops on the following topics.

- The Project Development Process will be a 2 day workshop to familiarize participants with the procedures the GOI will use to identify, develop, and tender projects, evaluate bids, and select private partners.

- Model Contracts and Pricing Procedures for Urban Services will be a 3-4 day workshop to review in detail the terms and conditions of model contracts. The course will explain standard terms of all contracts and identify those terms and that should be unique, and therefore should be negotiated, for each partnership. Duties and obligations of each party, assurances provided by the GOI, formulae for calculating the price of services to be charged by the private partner, and procedures for handling disputes will all be addressed. It may prove appropriate to prepare separate, shorter workshops to address water supply, wastewater treatment, and solid waste management separately.

- Monitoring and Oversight Procedures will be a 2-day workshop to explain how the GOI will monitor the actions and performance of private partners and ensure compliance with the terms and conditions of contracts. An important aspect of the course will be to identify those interests the government should protect and is entitled to protect through its contract, and to describe how responsibilities for oversight will be allocated among different levels of the GOI.

- Cost Analysis and Pricing Adjustments will be a 3-4 day workshop to train participants in evaluating the costs incurred by a private partner during

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performance of its contract, determining the reasonableness of those costs, and determining what adjustments to the price of services from the private partner are warranted by the cost data.

Project Development and Evaluation Methodology will be a 4-5 day workshop to teach participants how to perform each of the analyses involved in developing and packaging a project to be tendered by the GOI. The workshop will address methodology for evaluating technical feasibility, economic value, commercial viability, willingness to pay, and other related studies. It may prove appropriate to prepare several shorter workshops, each of which would address methodology for only one type of analysis.

The following table presents a recommended schedule for developing and offering these five workshops.

TABLE B

Workshop Topic	Year of Project *					
	1	2	3	4	5	6
Project Development Process	DEV	2	2	2	2	0
Model Contracts and Pricing Procedures	DEV	2	2	2	2	2
Monitoring and Oversight Procedures		DEV	2	2	2	2
Cost Analysis and Pricing Adjustments		DEV	2	2	2	2
Project Development and Evaluation Methodology			DEV	2	2	2

* Numbers indicate the number of locations at which a workshop is given once each year

DEV indicates the year in which the workshop is developed.

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The second part of the Training Program focuses on skills that private sector firms need to be able to deliver urban services efficiently and sustain a viable business operation. Under the general heading of Technical and Managerial Skills, the PURSE training program will facilitate the participation of private sector participants in existing courses on topics such as the following:

- construction management and oversight;
- operations and maintenance planning;
- financial management for small businesses, including accounting, cash management, cost control, financial reporting, and cost analysis to support applications for price adjustments;
- business administration skills, including payroll, purchasing, billing and collections, and personnel management.

If experience during the project indicates that more training is needed for technicians, the USAID and PURSE project staff should also consider facilitating training for private sector personnel in topics such as operator training for water supply, wastewater treatment, and solid waste facilities, truck and equipment maintenance, and meter installation and reading.

To promote the sustainability of these activities, the PURSE project should offer as much of the recommended training as possible through or in collaboration with existing training organizations. The following organizations have been identified as possible collaborators; project staff should explore opportunities with these organizations and others not yet identified.

- The Ministry of Public Works and PLN, the national government enterprise in power, each have training programs in government procurement; these programs are being improved by support from USAID/Jakarta project on Economic Law and Improved Procurement Systems.

- The Directorate for Environmental Sanitation (PLP) within the Ministry of Public Works, Directorate General of Human Settlements (PU/Cipta Karya) provides technical training for operators of solid waste and wastewater management facilities.

- The Rural Roads Management System project sponsored by USAID/Jakarta is working with the GOI ministry responsible for roads to develop and offer courses on truck and equipment maintenance.

- The Rural Roads Management System project sponsored by USAID/Jakarta is working with the GOI ministry responsible for roads to develop and offer courses on truck and equipment maintenance.

- Two private management consulting and training firms, IPPM and IPMI, offer a number of training courses in business management and administration.

- The national trade association for construction companies, GAPENSI, is reported to have a training program for its members.

The Rural Roads Management System project has supported the training program offered by the Ministry of Public Works, and has been able to persuade the Ministry to open its training programs to private sector participants. This experience may be a model for the training activities under Guidance for Public/Private Partnerships. Because most of the subject matter to be addressed under this component concerns procedures that the government will institute or has established, it is appropriate that a government ministry offer the training. Working with a government ministry to develop courses that the ministry will then offer to both private and public participants is consistent with PURSE objectives, and follows a model for which the RRMS project has created a precedent.

The PURSE project should not develop original courses for topics addressed under Technical and Managerial Skills. Rather, the project should provide tuition subsidies for private sector participants and/or support to existing institutions for revising and improving course materials. It may also be necessary to make such assistance available to civil servants who are interested in the courses offered under this program.

C. <u>The Formal Overseas Training Program</u>

Long-term training opportunities, for up to two years for M.A.- level degree program in the United States, will be provided for up to six GOI staff as part of an effort to increase the technical skills of mid-level and younger staff. Joint programs in business administration and urban planning are available at U.S. universities such as MIT, Syracuse, UCLA and UC-Berkeley. GOI long-term participants would be selected by the Urban Services Steering Committee. All trainees will be sent as early as possible during the project to allow participants to make contributions later in the project.

Short-term training opportunities will be given to GOI senior, mid and junior level staff, and to potential private sector lenders, investors, owners or managers of urban services and infrastructure to participate in short courses and policy seminars (2-6 weeks duration) outside Indonesia. Approximately 84 short-term participants are anticipated over the life of this project.

PURSE long-term staff will supervise the studies and, when needed, short-term expatriate consultants will be used to supplement the capabilities of domestic consultants.

Research studies will be used to collect and evaluate information on topics such as the following:

- the true cost of urban services provided by the GOI;
- the willingness of urban residents to pay for improved services;
- changes needed in tariff structures to recover the full costs of services and to eliminate subsidies;
- likely effects of changes in tariffs on the utilization of natural resources (water, groundwater, land, and the absorptive capacity of rivers);
- reductions in the investment gap that can be accomplished with tariff increases and improving the efficiency with which services are delivered; and
- levels of private investment in urban services that can be sustained, given GOI limits on public and private debt.

Each PURSE demonstration project will be carefully and rigorously evaluated using the following three types of analyses:

- a financial analysis will examine the costs incurred by the private partner, realized rate of return, and the prospects for continued viability of the private operation;
- an economic analysis will examine improvements, if any, in the cost-efficiency of services provided to the public, and determine whether the total cost of services to the public has increased or decreased; and
- a legal/regulatory analysis will examine the success or failure of specific contractual terms and conditions, including private party compliance with design and performance standards, the government's use of oversight mechanisms, and the operation of provisions for price adjustments and dispute resolution.

The results of these evaluations will be used to inform continued policy dialogue, to modify procedures used in subsequent demonstration projects, and to revise materials used in the Public/Private Forum and the Training Program. The results will, of course, be available to be used in the mid-course and final evaluations of the PURSE project.

IV. Required Resources

The following table summarizes the estimated level of effort that will be required to deliver the recommended Training and Communications Program, as well as assumptions underlying the estimates.

Task	TA Required	LOE
Public/Private Forum Forty local meetings and five annual conferences for public officials and private entrepreneurs over six years. Meetings planned and organized by PURSE staff; run by public or private participants. The annual conference may require travel.	Assume meetings will use material prepared for briefings and workshops, so minimal cost for materials preparation. Preparing for each meeting requires 1 week of time, and each conference requires 1 month of time from both the appropriate expat and 1 PURSE local technical staff member.	15 person months (LTA expat) 15 person months (LTA local)
Training: Guidance for Public/Private Partnerships Prepare and deliver forty workshops on five topics for public and private participants. Workshops will address procedures for establishing partnerships and aspects of the relationship between public and private actors.	Assume preparation of 5 workshops; workshops will meet for 2 to 5 days; 40 workshops will be held. Developing each workshop will require 3 months from a STA expat. Delivering each workshop will require 3 weeks of time from the appropriate LTA expat, and 2 weeks of time from PURSE local technical staff member.	30 person months (LTA expat) 20 person months (LTA local) 18 person months (STA expat) Travel and per diem for instructors only.

Training: Technical and Managerial Skills Facilitate participation of private sector personnel in existing workshops and courses to teach specific technical, managerial and administrative skills needed to deliver urban services and sustain a viable small or mid-size business. Assume no preparation of original training materials; the project should provide support to public and private training institutions to modify existing courses.	Identifying sources of existing training and arranging for cooperation with PURSE will require 1 month per year from the appropriate expat and PURSE local technical staff member. Assume a tuition cost of 2.0 M Rp per student, no payments for travel and per diem, 20 students in each of 5 years (beginning in second year of project).	5 person months (LTA expat) 5 person months (LTA local) Tuition fund of Rp. 200 million
Formal Overseas Training Program Six long- and 84 short-term training opportunities will be provided to GOI staff and private sector investors, owners, or managers of urban services and infrastructure. Programs which combine urban planning with business administration will be promoted.	Identifying appropriate master's programs and short courses for candidates selected will require 1 month per year from appropriate expat. Local technical staff and Project Administrator will assist in processing trainees.	5 months LTA expat 5 person months (LTA local)
Research and Evaluation Establish a continuing program, involving GOI and private sector, to perform financial, economic, and regulatory analyses of demonstration projects. Incorporate results of evaluations into existing project development procedures, model contracts, and workshops.	Long term expat to manage evaluations. Short term expat assistance in designing and supervising evaluations. Local hire economists, attorneys and engineers to conduct evaluations under subcontract. Assume 12 evaluations over life of project.	5 person months (LTA expat) 18 person months (STA expat) 36 person months (local hires)

ANNEX A - 3(C)

POLICY ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

ANNEX A - 3 (C)

POLICY ANALYSIS

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ANNEX A - 3 (C)

POLICY ANALYSIS

1. Introduction

The Policy Agenda is a framework to guide discussions between USAID/Jakarta and the GOI. Based on research both in Indonesia and the United States, the Policy Agenda identifies actions to enhance prospects for both domestic and foreign private sector sources to invest in urban infrastructure (capital works), to provide other services in water, wastewater and solid waste and to increase the efficiency of resource consumption in the provision of urban services.

Policy actions include both development of broad policy statements and the adoption of detailed guidelines or standard operating procedures. The framework recommended here for A.I.D. discussions with the GOI consists of policy actions that address three types of constraints affecting the production of urban services and the possibilities for increased private sector participation.:

- Constraints that affect the private sector's perception of the opportunity and incentive to invest their own resources in various forms of urban infrastructure and services production;
- Constraints that arise from the structure of the prevailing system for financing urban infrastructure and services.
- Constraints that involve the inefficient use of natural resources in the production of urban services.

2. Issues For Policy Actions

2.1. Opportunity and Incentive

Opportunities and incentives for private sector participation in water, wastewater and solid waste are affected by legal and administrative practice. Private entrepreneurs perceive ambiguity in whether and how they may participate in the construction and operation of infrastructure facilities and in the provision of various services. They do not see clear regulations or guidelines governing the nature of the contracting relationship to public sector institutions involved in urban services production, and they do not have full confidence in the ability of regional authorities to meet contractual relationships. Private entrepreneurs indicate they need various forms of policy assurances regarding:

- The nature of their legal relationship to governmental (particularly Regional Governmental) authorities contracting for their involvement;

- The mechanisms by which they will recover costs and earn a profit; and
- The recourses available to remedy disputes and problems encountered in building and operating or providing contract services to water, wastewater and solid waste systems.

2.2. Prevailing System of Urban Infrastructure Finance

Regional (Level I or Province and Level II or Kabupaten and Kotamadya) Government has the primary responsibility for the provision of water, wastewater and solid waste services. Central Government, however, has the dominant role both in financing and carrying out capital works in urban areas. These capital works upon completion become the responsibility of Regional Government (mainly Level II) for operation and maintenance. At the regional level, it may be either the general local government body or the regional enterprise (PDAM or PDAL, for water and wastewater respectively) that performs the operation and maintenance. Once a PDAM or PDAL is formed, it has in principle the authority to undertake capital works construction in addition to its operation and maintenance responsibility, as does the general purpose local government (Kotamadya or Kabupaten for Level II), but in practice few capital investments are undertaken by regional institutions.

Under the GOI's national urban policy and its decentralization program, more responsibility for urban services provision is being shifted formally to regional level institutions, but the practical effect of these policy changes to date has been to increase local operations and maintenance activities, with no significant resource transfers or increases in local own source revenues sufficient to undertake capital works. The main construction activities continue to be carried out under central government's Ministry of Public Works. The major thrust toward decentralized planning, the Integrated Urban Infrastructure Development Program (IUIDP), has established a comprehensive investment planning and financing process for almost all the large and medium size cities in Indonesia, but the level of actual local involvement in these planning processes has varied widely, depending in many cases on consultants to prepare the investment and financial plans. These IUIDP plans do include provision for increased local financing for capital investments, but as yet there has been no significant increase in local revenues expended on major investment projects. The IUIDP financing plans also include credit financing, an essential mechanism as almost all the urban infrastructure in the present Repelita is financed from donor agency credit. However, it is not clear that many regional governments are aware that they are being obligated through the IUIDP financing plans to meet future loan repayment obligations. As the grace period for most of this credit has not yet expired, there really has been no test as to whether central government or local government will be repaying the majority of this external donor financing.

One of the consequences of financing urban infrastructure construction mainly through central Public Works DIPS (direct budget) has been that Regional Government and enterprise budgets contain only the operation and maintenance costs for capital works, except for those smaller works actually undertaken under regional government or enterprise authority. Actual construction (capital) costs will have been in the Ministry of Public Works budget. Thus there is no single place where both capital and operating costs are collected in one budget or financial statement, and therefore there is no obvious basis for determining a tariff for recovering more than operating costs.

Sources of local revenues for financing the operation and maintenance of capital works include locally collected and retained taxes and fees, user charges to customers, and Central Government transfers. In still rare but a growing number of cases, local budgets include borrowing for capital works construction. To now, this borrowing has been almost exclusively by water enterprises (PDAMs).

Under the prevailing system, local revenues from all sources are insufficient to meet the capital costs of infrastructure construction. And local authorities are not aware of the full costs of capital construction carried out on their behalf and turned over to them for operation and maintenance. Therefore, user fees for water and wastewater services are set by regional governments without any clear idea of capital cost recovery. The revenue streams generated by these user charges thus are insufficient for capital cost recovery, although the enterprise budgets of PDAMs typically appear to show a surplus since fees often are sufficient for the operation and maintenance costs included in their budgets.

To engage the private sector in the construction of capital works, whether on build and transfer, build operate and transfer, or build operate and own bases, will require regional governments to contract with private providers. The revenue streams collected from users under the prevailing system will not provide the funds necessary to pay those contracted private providers; and some combination of the present method of Central Government payment for capital construction, substantially increased user fees, and increased other local revenues will have to be employed to provide the necessary revenue streams. For example, a $125 million Jakarta Wastewater project will be financed by 60% Central Government payment, 30% Jakarta general revenue payment, and 10% user charges. If that were a private venture of the type anticipated by PURSE, the Central Government would have to continue that 60% participation either in the form of co-payment to the private contractor or transfer to Jakarta for payment to the private contractor, or user fees and Jakarta general taxes and charges would have to be increased to replace the 60% contribution.

This prevailing system will have two consequences for private sector participation in water, wastewater and solid waste services. First, in evaluating the potential revenue streams from user charges, private providers will realize that there is no current history of direct user charges providing revenues sufficient for both capital and operating costs for water and wastewater, and therefore will seek contracts that obligate the general

revenues both of Regional Governments and Central Government to ensure a sufficient revenue stream.

The second consequence follows from the first. To the extent that the present sharing of costs among Central, Regional and direct customers continues to follow the same proportions, no additional urban infrastructure will be provided by private participation, except to the extent that private construction (and operation) of urban infrastructure is more efficient, generating through cost savings additional government funds for urban infrastructure. In the event of following exactly the present pattern of finance, there would be a possible shift from Central Government investment budget to Central Government current budget, but otherwise no change (excepting possible efficiency gains). To the extent that the present Central share shifts to general Regional Government budgets, there would be a reduction in the Central budget, but a corresponding increase in Regional budgets, achieving no net gain (again excepting possible efficiency gains). Only if Regional budgets, either through general revenue increases or increased direct user charges, increase will there be additional urban infrastructure provision.

The second objective of the Policy Agenda aims at increasing the beneficiary share of urban infrastructure provision, thus producing a net increase in urban infrastructure financing.

2.3. Inefficient Resource Use in Urban Services Provision

Significant environmental damages are occurring due to the inefficient use of resources in urban services provision. Water resources are being depleted due to the lack of regulation or control on private usurping of clean water resources. Private individuals and private developers sink deep wells into aquifers and draw from surface sources to withdraw water at a rate that threatens to deplete water resources. Wastewater and solid waste are disposed of in manners that both damage water resources and generate unhealthy urban living conditions. While the involvement of private individuals and developers in the provision of privately constructed water and wastewater systems and solid waste collection and disposal systems will be encouraged, policy actions will be taken to synchronize those private developments with public policy toward water, air and land resources.

The present pattern for water and wastewater services already involves a high degree of private sector participation in the sense that high income residential areas, industrial estates, and large commercial establishments provide their own systems, usually deep wells for water and septic tanks for wastewater. However, except for very large industrial plants and large tourist hotels, most of this private production is unregulated. As a consequence, water in the aquifers is being depleted rapidly, with salt water intrusion already becoming a problem in areas of Jakarta. Inadequate pumping of septic

systems, and direct connections between septic systems and rivers and the sea cause increasing hazard from human and industrial wastewater.

If the present pattern continues, an adequate supply of treatable water for drinking and commercial uses is threatened, and a sufficiently healthy environment for urban residential and commercial exploitation is threatened. Thus, at the same time as policy and regulatory changes are adopted to encourage appropriate private sector production of urban services, policy and regulatory changes are necessary to regulate access to natural resources such as water in order to ensure an efficient allocation.

3. Policy Framework

The following policy framework includes three broad policy objectives intended to address the three sets of constraints discussed in the preceding paragraphs and related specific actions intended to accomplish those broader policy objectives. At this stage, the specific actions represent logical policy choices or implementing steps that have arisen during discussions with the private sector and with the GOI, but they do not represent policy commitments on the part of the GOI. Rather, they are talking points for policy discussions to take place between A.I.D. and the GOI. In addition, as the GOI decides on specific policy objectives, PURSE technical assistance activities will be available both to aid in policy studies and in the development of specific guidelines and regulatory practices.

POLICY OBJECTIVE	POLICY ACTIONS
1. Establish a legal and regulatory framework enabling and encouraging private sector participation in the production and financing of urban services (water, wastewater and solid waste)	a. Prepare and issue decrees for water, wastewater and solid waste services that: make explicit the GOI's interest in private entrepreneurs' participation in the production and financing of those services; formalize the legal basis for private investment of capital and other resources to build and operate facilities and to contract with regional governments and regional enterprises to provide services to public operators of facilities; Define the nature and extent of GOI guarantees or assurances of the performance of regional institutions in fulfilling contract obligations with private producers of services. b. Prepare and issue guidance and directives for Regional Governments that: Specify the types of Regional Governments or list the specific Regional Governments that are authorized to enter into contracts with private organizations to provide all or some portions of the respective services; Identify for the respective services the specific types of facilities and activities that may be contracted between Regional Governments and private entrepreneurs; Prescribe the procedures for announcing and issuing tender documents for competitive contracting for the construction and/or operations of facilities and the provision of specified services; Define the extent and nature of competition required; Specify procedural requirements for maintaining open competition and guarding the integrity of the bidding process; Provide model contracting procedures and documents for use by Regional Governments.

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2. Clarify pricing policy for urban services and encourage greater degree of self financing for water, wastewater and solid waste services.	a. Revise accounting procedures for regional enterprises and regional government units that: Identify the full cost of capital works on an accepted accounting basis as well as annual operation and maintenance expenses and any transfers to other regional government accounts; Identify as sources of income or revenues all financing including user fees, central government direct construction of capital works, and transfers from other central or regional sources. b. Develop and publish guidelines on the extent to which water, wastewater and solid waste services are expected to be self financing from user fees or other direct charges to beneficiaries.
3. Develop policies for water resource use and residential and industrial estates development that improve the efficiency of allocation of scarce resources.	a. Review policies toward licensing for private wells, private intakes, private wastewater and solid waste systems to clarify: Private rights; Public interest in environmental management and preservation of resources. b. Review policies on zoning and land use to clarify: Private rights to develop land; Public interest in environmental management and preservation of resources. c. Issue ministerial guidelines for Regional Governments to regulate land use, water source tapping and wastewater disposal, and solid waste disposal by private individual and commercial/industrial users: Access to water resources (aquifers and surface sources) by private individuals and firms not connected to water systems will be subject to charges equivalent to the costs imposed on water system users for the cost of the water resource itself (not including the cost of extraction of water from the source); Wastewater disposal by private individuals and firms not connected to wastewater systems will be regulated to require treatment comparable to that determined by public policy appropriate for public systems; Solid waste handling and disposal through private facilities will be subject to the same standards for health, safety and environmental preservation as are applied to public waste handling and disposal systems.

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ANNEX A - 3(D)

DEMONSTRATION PROJECT ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

ANNEX A - 3(D)

PILOT/DEMONSTRATION PROJECTS

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ANNEX A-3 (D)

PILOT/DEMONSTRATION PROJECTS

1. Introduction

The Purse Project will seek to develop a minimum of five B.O.T. pilot projects and six service contracts in order to demonstrate the ability of the private sector in partnership with Indonesian Government units to implement water, waste water and solid waste projects; test technology and methodology; examine legal, financial and organization framework; and measure comparative efficiencies. The projects will be directed at private participation of both foreign and domestic investors, large and small.

The final selection of the specific projects will be determined in the early stages of the Purse project. Since the demonstration projects will specifically identify and surface policy and institutional short comings, training needs and required technical assistance, it is important that the projects have an early and vigorous start. Furthermore, setting out on unchartered waters of privatization of a perceived public domain will require a strong statement of support from the beginning by the governmental leadership, an active technical assistance in introducing new roles and techniques, together with a large measure of sensitivity to make new ideas become realities.

2. The Public/Private Partnerships

The key element in initiating a project and its successful implementation is for both sides, the government and private investor to each gain benefits, but neither at the expense of the other. It is a public/private partnership in the sense that the contractual relationship gives the public sector, who has the obligation and responsibility to provide urban services, the opportunity to provide those services earlier, in larger quantities, and at lower costs than were otherwise possible, and eventually obtain ownership and management of the service. The contract calls for the private sector to design, construct, finance, own and operate the works and/or system for the public sector under a service contract and transfer ownership at some future stipulated time. The private provider in return receives a reasonable profit and a fair return of its investment.

The responsible government body and management must feel that it has not given up authority or a responsibility to the private provider but has added capacity to deliver services to its constituency. Only in unusual circumstances would the relationship between the public provider and the consumer or user be substituted with the private contractor. Even if a contract for example, calls for the delivery of water to the household, it would be at the direction of the public entity and on its behalf.

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The contract must be constructed in a way that each side of the partnership has the same incentives and benefits from the desired decisions of the other.

3. The Selection Criteria for Demonstration Project

The emphasis will vary in the selection of specific projects, but in general, the criteria will encompass the following guidelines -

- Each project should provide the means to develop an urban service that will answer an urgent need. The particular required service has been strenuously advocated by the locality which will be served and recognized as an immediate priority by the responsible government agency.

- The proposed project should be immediately commercially viable. The project should appear to be financially feasible with large user fee revenues in relation to the capital requirements.

- The project, when possible, should introduce new management and technological developments.

- The projects, particularly water and waste water, should bring additionality to the sector and fill an apparent funding gap under current fiscal constrains.

- Some projects, particularly solid waste, should introduce an avenue for small local private enterprises to provide contract services.

- The project would be presented to the private sector on a "prepackaged" approach with schematic designs, with feasibility analysis and established contractual conditions. It is therefore important to select projects where demographic, market, demand, supply sources and distribution can be readily identified and developed.

- The project, or specified components of the project, should provide opportunity to demonstrate, analyze, and disseminate information regarding opportunities and constraints to private sector participation targeted by the PURSE project.

4. The Composition of Projects

In the selection of all the projects an overriding concern is ability to implement the project. Only if the pilot project is successfully implemented will it demonstrate the

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positive outcomes of private provision. A failed project however may point to what needs to be changed.

There should also be an emphasis on the speed of implementation. The various benefits and requirements of the staffing of the technical assistance can be identified quickly and more accurately, thus making the Purse project more efficient and cost effective.

Too many projects will tend to spread management and other resources too thinly and slow implementation. Furthermore, if the demonstration projects require exceptions in present policy or regulations, a few selected exceptions will be received and approved more readily than a large number.

4.1. Format of Projects

The following format for the selection of projects has been determined.

Piped Water : Two B.O.T. projects
Two Service Contracts (SC)

B.O.T.(1): The introductory project should be relatively easy to implement calling for a concise smaller project that is commercially viable. The contract would be with a PDAM or equivalent to sell water either in bulk or delivered to the user. This might be a contract to serve an enclave or purely a water supply contract.

This project would demonstrate the ability to formulate and implement a project in a relative short period of time, produce a financially viable project and establish contracts with government sectors.

B.O.T.(2): The second project might be more comprehensive and provide water to a full range of users. In an urban area, the contract might include both supply, distribution and management.

This project would bring a more complete menu of issues to formulate policy decisions concerning cost recovery, establishing user fees, and contractual issues.

The framework of domestic private approaches to continue and sustain the market and expertize to formulate and implement B.O.T. projects will be incorporated into the project implementation.

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S.C.(1&2): One contract might be defined as a maintenance contract. Another might be for billing and collection. A full management contract might be considered for an enclave development.

Potential Projects :

Serpong water treatment and distribution
Pontianak water supply
Bandung Raya water supply and distribution
Bekasi water distribution
Ujung Pandang water supply
Dumai water supply

Waste Water: Two B.O.T. Projects
One Domestic Investor Service Contract (DISC) project.

B.O.T.(1): The first project would be, as the water project, a concise, well defined project that is commercially viable and relatively easy to implement. It might consist of a treatment plant and effluent control. It would include collection from an enclave or the rehabilitation of a present system with collection and treatment.

B.O.T.(2): A second more comprehensive project might include a complete system of collection and treatment in an un-serviced area.

Again as in water, the first project would demonstrate the ability of the public sector to contract with the private supplier on an equitable and viable basis. The second project would bring more comprehensive policy issues to the table to be formulated. It will also address the ability of the domestic private sector to continue developing B.O.T. projects.

DISC (1) : A domestic investor might invest in a septic tank collection business. The DISC would purchase trucks and contract with households, business and industrial concerns to empty septic tanks and dispose of the waste under an arrangement with the municipal PDAL.

Potential Projects :

Surakarta collection and treatment
Ujung Pandang collection and treatment
Malang collection and treatment
Ambon collection and treatment

Yogyakarta sewerage collection rehabilitation and new treatment facility

Solid Waste: Two Domestic investor service contract (DISC) projects.
One Service contract (S.C.) project

DISC (1) : A project might consist of a local or regional garbage collection company that either provides transportation from transfer collection points or from individual households, businesses or industries. The disposition of the waste could be to private, but licensed land fills.

DISC (2) : A second project might be to organize a land fill business (DISC) which received solid waste. There could than be several ways of disposition such as compost, recycling, energy generation, or burial.

S.C. (1) : This could be purely services rendered with no capital investment. The service could include garbage collection in neighborhoods or organizing a land fill operation.

Potential Projects :

Transfer, Disposal, Transportation in :

Bandung, Medan, Bogor, Surabaya, Semarang, Malang, Jakarta.

Comprehensive Urban Service District

A private water, waste water and solid waste company formation project (3WC).

A project might be formulated to provide all the above urban services for a municipality or enclave development. This would include water supply and distribution, waste water collection and treatment, and collection and disposal of solid waste.

A company would be formed under the authority of the municipality or regional government. The planning of such an enterprise would fall under the direction of the Integrated Urban Infrastructure Development program (IUIDP).

This demonstration project would be formulated out of the experience and policy formulation of the other projects. It would demonstrate the ability of private investors to construct, and operate under new policies and regulations, as well as point to greater efficiencies in construction and operations. The emphasis would be directed to implementing the project with domestic expertise and efforts.

* Potential Projects :

East Bandung, Padang, Serp

5. Implementation Process

The implementation of the projects a logical sequence of steps which encompasses identification, analysis, formulation of the project plan, selection of the private investor contract negotiations, construction and operation. While these steps outline the process for the pilot projects, the methodology is applicable on a continuing basis and offers a demonstration in itself.

5.1. Project Identification

The projects which might become candidates for private participation can be classified in a number of categories; strength of demand for service priority; public funding availability; location; and authority. A matrix formulation will aggregate the categories and point out those projects that appear to have best chance for success. The final decision rests with the government authority responsible for delivering the service. The Purse Coordinating Unit, however, can have a strong influence with local authorities and implementing agencies.

The severity of the need is, of course, of paramount importance. The recognition of the demand of consumers and local officials stimulates the required actions.

The progressiveness and creativeness of local governments brings about innovative approaches. The identification of the most progressive regional governments and municipalities will help private participation work more rapidly.

The established priority for new works can be examined, and if the priority is low for Ministry of Public Works or other agency execution, (but need great) then the project might be a good candidate for PURSE demonstration.

Closely related to this condition is the funding ability and authorization schedule of capital projects. If there is no apparent or immediate public financing available the private approach becomes more attractive.

Several G.O.I. ministries have organized efforts to study private approaches. In the Ministry of Public Works, The Directorate of Human Settlements has a team studying privatization. This team has the technical assistance of a member of the Municipal

Finance Project who is assisting on a part-time basis. A line of communication and coordination will help identify projects.

Within the Purse Project Urban Services Subteam Component, there needs to be a Demonstration Project committee to recommend demonstration projects. Within the technical assistance organization, a specific responsibility will be assigned to a team member to coordinate the identification of projects.

In order to begin an early implementation of the demonstration projects, a bridge contract should provide an interim Project Manager whose immediate task will be to identify one or two demonstration projects. It will take 3 to 4 months to investigate potential projects, study the various alternatives and make a recommendation of initial projects and their organization.

5.2. Two Approaches to Project Presentations

Once a project has been identified and there is a decision to move forward to develop the project, two approaches can be taken for the project presentations. The first is to provide the project in "outline" form, requiring the private developer/investor to complete the project proposal. The selected potential investor would prepare a technical program, feasibility analysis and contract proposal.

In the first approach, the initial costs of making the up front investment becomes a risk of the investor. This approach requires an investment from $100,000 upwards, generally 2 to 4% of the total project costs, before the project is accepted by the government and a contract is negotiated. At the early stage of the privatization program, there would be very few responses if any, to this approach. After the investment community has confidence in the G.O.I.'s intent and with projects completed on a profitable basis, this may be possible in some instances. Perhaps local and smaller solid waste projects can be approached or an "outline" basis where exclusive approval is given for a private investor to prepare an offer within an agreed time.

The other and recommended initial approach is to "prepackage" the projects; that is, present the project to potential investors with the pre-engineering or schematic designs the feasibility analysis, and capital requirements analysis completed. The preparation costs involving these technical assistance requirements would be funded by the Purse Project. These costs, plus the professional engineering design and other consultancy expenditures would become a part of the capital costs of the project. If the project was successfully negotiated with an investor, the portion of those applicable project expenditures would be refunded to the Purse Project and capitalized by the investor. These funds then could be recycled and used as the seed money for another project.

Certainly the marketing of the investment is facilitated by developing a pre-packaged project clearly outlining the opportunities and, no doubt, would attract more and broader interest. The pre-package approach appears to be a prequiste to get private entrepreneurs involved in completely new territory.

5.3. Project Package Preparation

To bring the project to the level where it will be presented to potential investors requires a formulation of the (1) technical elements (2) the market and financial elements and (3) the project proposal.

The Technical Elements

The design of the project will be prepared to a schematic level. This includes the scope of the physical works and capital costs estimates along with potential options. The technical operations will be defined and described. The role of the private investor and the contracting government entity is established.

In the case of water, it may include the supply and/or distribution to the user. The operating responsibilities may or may not include billing and collection on behalf of the governmental unit.

In the case of waste water, various technical options are available. The collection system may be included together with the treatment facility which may be an oxidation pond or treatment plant. Disposal of the effluent also will be set forth.

The Market, Financial and Feasibility Analysis

The existing demand for the service needs to be accurately measured. Future growth patterns of household, commercial and industrial sectors need to be projected. Existing tariffs, ability and willingness to pay also need to be analyzed. The financial analysis will include proforma operating statements, cash flows and rates of return. The financial analysis will produce the amount of tariffs and contractual arrangements to amortize capital costs, operating and maintenance and produce a return to the investor.

The financial feasibility will show the degree of subsidy to users that is required. While the contract to purchase water or wastewater will be with a government unit, the future ability of the market to produce revenues to pay operational and maintenance costs and amortize the capital costs is important in measuring the viability of a project. If user fees can be slowly raised to a level to sustain

operating, maintenance and replacement costs, the fiscal pressures on the government budget are reduced, the project becomes self financing and there is greater opportunity to replicate the process.

The Project Proposal

The presentation of the proposal to prospective bidders or terms of reference (TOR) will include the scope of the physical works, market demand, feasibility analysis and the proposed contractual relationship between the investor and the government unit. The documentation of the transaction is complex and encompasses a broad range of issues including institutional, financial, contract stipulations, and technical performances.

The documentation includes ;

a) Institution arrangements

1. The Governmental contracting units
2. Approval process
3. Technical Assistance
4. Design approvals
5. Implementation oversight
6. Joint Venture Incorporation approvals

b) Financial Arrangements

1. Capital requirements
2. Debt and financing availability
3. Guarantee agreements
4. Credit enhancement
5. Exchange risks

c) General Contract Stipulations

1. General obligations of the parties
2. Basis of payment
3. Length of contract
4. Responsibilities and risk
5. Employment agreements
6. Defaults
7. Oversight and inspections
8. Tax concessions and import duties
9. Hand over arrangements

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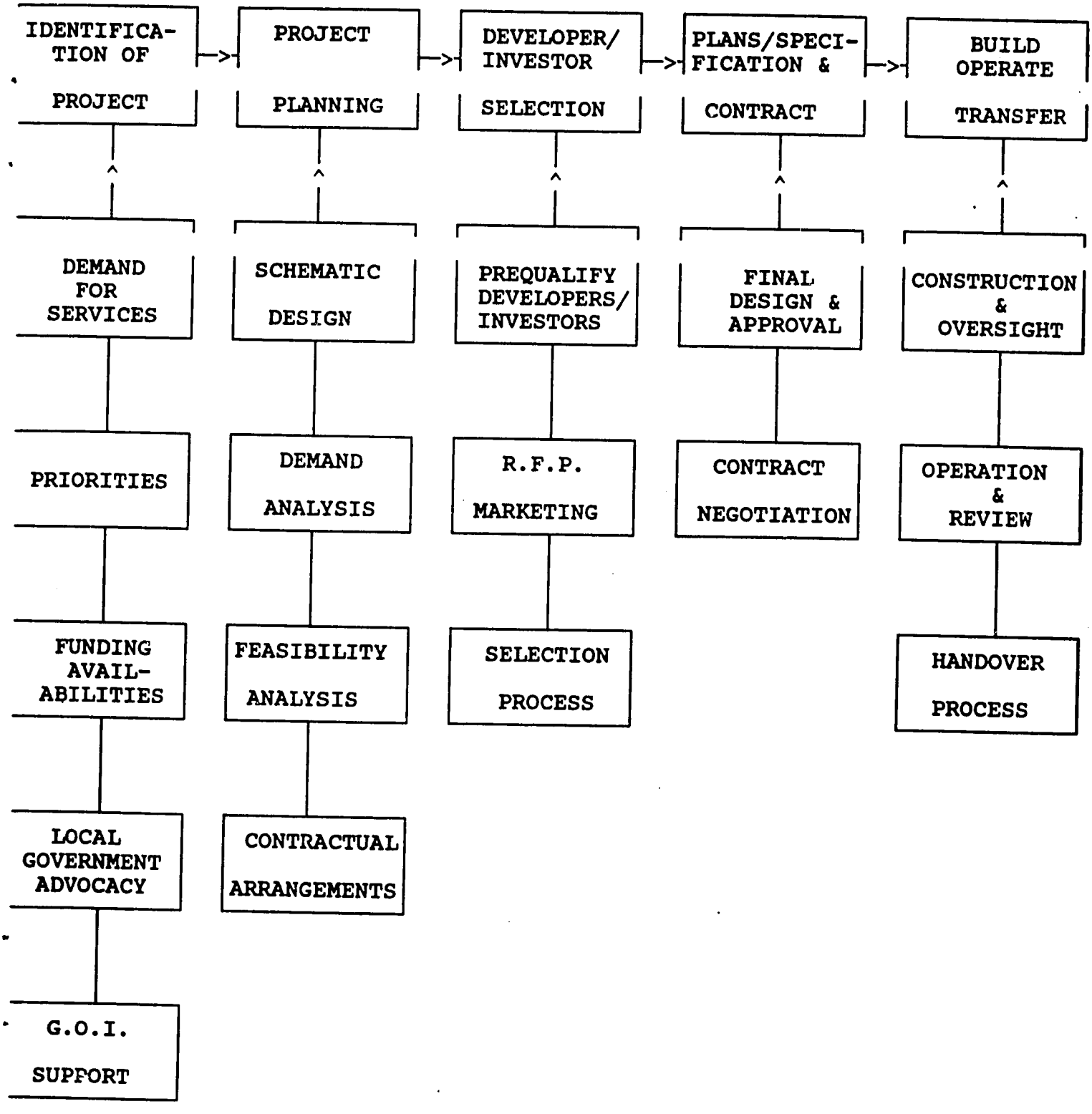
d) Technical Performance

1. Construction standards
2. Operational agreements
3. Maintenance
4. Volume minimums and maximums
5. Training requirement

A FLOW CHART OF THE IMPLEMENTATION OF PRIVATE/PUBLIC BOT DEMONSTRATION PROJECT



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5.4. Technical Assistance Requirements

The steps leading to the project proposal will take from 3 to 6 months for preparation and will require technical advisors of the following areas of expertise;

* A technical expert with a high degree of experience in water, waste water or solid waste management as appropriate, will be required to assist in the design.

* An economist with financial expertise will be required to help prepare market analysis and the financial feasibility study.

* A Project Manager Technical Advisor with experience in developing, financing, marketing and managing projects will be required to manage the project, put the project package together and expedite its completion.

5.5. Negotiations and Contract Completion

The project at the time it is presented to potential investor will have:

(1) The physical scope developed
(2) The feasibility analysis completed
(3). The terms of the contractual package set out.

The selection and contracting process identifies potential private developers/investors, pre-qualifies firms, markets the projects among the list of qualified firms, solicits proposals, selects the investor and negotiates the contract. The identification of potential investor naturally will depend on the size and nature of the projects.

The smaller projects and services contracts will be directed to domestic private companies. Efforts will be organized to solicit their participation.

The identification of potential companies and firms will require a search under the direction of local technical assistance among private Indonesian businesses, trade associations, and Chamber of Commerces.

The solicitation of domestic project proposals will require that the opportunities be pre-packaged particularly since there is little experience in private participation in urban services.

The opportunity to franchise waste management services will be explored as a potential demonstration project in the latter stages of the Purse Project.

Potential investors in the B.O.T. approaches, which are large capital investments in water and waste water projects, have been identified to a degree through the survey of Investor Requirement in Annex 6. Over 44 firms were contacted out of several hundred U.S. firms. These were identified by size, experience in water, waste water and solid waste development, and experience in foreign work, specifically in Asia and Indonesia. These firms were contacted to seek out their specific interest in considering entering into a B.O.T. investment in Indonesia.

A general description of type, size and framework of the privatization program will be communicated to potential investors. Those firms that respond positively will be asked to participate in a pre-qualification process. In addition, advertisements in international media will be run to request firms to prequalify. Once the project package is prepared, the prequalifiers will be presented with a request for a proposal (RFP).

Marketing efforts will be made to stimulate investor interest. In addition to the formal request, brochures can be prepared to attractively present the investment opportunity. The preparation of a video that can be presented to potential investors is an effective way to vividly show the area and context of the physical investment, save travel expenses and expand the investor interest. Video presentations have been effectively used to attract investor interest in private power B.O.O.

A part of the marketing effort is to visit the potential investors. A presentation can be prepared and made in their offices.

Project presentation will be made at scheduled times near the sites of the project and Indonesian government officials can meet with the prospective investors.

5.6 The Selection Process

The selection of the investor is based on both tangiable and intangible rationale. The relationships between the two parties are very important to successful completion of the project. There must be a great amount of trust. Working together to understand the needs and concerns of both parties is essential. While price is important, so is confidence and the flexibility to solve unforseen events.

The investor may be given 2 to 3 months to respond to the proposal. Depending on the number of responses, it may take another 2 months to make a selection or reduce the number to 2 or 3 firms. The whole process could take 4 to 6 months.

The selection criteria would consist of the following :

1. Corporate financial strength
2. Management capacity
3. Experience
4. Professional reputation
5. Construction and operating schedules
6. Material and equipment standard
7. Operating plan
8. Ownership arrangements and transfers
9. Costs and tariffs

Once the investor is selected a letter of intent or a memorandum of understanding will be drawn. This letter will allow each party to move forward to begin designs, arrange financial commitments and beginning with contract preparation.

The planning, solicitation, selection and negotiations phase of a demonstrate project would require 11 to 12 months. It would take another 6 months to complete the designs and negotiate the final contract. A fast track construction schedule could be used since the owner in many instances will be the contractor.

5.7. Time Frame

The earliest date to begin construction would appear to be 18 months from the date the project identification began, and with a contingency for delays, 24 months may be more realistic.

It would require the direct involvement of the Project Manager Technical Advisor on a continued basis throughout the identification, project package preparation and negotiation.

5.8. Project Construction and Operational Oversight

During the construction period, there will be periodic oversight to ensure the construction of the works and equipment meets the specification and construction standards.

Upon completion of the works the operating components will be tested to ensure product standards have been met. In the case of water projects, quality standards and volumes will be assured. In waste water projects the treatment facility will be tested for volume capacity and quality of the effluent.

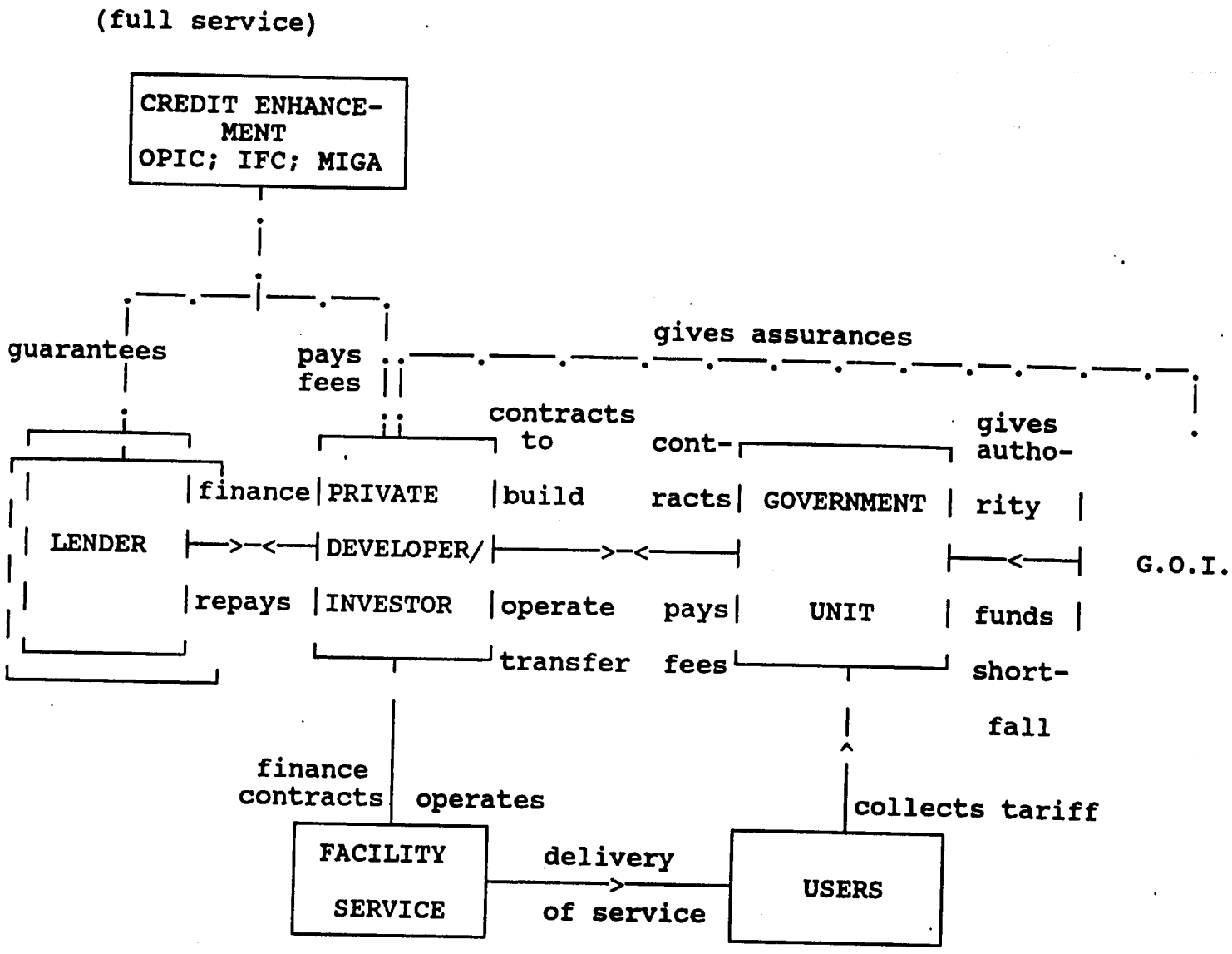
In the operational mode, periodical review of standards, volumes, and maintenance will be conducted by the contracting entity. At the time of the transfer, the G.O.I. will want to ensure the facilities are in the condition as stipulated in the contract.

6. A Framework of Contractual Relationships of Demonstration Projects

The success of the demonstration projects is to large degree based on developing contract agreements that provide a reliable source on income flow; a financing mechanism that allows the majority of the project costs to be borrowed; debt amortization generated from project cash flows and the assurances of the contractual integrity of all parties.

From the criteria of a rate of return on the capital investment, the minimum rate of return will depend on the associated risks, but based on present expectation and opportunity costs,a minimum rate of return (IRR) of 16 to 18% may be acceptable if there is a potential of perhaps 9% points or more to be gained from increases in income over the life of the contract. If there is no upside potential, the rate of return may need to exceed 20 to 22%.

CONTRACTUAL RELATIONSHIP OF B.O.T.



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6.1. The Joint Venture

If there is a foreign investor, Indonesian investment regulations require the inclusion of a domestic partner. If the total investment is over $ 10 Million, the minimum capital share the Indonesian partner is 5% of the total. The logical partner in the domestic corporation is the entity with whom the investor is contracting. As an example in the case of water supply projects, the partner would be a PDAM or PDAB and in the case of waste water, a PDAL.

Other than meeting the regulations of the Investment Coordination Board (BKPM), there is little incentive for the contracting partner to have a large stake in the operating company since the ownership of the facility will be transferred to it at the end of the contract. Furthermore, common incentives can be structured through sharing of gross tariff revenues. As revenues rise from either growth in demand and/or increased tariff rates, the increased revenues can be shared based on equity participation

The PDAM's have little cash to invest in projects. Their portion of the equity can be contributed by valuing or capitalizing the concession rights, or land and easement leases.

The foreign investor, no doubt, would want full management control of the new operating company.

6.2. Payment Terms for Services

The early demonstration projects will need to develop contracts that produce a revenue stream with as little risk as possible. A water contract, for example, will require a minimum volume of water purchase on monthly basis and at a minimum price.

The social issues of water tariff should not enter into the contractual arrangements. The contract would be with the regional enterprise and ratified by Ministry of Public Works (MPW) and Minister of Home Affairs (MHA). The assumption is that the G.O.I. would give the assurances that the minimum purchase agreements would be honored. Without such guarantees, the financing would be very difficult and the developer, particularly foreign investors, would not take the risk.

The amount of tariff paid by the users, however, is an important issue that might be addressed in later demonstration projects. The development of a tariff revenue stream that services the contract would make a financially stronger project, and take away the need to subsidize users through the general government budget mechanism.

It must be recognized that the raising of tariffs will have to be made gradually and compatible with political realities. A contractual agreement could call for increased tariffs and a sharing of those incomes after a minimum gross revenues level had been

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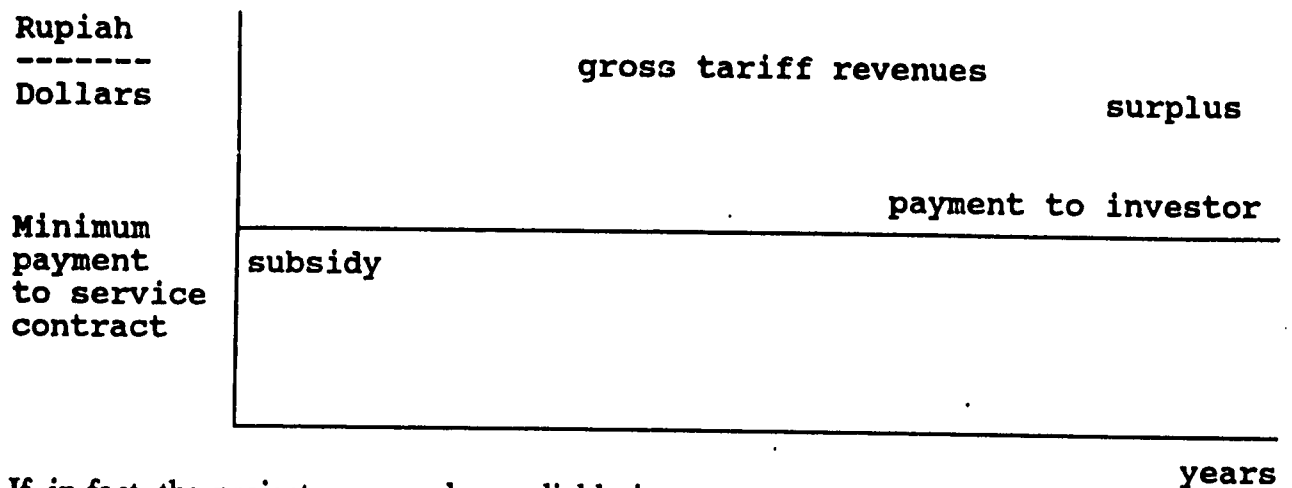
reached. This might allow the minimum revenue payments to the investor initially to be lower.

A graphic description might illustrate the concept.



If, in fact, the projects can produce reliable income streams over a period of time, then financing may be able to be produced out of the project, just as revenue bonds are issued, pledging only project revenues.

6.3. Financing

The financing of the project is a key consideration in making demonstration projects viable. The first consideration is to make the project financable. The second point is to be able to leverage the income flow through a loan that will require about a 10% investment of project costs by the developer. This would allow a contractor to invest an amount equal to his expected profit from constructing the project.

The ability to obtain foreign loans in US Dollars at low interest rates on project financing (non-recourse) increases substantially the borrowing limits and furthermore reduces the minimum revenue requirements. With Indonesian bank rates above 20% interest and with short maturities, the financing of big capital projects with long capital amortization cannot be accomplished through domestic lenders. (For example the payment of a $ 10 million U.S. Dollar loan with a 20 year maturity at 10% requires $ 1.17 million compared to $ 2.054 million at 20 % or 1.84 times more.

To obtain a borrowing rate in the neighborhood of 10% would require credit enhancement by a U.S. agency or a World Bank agency. There are established programs that guarantee foreign payments and insurance against other foreign risk. These include Overseas Private Investment Corporation (O.P.I.C.), the World Bank Group Agency, the Multilateral Investment Guarantee Agency (MIGA) and International Finance

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Corporation (IFC). International Banks appear willing to syndicate loans with US guarantees.

Local projects of smaller scopes would be funded through local credit facilities. Projects that require borrowing for truck and solid waste disposal equipment may be difficult to finance. Local entrepreneurs with little experience may require special credit arrangements to enable them entry into the market place. One of the efforts of the demonstration projects would be to find a source that will finance small local firms.

6.4. Exchange Risk

With U.S. dollar investments and loans financing the projects, the exchange risk becomes an issue in the contractual arrangements. The developer is investing foreign currency and will need to repay the loans in the borrowed currency, thus will require protection on convertability and rates of exchange.

One approach is to price the contract payments in U.S. dollars. The G.O.I. would assume the currency risk. Based on current trends the G.O.I. would have to make up a loss in Rupiah each year.

6.5. Other Risk

The investor would take on the construction risk of completing the project within its budget but also benefit from lower costs and efficiencies. The same risk would be assumed in operations and maintenance. As long as the risk are controlable by the operator, it is logical to also accept the risk.

Risks in delays in project completion would fall where the control rests. The risk caused by governmental actions would be insured by a U.S Agency such as the case with breach of contract. The insurable risk would be a cost of the project and reflected in contract payments.

7. Technical Assistance

The implementation of the demonstration projects will require the support of technical expertise and management of the projects.

The BOT/BOO and comprehensive urban service projects will require a substantial project management, which will be provided primarily by the Demonstration Project Manager. The Demonstration Project Manager would provide forty-eight person months of management capacity from the identification process, project planning, investor

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selection, project negotiation and on a part-time basis oversee construction schedules. He or she will plan, manage, market, negotiate, and expedite the demonstration projects, with substantial assistance from the Urban Environmental Specialist and the Senior Urban Services Advisor.

Short term technical assistance will be requested primarily for project design and development. This should require six months of assistance by an engineer with expertise in water and waste water facility design and construction, and ten months for the comprehensive urban service district project. Once the contract is awarded, there will need to be oversight required on a periodically basis. In the first two projects, short term technical assistance will be used for marketing and negotiating investment packages, a task which will be handled by the long term technical assistance team and local consultants for projects in later years.

Assistance will also be needed in preparing six small scale service contract projects in the solid waste sector. The Municipal Services Advisor will allocate eighteen months to this activity. It is estimated three months of time will be required from the Municipal Services Specialist for each project. The majority of the expertise will be drawn from domestic consulting firms. With six contracts, it is estimated that forty-four person-months of consulting will be required for the small scale, less capital intensive demonstration projects.

The BOT/BOO and comprehensive urban service demonstration projects will require a total of seventy-two person months of long-term technical assistance, twelve person months of short-term expatriate economic/financial assistance, and thrity-nine person months of short term expatriate engineering assistance. It is estimated that 75 percent of the short term technical assistance and 50 percent of the long-term technical assistance will be recaptured from the successful completion of these projects. It is further assumed that there will be no recoverable costs from the six service contract projects.

8. Demonstration Project Costs

The PURSE Project will take on the costs of pre-packaging the BOT/BOO water and wastewater projects, as well as the comprehensive urban service district project. This will include schematic designs; market analysis and feasibility studies; a project contract proposal investor solicitation efforts, investor selection, and contract completion. All these activities will be subcontracted by the PURSE Project. It is planned however, that those expenditures that are applicable to the proposed projects and are costs that would normally be incurred in such a project would be repaid to the PURSE Project and capitalized as part of the demonstration project, according to the assumptions listed above. These costs would be specified in the project presentation. These costs consist of:

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(1) Technical advisors assigned to the project for project management **(Tech Ass't expat and local)**;

(2) The employment of a both local and foreign engineering firms to prepare the schematic design **(Design and Development)**;

(3) Presentation of the contract proposal; investor solicitation and marketing; the selection process and negotiation of the contract **(Pack/Mart/Negotiate)**;

(4) Construction oversight **(Oversight)**;

TABLE 7

DEMONSTRATION PROJECT COST ESTIMATES
(in $000)

Projects	1	2	3	4	5	Small Scale	Total
Tech Ass't (expat)	450	450	250	200	200	450	2000
Tech Ass't (local)			15	25	35	70	145
Design Development	200	200	250	175	250	30	1105
Pack/Mart/Negotiate	50	50	75	75	100	130	480
Oversight	50	50	65	70	75	15	325
Total Costs	750	750	655	545	660	695	4055
Rec. Costs	450	450	350	290	340	-	1880
Net Costs	300	300	305	255	320	695	2175
Net Cost BOT					1480		

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ANNEX A - 4

INSTITUTIONAL ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

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ANNEX 4

INSTITUTIONAL ANALYSIS

1. Introduction

Institutional problems and constraints are a major factor impeding improvement of Indonesia's urban services delivery capacity. Among the problems described throughout this Project Paper are

- the absence of an overall GOI strategy for the development of public-private partnership in the provision of urban services in Indonesia;
- the lack of a clear path for potential developers of private sector infrastructure projects to obtain the necessary approvals and define a framework of negotiation for their projects;
- weak, fragmented, and understaffed sector agencies at all levels involved in urban services planning and provision;
- inefficient and irregular procurement procedures; and
- a variety of legal and regulatory constraints hindering private sector participation in service delivery.

These problems contribute to low service coverage, particularly for the poor, and inadequate arrangements for wastewater and garbage disposal and drainage in major cities which, together with industrial and saline pollution of surface and groundwater, cause major environmental hazards for the urban population of Indonesia.

The legal and regulatory aspects of these constraints are discussed in Technical Annex 3C. The structure of sectoral and local agencies in water supply, wastewater treatment, and solid waste management is discussed in Technical Annex 3A. This Institutional Annex (1) addresses the roles and responsibilities of national agencies in the coordination of selected urban services and in establishing a framework for private participation in the provision of these services, and (2) discusses proposed project implementation arrangements.

2 Government Agencies Involved in Urban Infrastructure Services

A number of Central Government agencies are involved in various aspects of urban and municipal services provision (and private participation therein) in water, wastewater, and

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solid waste management. The major players are the National Planning Board (BAPPENAS) the Ministry of Home Affairs (MOHA), the Ministry of Public Works (MOPW), and the Ministry of Finance (MOF). Other concerned agencies include the Ministry of State for Population and Environment, the Ministry of State for Housing, the National Investment Coordinating Board (BKPM), and the National Land Agency. Key agencies for the PURSE Project are represented on the Interagency Coordinating Team for Urban Development (TKPP) chaired by the Deputy V for Regional Affairs in BAPPENAS.

Agencies represented on the PURSE Steering Committee are discussed below.

2.1 The National Planning Board (BAPPENAS)

BAPPENAS is responsible for overall allocation and planning of Indonesia's national resources, keyed to the country's five-year development plans and annual national development budgets. BAPPENAS is chaired by the State Minister for National Development Planning.

BAPPENAS plays a coordinating role between the other Ministries, evaluating projects put forward by them for Central Government funding, determining priorities and deciding which are to be included in the Annual Implementation Plan.

BAPPENAS is comprised of several sectoral divisions chaired by deputy ministers, each dealing with specific types of projects. There also is a Deputy Minister for Regional Affairs with responsibility for coordinating regional development. Within this division there are three regional bureaus for different geographic areas of the country as well as bureaus for Socio-economic and Spatial Development and for Development Aid to the Regions. The Deputy for Regional Affairs chairs the Interministerial Coordinating Team for Urban Development (TKPP). TKPP was established to "ensure synchronization of planning, financing, and implementation of various urban development investments." TKPP also is the coordinating location for the multi-donor sponsored Integrated Urban Infrastructure Development Program (IUIDP), the closest equivalent to an urban development master plan for Indonesia. Under IUIDP, pilot projects to improve local revenue administration, operation and maintenance planning, and financial management have taken place in several cities.

The TKPP was established in 1987 with 9 members representing BAPPENAS, the Ministry of Finance, the Ministry of Home Affairs, and the Ministry of Public Works. It functions through several working groups addressing policies and programs, program implementation, financial resources, and institutional development.

Because of its coordinating role, BAPPENAS has been involved in a number of previous USAID projects in Indonesia. It is the implementing agency for the policy-oriented

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Development Studies II Program currently underway. PURSE will provide the first opportunity for direct USAID cooperation with BAPPENAS on urban services issues although the Municipal Finance Project also falls under the coordinating mandate of the TKPP.

2.2 Ministry of Home Affairs (MOHA)

This Ministry has major involvement with urban issues through its responsibility for the supervision and development of regional government. MOHA has oversight through the Provincial Governors for all aspects of provincial and local government, including government-owned provincial and local enterprises (Perusahan Daerah or PDs). Such enterprises currently exist widely in the water sector (PDAMs) and in a few major cities for wastewater treatment (PDALs) and solid waste management (PDKs).

Within MOHA there are five Directorates General, of which the following two have particular responsibilities in relation to public utility services:

2.2.1 Directorate General of Public Administration and Local Autonomy (PUOD):

The principal functions of PUOD are to (1) formulate technical policies and to give guidance and approval in the area of regional government administration, (2) provide assistance to provincial and local governments; and (3) monitor and control regional project implementation within established policy frameworks. Management of regional enterprises also is a PUOD responsibility.

The Directorates of Regional Finance and Administration within PUOD are most actively involved with urban matters. Major responsibilities include:

- development of urban administration through decisions to expand municipality boundaries, upgrade towns to municipality status, or transfer district capital status between towns in a region;
- guidance to local authorities in the preparation of master plans, review and approval of such plans; and
- improvement of urban services by assisting local government in the administrative aspects of infrastructure operation and development (including financing, budgeting, staffing, management, and maintenance).

The Subdirectorate of Public Enterprises within the Directorate of Regional Finance has specific responsibility for administrative guidance to regional enterprises such as those

engaged in municipal service delivery. For example, the Association of PDAMS (regional water supply enterprises) is headed by a PUOD staff member from this Subdirectorate.

2.2.2 Directorate General of Regional Development (BANGDA)

The Directorate general of Regional Development (BANGDA) plays a coordinating role for cities and towns within the region, and administers the central government development grant program. The Directorate of Urban Development within BANGDA is specifically concerned with all aspects of urban administration and planning at national, provincial, and sub-provincial levels. The role of local government in urban services has grown in importance as the process of decentralization has moved forward. As a consequence, the fashion in which the supervisory function of BANGDA is carried out will directly affect the success of efforts to increase private partnership with local government.

Within BANGDA lies the Directorate for Urban Development, moved from PUOD in 1987. In reality, BANGDA and PUOD share responsibility for guidance related to urban and regional development with PUOD focused mostly on administrative issues and BANGDA on the development process. Financial questions involving local government such as tariff setting or borrowing are PUOD concerns.

USAID has worked closely with the MOHA in projects supporting decentralization since the early 1980s. Currently, the Municipal Finance Project (MFP), the Uplands Agriculture and Conservation Project (UACP), and the Financial Institutions Development Project (FID) are placed in the MOHA and provide technical assistance to the Ministry and/or regional government bodies. In view of this level of activity, PURSE is not intended as another institutional strengthening mechanism for the MOHA. Rather it will work with the MOHA as a necessary approach to assisting municipal governments with planning and packaging private sector participation opportunities.

2.3 Ministry of Public Works (MOPW)

The Ministry of Public Works is the GOI technical agency most directly concerned with urban infrastructure and services, as well as spatial planning. As a technical agency, it has the task of assisting local governments in urban services and infrastructure planning and programming, project preparation, and financial mobilization from donor sources or the private sector. The MOPW also assists local government in urban spatial planning and its implementation. MOPW offers as well to help local governments negotiate with the private sector and provide related technical assistance though MOPW officials acknowledge that they need additional training in how to structure deals attractive to private investors. As stated by one senior official, this involves moving from an administrator's perspective to an investor's perspective.

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Within the Ministry, the Directorate General of Cipta Karya (Human Settlements) is responsible for city planning and for guiding development of water supply, sewerage, and sanitation, solid wastes management, and other programs of community development. Also within MOPW, the Directorate General of Water Resource Development is responsible for bulk water supply (and urban flood control). For infrastructure construction as in water, MOPW supports the MOHA with project development and implementation. For example, the Directorate of Water Supply within the Directorate General of Human Settlements is responsible for evaluating water supply projects proposed by different local governments, and for the planning, design, execution and management of the water supply sector.

A USAID-financed advisor in urban planning has been assigned to the Directorate of City and Regional Planning in Cipta Karya through the Municipal Finance Project. This advisor's responsibility includes urban spatial planning and infrastructure programming. Among other things, his work supports an Asian Development Bank assisted program of Integrated Urban Development (IUDP) which has begun with studies conducted for the eastern part of Bandung city and selected medium and small cities in Sumatra and West Java.

Within Cipta Karya, The Directorate of Bina Program supports integrated planning by serving as the Secretariat for the Integrated Urban Infrastructure Development Program (IUIDP). This program, supported by several multi-lateral and bi-lateral donors, is aimed at decentralizing to local governments more responsibility in urban infrastructure and services planning.

Also within MOPW, there is a newly created (December 1990) Center for Strategic Studies (CSS) whose mission is to generate strategic thinking within the Ministry, including private sector issues and other innovation. CSS is headed by an Special Assistant to the Minister for Integrated and Urban Spatial Planning. CSS also addresses human resource development and organizes forums for discussion of key issues within the Ministry and with local government staff. Currently, CSS has 15 professional staff with graduate degrees.

CSS is giving particular thought to the issue of integrated urban area development. In part this is a reflection of the close linkage between urban infrastructure and private land development which has created opportunities for public-private partnership in area development. CSS expresses the goal of moving from the present ad hoc project-by-project and trial and error approach to a more strategic and national approach to private sector investment policies and program strategies for urban infrastructure and services.

USAID has worked with MOPW on a number of public infrastructure projects and, as noted above, has placed an urban planning advisor in Cipta Karya under the Municipal Finance Project. PURSE will augment the efforts of this advisor with particular reference to private participation strategies. Because the focus of PURSE is not on construction *per se* but rather on facilitating private participation, CSS is a more appropriate point of technical cooperation.

2.4 Ministry of Finance (MOF)

The Ministry of Finance is responsible for central and local finance through its Director General of Monetary Affairs, through the Director General of budget actually administers grant transfers and, through its Agency for Financial Analysis, monitors local finance.

All central government budget (APBN) allocations are prepared through the Directorate of Development Budget within the Directorate General for Budget. The Directorate General for State Wealth (PKN) deals with different aspects of development projects put forward by Ministries such as Public Works, Housing, Communications, etc. It evaluates feasibility studies put forward by Cipta Karya or other agencies and costs of projects. PKN also has to determine the proportions of funding for local projects which should come from Central Government subsidies, and arrange appropriate loans.

There appear to be no fixed procedures whereby the MOF would become, in normal circumstances, directly involved in the establishment and operation of joint venture companies for provision of urban services supply development. Implementation of MOF policy in this respect is already delegated to the BKPM and is embodied in the licensing procedures applied to prospective investors by BKPM.

Nonetheless, the MOF will play a critical role in public-private partnerships by providing key assurances regarding performance on contracts by GOI agencies. The private sector will require "comfort" in the sense that there be assurances that the resources necessary for a contract to be honored will be provided. The MOF policy role in this regard is reflected by its membership on the PURSE Steering Committee.

USAID currently cooperates with the MOF under the Municipal Finance Project and the Capital Markets project, both of which have placed advisors in the MOF.

3 Recommended Institutional Arrangements

To achieve significant private participation in urban services in an efficient and timely fashion will require carefully designed implementation machinery and, of necessity, involve a variety of institutional actors. Project committees with a coordinating role must be staffed at as high a level as possible and represent the main interests of the government -- technical, economic, and financial. Coordinating bodies will need to be assisted by a broader group of resource persons drawn from relevant implementing agencies. They also will need adequate and quick access to the right kinds of focused expertise to be called upon as the need arises. Legal, commercial, and financial skills of the highest order will be required in all sectors involved. While some of these skills will be provided by technical assistance, it will be important to establish accessible capacity at appropriate points on the government structure as well as ensure that they are available from contracted private sources.

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3.1 Project Management

Management of PURSE requires arrangements that effectively coordinate and direct the work of several government agencies concerned with various aspects of municipal services delivery.

3.1.1 PURSE Steering Committee

Project activities will be coordinated by a PURSE Steering Committee attached to the Deputy for Regional Affairs at BAPPENAS who chairs the existing Interministerial Coordinating Team for Urban Development (TKPP). This also is the location for the multi-donor sponsored Integrated Urban Infrastructure Development Program (IUIDP), the closest equivalent to an urban development master plan for Indonesia.

A lesson learned from past AID experience in Indonesia and elsewhere has demonstrated that it undesirable to create a new institutional entity to manage a project. Such creations lack institutional legitimacy and do not serve interests of sustainability. It is appropriate, therefore, to link PURSE management to the existing TKPP which includes all the key agencies potentially involved in private participation in local services. A PURSE Steering Committee will allow the group of agencies most directly involved in implementation of this component to focus on the coordination and management needs.

Agencies to be represented on the PURSE Steering Committee are the Ministry of Home Affairs (Directorate General PUOD and Directorate General BANGDA), the Ministry of Public Works (Directorate General Cipta Karya), and the Ministry of Finance. The Chair of the Steering Committee will be designated by the BAPPENAS Deputy for Regional Affairs. He also will designate the GOI official from one of the implementing agencies who have signature authority for PILs and other implementation agreements during the life of the project. The PURSE Project will not provide long-term technical assistance to BAPPENAS but will provide appropriate TA to the implementing ministries, Home Affairs and Public Works.

BAPPENAS will have responsibility for providing direction and setting priorities for the agenda of this project component. BAPPENAS will have particular responsibility for the policy and regulatory agenda and, as such, will work with implementing Ministries, especially Public Works and Home Affairs, to assess and help overcome constraints to private participation in infrastructure projects.

The BAPPENAS Steering Committee Chair or his designee, working through this committee, will liaise with other GOI agencies involved with the project and maintain close contact with the USAID Project Officer. PURSE technical assistance activities will be under the overall coordination of the BAPPENAS Deputy for Regional Affairs and the USAID Project Officer, though allocated to various agencies over the life of the project.

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The Chair of the PURSE Steering Committee also will have responsibility for reviewing and approving Annual Plans.

3.1.2 Implementation

Demonstration projects and other implementation activities involving local and regional government and regional enterprises will, in most cases, be managed by members of the technical assistance team in coordination with the Directorates General of Public Administration and Regional Autonomy (PUOD) and Regional Development (BANGDA) in the Ministry of Home Affairs. The focus of the MOHA in recent years has been on implementing a more decentralized local government structure. In this context, local authorities have considerable scope in dealing with pricing, contracting, and other issues of importance to facilitating private participation in urban services provision. The focus of the project will be on regional governments and regional enterprises under the guidance of the MOHA. Likewise, TA "assigned" to the MOHA will, in fact, work primarily with local entities.

In view of its particular interest in integrated spatial planning, consideration will be given to developing one multi-sectoral project involving a combination of water, wastewater, and solid waste management. If project investigation supports the feasibility of such an attempt, it is expected that it will be implemented through the MOPW under the guidance of the CSS. TA will be assigned to the MOPW to work with CSS on arrangements to encourage private sector participation in the urban services aspects of integrated area development schemes.

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ANNEX A - 5

SOCIAL SOUNDNESS ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

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ANNEX A - 5

SOCIAL SOUNDNESS ANALYSIS

1. Overview and Key Issues

PURSE Project interventions do not focus on particular social groups in Indonesian society, but seek instead to alter the environment within which water, wastewater and urban services are provided to increase private sector participation.

Specifically targeted are individuals and groups which may contract with regional governments or regional enterprises to produce urban services. These include both large private firms that will benefit from increased participation in major construction and/or operation of urban infrastructure and small entrepreneurs who will benefit from increased opportunity to sell their services to regional governments and regional enterprises.

Lower income individuals and households may benefit from increased employment opportunities with private sector producers of urban services, but the main benefits to economically and socially marginal groups will be through improved provision of these services.

Lack of adequate urban services has particular impact on low income households. While there has been a significant reduction in the incidence of rural poverty, from 26 million people below poverty income in 1984 to 20 million in 1987, there has been a smaller reduction in proportion in urban areas, with an actual increase in numbers from 9.3 million to 9.7 million due to growth rates in urban population.

The GOI's poverty alleviation strategy includes two elements related to urban services: 1) ensuring adequate provision of basic infrastructure and services; and 2) improved targeting of public expenditures to meet the needs of the poor. The PURSE project will contribute to both of these elements by increasing the supply of urban infrastructure and services and by improving the efficiency of resource allocation decisions on urban services.

The underlying assumptions are:

- Increased private participation will increase the overall level of supply of urban services, thereby benefitting all groups not now served adequately; and
- Increased private participation will alter the market for urban services by increasing the efficiency of both services provision and the use of natural resources.

2. Cost of Urban Services

To the extent the first assumption holds true, the overall quantity of urban services will increase, and that increase will benefit economically and socially marginal groups in two ways. First, lower income households and households living in unregulated and unserviced slum areas are the main sufferers from a lack of quantity in urban services. Higher income groups and households living in enclaves and organized, official neighborhoods already receive reasonable quality and sufficient quantity of urban services. Marginal groups now do without those services, or, as in the case of water, pay significantly higher prices for those services than groups living in serviced areas. Thus increased supply, to the extent that it displaces vended water and other higher priced sources, will lower the price of water to low income households.

The second effect is due to the impact of private participation on subsidized pricing policies. GOI policy is to subsidize the costs of urban infrastructure based services such as water by financing the capital costs of construction out of general revenues and requiring, through regional governments and regional enterprises, cost recovery only on the operating and maintenance costs. Therefore, those who are receiving formal service from the public sector, mainly higher income groups, actually are benefitting most from the subsidy policy. Therefore, an increase in supply brought about by private participation will somewhat redistribute pricing patterns to cause more direct cost recovery from beneficiaries. This will happen to the extent that at least some capital costs are included in tariffs, thus allowing already existing subsidies or cross subsidies among beneficiaries to be more accurately targeted to lower income households. This effect is secondary rather than an overt result of project interventions.

3. Quality of Urban Living Conditions

The lack of sufficient quantities of safe drinking water and the inadequate handling of wastewater and solid waste have a greater negative impact on the quality of life of economically and socially marginal groups than upon any other groups. Though coverage of urban services has improved significantly in Indonesia over the last 2 decades, it continues to be low by international standards. About three quarters of the urban population do not use piped water for drinking (much of the population still relies on shallow wells which are increasingly becoming polluted and less than 35% has access to adequate sanitation. Drainage is ineffective and lacking in many urban areas. These deficiencies contribute significantly to the serious urban environmental degradation and affect, in particular, the urban poor. The growth in cities also exacerbates the incidence of urban poverty. Much of the immigration reflected in the high urban population growth rate of about 5.4% per year fall into the lower income groups which places a strong demand on urban infrastructure.

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In serving the urban poor, the GOI has adopted a program whose stated objective was to provide improved piped water service to reach poor household through a ratio of 50% individual connection and 50% public standposts. These targets have not been reached, and currently 10% of urban dwellers rely on vended water, mainly the urban poor. In a recent study (Lovei and Whittington, 1991) the cost of vended water in some cases was as much as 50 times more per unit of water than for households connected to the municipal system.

4. Health Impacts

A review of the health benefits of access to potable water by Esrey et.al. revealed that the negative health consequences of inadequate drinking water and poor handling of wastewater falls disproportionately on lower income groups (WASH Technical Report #66, 1990). Higher rates of diarrheal and other water borne diseases reduce life expectancy, cause loss of work opportunities, increase family care burdens assisting ill family members, and cause less productivity among workers while actually working. Overall diarrhea is the third largest cause of infant mortality in Indonesia, contributing to 16% of infant deaths. The severity of the illness, i.e. days reported ill, appears to be higher for diarrhea among urban poor than rural poor.

Improved sanitation conditions through improved solid waste handling and wastewater disposal as well as access to potable water have shown that the median reductions in incidence of diarrheal disease have improved 26%. Other morbidity reduction to improved water supply and sanitation are set out in the following table.

MORBIDITY REDUCTION

	All Studies			Better Studies		
	#	median	range	#	median	range
Diarrhea	49	22%	0-100%	19	26%	0-68%
Ascariasis	11	28%	0- 83%	4	29%	15-83%
Guinea worm	7	76%	37- 98%	2	78%	75-81%
Hookworm	9	4%	0-100%	-	-	-
Schistosomiasi	4	73%	59- 87%	3	77%	59-87%
Trachoma	13	50%	0- 91%	7	27%	0-79%

Source : Water and Sanitation for Health Project (WASH) AID

Water, sanitation and solid waste improvements will have greater health, and linked economic, benefits to the marginal households because they now are the ones suffering the greatest negative impacts. Women and children are also likely to benefit most from water and sanitation improvements, the former from additional productivity and time saving benefits and the latter because children are most at risk from diarrheal disease.

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5. Environmental Concerns

In addition, to the extent that natural resources such as water in the aquifers are being used at a noneconomic pace and/or are being damaged or destroyed by the lack of environmentally sound practices, it will be the marginal economic and social groups who will lose services first, or face higher prices for services because they are the last served. Higher income groups can afford to escape to some extent these environmental consequences by choosing their residential locations, leaving environmentally riskier space to lower income groups. To the extent PURSE improves environmental conditions by increasing the regulation of uncontrolled resource exploitation, lower income groups will be at least equal beneficiaries.

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ANNEX A - 6

U.S INVESTMENT ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

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1. INTRODUCTION

This background paper examines the feasibility of seeking to involve U.S. private firms in the development of urban water, waste water and solid waste infrastructure in Indonesia as part of the proposed Privatization of Urban Services (PURSE) Project.

The findings and recommendations are drawn primarily from direct contacts and informal discussions with U.S. industry representatives, financial institutions and bilateral agencies.

Chapter Two reviews the nature of and recent trends in these sectors in the United States, summarizes the range of views expressed regarding international business opportunities and perceived risks and constraints to be overcome, and presents various suggestions offered by industry representatives for the design of the PURSE Project.

Chapter Three provides an overview of resources available at USAID and other agencies that can be tapped by AID/Jakarta and private firms participating in the PURSE Project, and identifies some of the lessons learned in attempts to involve the private sector in infrastructure projects in developing countries.

Chapter Four discusses potential strategies that could be incorporated into the PURSE initiative to stimulate interest among U.S. firms and private financial institutions and to help bring viable projects to fruition.

The PURSE Project arises at a propitious time, since (a) the interest of U.S. firms in considering overseas opportunities in these sectors is growing as a result of budget constraints and heightened competition domestically, (b) both public and private financial institutions are mobilizing to support privatization and private investment in infrastructure, and (c) a body of experience is beginning to develop in the specific sectors being targeted by AID/Jakarta in the Pacific Rim countries and elsewhere.

With some notable exceptions, few U.S. firms with capabilities in these sectors are present in Indonesia, and few have succeeded in structuring Build-Operate-Transfer (BOT)-type projects outside of the United States. It seems that they would be quite receptive to if not initially dependent on USAID promotional efforts and support programs. Moreover, the better-placed firms and financiers suggest that the government's commitment to privatization and BOT-type arrangements and its ability and willingness to designate specific priorities for project development are the basic foundations they require in order to focus their attention on the target sectors. They too seem to welcome USAID's plans to play a more active role, both in the policy arena and in the sponsorship and early support of specific projects.

2. PERCEPTIONS OF U.S. COMPANIES

All of the information contained in this Chapter is drawn from interviews with approximately 40 private firms and individuals in the U.S. water and waste management sectors and relevant financial institutions. This synthesis focuses on:

- key characteristics of the "industry" of relevance to the PURSE project, and observations on its status in the U.S.;
- recurring or unique perceptions of international business opportunities and constraints; and
- various industry suggestions for the design of the PURSE project and similar USAID efforts.

The discussions yielded several areas of consensus and points of contention that provide important assumptions for the design recommendations of this paper.

2.1 NATURE OF THE BUSINESS

The water and waste management sectors consist of thousands of firms[1], collectively specializing in hundreds of disciplines as to the types of water and waste examined or handled, technology being applied and services being provided. Their activities encompass consulting, engineering, procurement, construction management, construction, equipment manufacturing, operations management, maintenance and training. Financial advisory services are provided both by units or affiliates of these firms and by commercial and investment banks, as well as by specialized financial intermediaries and research firms. Project development and operation are often undertaken by consortia, with various firms contributing unique functional capabilities.[2]

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[1] For example, the National Solid Waste Management Association has close to 7,000 members with $25 billion in sales. The top two firms, Waste Management Inc. and Browning-Ferris Industries Inc., account for almost half of these revenues, while no more than a dozen other members have sales in excess of $100 million. A number of major firms peripherally involved in solid waste projects are not members of the association.

[2] For example, a comprehensive hazardous waste project in Hong Kong was awarded in 1990 on a 17-year BOT basis to a consortium that includes Waste Management Inc. (primarily providing operations management services) and Bechtel (providing engineering, construction management, financial advisory and management

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The most specialized engineering and construction management firms often collaborate with construction firms and equipment suppliers who are not necessarily specialists in the water or waste sectors, including local firms in developing countries. Consulting and engineering firms also provide extensive training and supervisory support to operating entities, whether public or privately-owned, as well as to new project sponsors and investors that may or may not have had prior experience in the sectors or in the specific technologies being introduced. Finally, many of the larger firms involved in water, waste water and solid waste (less so) projects have extensive if not predominant activities in other sectors, including power, civil and industrial engineering and construction.

In their many forms, water and waste management firms are above all management intensive businesses selling services and know-how. According to some observers, the level of competence and sophistication varies widely, and even more so the ability of firms to field qualified staff for ambitious new projects, whether international or domestic. There appears to be a growing shortage of highly specialized and experienced professionals towards the purely consulting end of the spectrum (considerable in-house training and supervision by senior staff is required), and of senior management at the more operational end, which involves complex, round-the-clock materials handling, personnel and financial management activities.

Trends in the United States

Following significant profitability and expansion during most of the 1980s[3], and despite excellent future prospects in the aggregate U.S. market, a recurring theme in the interviews was that growth has slowed in the target sectors over the past 2 or 3 years. This is attributed to the recession and budget crises at all levels of government, as well as to growing competition and reduced profitability in some sectors. The twin pressures of recession and competition seem to provide a more promising context for USAID efforts to attract U.S. engineering, construction and specialized water or waste-related operations management firms overseas than at any time since the recession of the early 1980s, which saw the emergence of the BOT approach to international infrastructure project finance.

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assistance services). The construction value is estimated at $125 million and life-of-contract revenues at $420 million.

[3] For example, the private sector handles some 80 percent of the solid waste output in the United States (including 2/3 of the household output) and over 90 percent of the industrial and hazardous waste. In some municipalities, especially those with strong unions, solid waste facilities continue to be operated by public entities.

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There also appears to be some consolidation underway, especially in the solid waste industry. The largest companies are buying market share, management talent, real estate and access to specialized technologies through numerous acquisitions, often issuing new stock, which has been known to sell at multiples of over 20 times earnings. Nevertheless, the importance of specialization is highlighted by the recent failed attempt of Browning Ferris Industries to enter the hazardous waste sector, where there are many small-to-mid-size specialized firms (ranging from $50 to $250 million in sales). Many of these firms have successfully completed public stock offerings in recent years, often capitalizing on unique technologies and market niches in industrial and hazardous waste.[4]

Regulatory and financial arrangements in the water and waste management sectors in the U.S. cover a broad spectrum, and considerable expertise has been built up over the years by firms in the industry and their legal and financial advisors, as illustrated below.

- Although the expressions are used to refer to projects in developing countries, Build-Operate-Transfer (BOT) and Build-Operate-Own (BOO) arrangements are quite common in the U.S. solid waste sectors, whereby the private company will finance, develop and operate a facility on a turnkey basis, with or without the obligation to transfer any ownership interest they might have taken as part of the package to a municipality after a given period of time. These types of arrangements are far less common in the water and waste water sectors, as discussed in greater detail below.

- Several interviewees stated that project companies do not view the arrangement of private financing packages as an end in itself, but rather as a means to assist a client municipality (or foreign government) and win a contract or concession.

- A privately-owned project may very well engage in revenue-sharing with a municipality as a strategy for overcoming the "not-in-my-backyard syndrome".

- For projects undertaken on a lease or other contractual basis using public sector financing, two common models are (a) where the private company's mandate is periodically renewed by mutual consent and (often referred to as a "franchise"), and (b) where the mandate is granted for a fixed term and renewed by public tender (a "concession").

- When a privately-financed or privately-owned operation is governed by a long-term arrangement with a municipality, it is often agreed that rates will be revised once the major capital investment has been amortized.

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[4] First Analysis Corporation maintains an "Environmental Index" of some 78 publicly-held private companies, many of which have come to the market in the past 5 years, some with the backing of larger firms.

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- Billing arrangements for solid waste and waste water services vary widely (including direct billing, the water bill and taxes). Responsibility for revenue collection can rest with the private owner/operator (who in some cases holds a lien on the residences served, as in San Francisco), or with the municipality (even if the waste management service is provided by a private entity).

- Typically voluntary and smaller-scale activities with a low-value output, such as composting, are still viewed as being more in the public sector realm.

It was noted that several changes introduced by the 1986 tax law (e.g. in investment tax credits and depreciation) have made it more difficult to mobilize private finance for public infrastructure projects, when compared with the traditional option of using tax-exempt municipal and state securities. However, government budget problems in the U.S., as well as potential advantages in terms of cost and operating efficiencies, have continued to promote interest in private financing and operation of infrastructure projects.

These trends also reflect (a) the growing acceptance of private involvement by government entities and the public, particularly for the more complex and/or costly projects, (b) the growing experience in devising public-private business arrangements and rate structures that permit them to be run on a profitable commercial basis and (c) the ever-higher comfort levels of operating companies and financial institutions in the permanence of federal, state and local government commitment to environmental regulation and enforcement.

It is readily admitted that most waste management activities owe their existence and prosperity to regulatory fiat and enforcement. They have also benefitted from significant public sector capital investment, and that have enjoyed significant operating subsidies and protection. A prime example of the latter is the complexity, cost (up to 40% of the cost of a new landfill) and extremely slow pace of the permitting process. Delays of up to 8 years in completing the formalities for new solid waste facilities have helped existing operations generate extremely attractive profits margins, with gross margins "well in excess of 50 percent" according to a key participant in the industry. One observer commented that for many smaller operators, the next step is more likely to be a prosperous retirement rather than pursuit of corporate much less overseas growth.

Some of the other salient characteristics of these sectors in the U.S. that emerged from the interviews are summarized below.

Solid, Industrial and Hazardous Waste

The "bread-and-butter" of the solid waste industry continues to be collection, hauling

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and disposal of refuse through landfills or incineration. The vast majority of the members of the National Solid Waste Management Association are engaged essentially in these activities, and they also constitute the prime acquisition targets of the larger firms.

There was significant private investment in mass burn waste-to-energy facilities during the 1970 and 1980s, and they continue to receive a great deal of attention in the industry and support from private investors and lenders. However, two interviewees emphasized that their economic and financial viability depends largely on the price of electricity in a given locality (which varies enormously, for example from 2-3 cents per kilowatt in some cities in Canada to 8-9 cents in parts of southern California). They each indicated that the all-in cost of a typical facility (including financing costs) might be $100 per ton, as opposed to $30-40 per ton for landfilling and simple incineration. There has also been concern in both the United States and Europe[5] about the possible adverse environmental impact of the ash and particulate emissions these facilities produce.

For all of the attention it receives, there was a notable consensus that the commercially-driven as opposed to public contract-driven investment in waste processing (sorting) and resource recovery or recycling industry (including methane gas-to-energy recovery) is still modest, not particularly profitable and of only peripheral interest to large firms. According to a leading institutional investor in this field, the challenge is to identify high value end products and adequate markets: initiatives in industrial waste recovery,

typically for further use as industrial inputs, have typically been the more successful to date.[6]

Water and waste water management

Despite the recognized potential for achieving cost savings and shifting the financing burden to the private sector, a number of observers were pessimistic about the scope for

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[5] For example, the Institute for Local Self-Reliance reports that "the moratorium on new incineration plants in Sweden in 1984 to 1986...stimulated concern and guided research in the United States" and that within two years of becoming standard in Europe, "baghouse fabric and acid-gas scrubbers...were required in the United States by most stage agencies and by the Federal government" (from Garbage in Europe: Technologies, Economics and Trends, ILSR, 1988).

[6] For example, there is comparatively little experience in the U.S. with composting, and the end-product is often sold below cost or given away, both in the U.S. and in European countries where composting is more prevalent.

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a major expansion of privately financed and/or operated water and waste water management systems in the U.S. during the coming decade. The U.S. private sector provides engineering and other services, but there are very few privately-owned or operated sewage piping, treatment or disposal systems. These have traditionally been and still are almost exclusively financed through federal and state grants (chiefly for upgrading existing facilities) and municipal budgets.

Perceived constraints raised in the interviews include:

- Public sector reticence to cede control of sectors it has traditionally managed.
- Popular sensitivity to private management of vital public services.
- Labor union resistance.
- The ability of municipalities to raise lower-cost, tax-exempt financing (this does not preclude private operation, however).
- The very long term nature of investments in piping and other civil works (sewage treatment plants are more likely to constitute a reasonable sector for private investment).
- Inherently less attractive economics that make non-recourse financing and private equity investment difficult to obtain.
- High transaction costs involved in organizing an appropriate regulatory framework and business arrangements.

Even though municipalities do attempt to pass on the full cost of water and sewage service to the consumer, the general consensus seems to be that private investors would be unable to generate an attractive return on investment from building, owning and operating such facilities without introducing significant and politically unacceptable price increases. However, there are privatization examples for the PURSE Project to examine more closely, both in the U.S. and in countries like the U.K., France, Spain, Malaysia, Cote d'Ivoire and Guinea. Interviewees agreed that there is a significant role for the private sector to play on a contract basis, whether in the planning and construction of the facilities and the training of municipal operators, or in providing a variety of operations management services.

2.2 INTERNATIONAL OPPORTUNITIES AND CONSTRAINTS

There was a convergence of opinion on a number of points, and significant contradictions thereof are noted as appropriate.

Level of Awareness and Perceived Opportunities

A number of the very large general engineering and construction firms have been conducting international business extensively for a long time, but most observers agreed that the vast majority of firms more narrowly specialized in waste management systems and operations have hardly begun to examine the opportunities. Some suggested that most U.S. firms look overseas out of necessity, as a result of perceived market decline in the U.S., and that presently there is still no lack of domestic opportunities. However, there is also a perception that overseas business is likely to be more profitable and to offer strong growth potential, particularly against the industry-wide backdrop of recession and stiffer competition.

A number of the large engineering and construction firms maintain business development offices in Asia (and Indonesia specifically), while the few specialized waste management engineering firms and operators active internationally use their overseas presences for further business development and maintain dedicated personnel at headquarters. They have traditionally operated overseas on a contract basis financed by host governments and donor agencies, while providing working capital financing and performance bonds as needed. However, from the many opportunities they are considering at any given time, they are well aware of the growing demand for private financing packages for the underlying capital investments, and have both in-house project finance capabilities and strong relationships with private financial institutions.

It was pointed out that after many false starts, there are apparently only 3 private power facilities of more than 10 MWs operating in developing countries, with a greater number of less than 5 MWs. Nevertheless, private power generation projects are expected to account for at least half of all new developments in the United States in the 1990s, and a fast-growing proportion of such investment elsewhere. By contrast, privately-financed and/or operated projects in water and sewage, waste-to-energy, recycling, and so on, are an even more recent phenomenon in the U.S. If they follow the pattern of the energy sector, the development of private projects in these sectors by U.S. firms overseas may have a gestation period of up to a decade, without strong stimulus and support from USAID and other public agencies.

Above all, U.S. firms interested in overseas opportunities in water, waste water and solid waste appear to be looking for high quality projects in areas where they are highly qualified and likely to be able to perform up to their reputation. This is understandably

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a vital concern in sectors where the principal and most profitable private sector products are know-how and management services, irrespective of the source of financing.

Perceptions of Indonesia

Specifically with regard to Indonesia, a number of firms contacted, both large and small, have had recent involvement in the development of private power projects, and at least one firm has been providing waste management services to private industrial clients. Other firms, essentially large ones, have submitted proposals to the Indonesian government in the other sectors targeted by the PURSE project (not necessarily involving private financing), but none appear to be pursuing specific opportunities today. These firms must be adept at recognizing situations where a marketing effort had best be postponed, as apparently has been the case of Indonesia for some firms in the past.

Nevertheless, several interviewees were aware of substantial needs and opportunities in Indonesia, and there seems to be a fair level of confidence that commercial financing packages can be organized in any of the sectors targeted by the PURSE project, provided that the government is firmly committed and that the projects are very carefully structured, with the key ingredient being a contract with the government containing the requisite "guarantees".

It was also pointed out that Indonesia will require infrastructure development not just to meet public health and welfare objectives, but also to maintain its position as a fairly attractive market for private investment in other sectors. Its competitive strength as a source of lower cost labor than most of the other Pacific Rim countries could be jeopardized by a greater opening in such countries as China, Vietnam and Burma, and a sound infrastructural base with adequate regulatory standards could be an important asset for drawing investors.

Few interviewees were prepared to suggest what opportunities exist or what an appropriate set of water, sewage or waste management projects would be for Indonesia specifically. A few firms expressed enthusiasm for the industrial and hazardous waste sectors, while others have long been aware of the major urban sewage problem. Solutions depend on the exact nature of the waste stream in a particular locality or from a particular source, potential uses and markets for resource recovery projects, specific regulatory and business arrangements that have yet to be established, and so on.

One recurring view was that more labor-intensive technologies involving a minimum of mechanical processes would be more appropriate and certainly less costly for Indonesia, for example in the household solid waste sector.

On the other hand, it was pointed out that the comparative advantage and economic interest of U.S. firms lie in higher technology, where foreign competition supported by

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lower cost financing is less likely to dominate. Some also suggested that the high-tech equipment and know-how offered by U.S. firms lend themselves more to industrial and hazardous waste than to water and sewer projects, with municipal solid waste lying in between.

Important general and country-specific constraints raised in the discussions relate to deficiencies in the regulatory environment, the lack of planning, prioritization and commitment to well-defined objectives, the competitive advantage of firms from other countries benefiting from home government financial and political support, the long-term nature of potential project returns, and difficulties with government-business interaction.

Industry Concerns and Perceived Constraints

There was above all a widespread consensus that authoritative and highly convincing government commitment to well-defined objectives and priorities was of primordial importance, and that U.S. know-how could then help flesh out specific problems and solutions. In a particularly receptive environment, the large U.S. firms appear ready to engage in fairly extensive pre-feasibility or policy advisory work for little or no immediate return, or to undertake small-scale "demonstration projects" on a fee-paid basis, provided that there is a strong prospect of follow-up business opportunities. A number of larger companies indicated that they would not provide significant access to their technology (e.g. by carrying out a detailed feasibility study) without a contractual agreement or strong understanding that they would be retained to develop a major project. Planning and design activities typically do not exceed 10 percent of the construction value of infrastructure projects.

The next greatest concern is whether a technically adequate and politically stable regulatory environment (beyond project-specific arrangements and guarantees) is in place or that the firm commitment has been made to the developing such a framework. This factor provides confidence there will be future business for a company that enters the sector early. In addition, if countries are not prepared to meet high enough standards, the larger firms may not be interested in devising and implementing intermediate, lower-cost solutions.

Another basic consideration is whether relevant government authorities have sufficient management capacity to meet their responsibilities in the development and supervision of given projects to be built and/or operated by U.S. firms. The latter would also want to avoid situations where there is a significant risk that local operating entities would have insufficient operating funds or otherwise mismanage projects that the U.S. firm has sold and installed: again, if there is no continuing role, the potential negative impact on a firm's reputation is an important consideration.

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Many firms express reluctance to enter any market where there is a strong likelihood that the government will want to influence private business arrangements and the resolution of disputes, for example as to the allocation of roles, responsibilities and financial returns among foreign and local participants in a consortium. However, on the technical side, they seem to welcome challenging, professional government standard-setting and enforcement. In this regard, one observer noted that public health objectives and standards cannot be left to the appreciation and management of the private sector, and that in the U.S. these responsibilities continue to be exclusively within the province of government.

Just as in the United States, the waste water sector was seen as a particularly difficult one to pursue on a more or less commercial basis with private financing. There is a general consensus that consumers must be readied to pay for a sewage infrastructure that they have lived without until now. Even if the private provider is paid strictly on the basis of a cost plus or fixed fee contractual arrangement with government, the underlying financial viability of the system rests on creating a revenue stream that ultimately involves billing or taxing thousands or millions of households. If at all feasible, this process must in all likelihood remain a government hands-on responsibility, or on a worst case basis a government-guaranteed process managed by the private provider.

In the area of resource recovery, the market risk is presumed to be significantly higher in a developing country such as Indonesia, if there is any market at all. The waste stream is likely to be high in organic content, particularly in light of informal sector scavenging activity, and therefore suitable primarily for already low-value composting and potentially for methane gas production. However, many interviewees suggested that there may be unique, commercially viable opportunities in industrial waste recovery. Indeed, industrial processes are often highly inefficient in developing countries and generate larger volumes of marketable materials than more sophisticated plants.

There was of course a broad consensus that foreign exchange transfer risk and exchange rate risk must be properly mitigated if the firm is to provide long-term financing and services in exchange for long-term financial returns. Faced with serious foreign exchange transfer and debt service problems in one developing country, one large firm expressed a strong preference for local currency-denominated debt to local institutions, even if willing to have its U.S. entity guarantee it. Strong confidence in the transferability of dividend payments and capital gains are also essential for any equity investment.

One large firm suggested that it would only work in a developing country on a cost plus basis, given perceived difficulties in controlling costs and other local conditions that could have an impact on project efficiency and profitability.

U.S. companies also have some perceived internal constraints:

- Smaller companies in particular may have the technical know-how and management capabilities, but have little or no experience in developing country administrative, market and social environments, and in many cases have not or rarely worked outside of a given region of the United States.

- Smaller firms have little scope to risk their own capital or absorb losses if they were faced with an opportunity to participate in a BOT-type project. Their top priority is profitable investment and growth in the domestic market: "why look halfway around the world if you're judged by how well you do here?".

- In addition, U.S. companies are often perceived to require a faster return on investment than their competitors, and they express concern about shareholder and board sensitivity to potential losses from foreign subsidiaries. They must justify overseas financial and human resource investments as the means to generate high-return, low-risk opportunities.

- Several of the larger firms expressed concern about the potential drain on their personnel and indicated a preference for markets with a services industry capable of providing turnkey support or experienced management and skilled labor resources.

As a final general comment on all of the sectors targeted by the PURSE Project, some observers indicated that few firms can offer all of the needed expertise in evaluating the status and requirements of a given sector at the national level or in a given locality, reviewing all possible alternatives and producing a comprehensive sector development plan. Although there are different "schools of thought" on the types of approaches that are likely to be most effective (see below), there was certainly a widely shared consensus that any approach to a given problem that is not properly supported by local conditions (regulatory, social, etc.) is bound to fail, whether in the U.S, or in any foreign and/or developing country.

2.3 INDUSTRY SUGGESTIONS

Most interviewees perceived USAID's strengths to be chiefly in funding technical assistance and training for public policy-makers and public utility managers, and in identifying the potential for and promoting U.S. private sector involvement. Its ability to provide project-specific financing and logistical support beyond the feasibility study stage was considered by some to be of secondary importance, particularly for larger projects.

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In order to generate interest among U.S. firms, it appears to be vital to describe the country environment, the potential in a given sector, and the ingredients of a particular project in considerable detail. Few companies not already present or active in Indonesia are in a position or have the inclination to carry out basic market research. The more background information USAID can provide up-front, for example in an RFP, the easier it is for a broader range of firms to evaluate a given opportunity and the more responsive they are likely to be.

The types of background information that were often mentioned as particularly useful are as follows:

- evidence of government commitment
- regulatory environment, both sector-specific and general as it relates to foreign investors and contractors
- enforcement capability and performance
- nature of the specific problem to be solved and options under consideration
- identity and proposed role of the public entities and potential private sponsors or partners to be involved
- availability of local services and personnel
- preliminary financing plan

Regarding potential approaches to Indonesia's requirements, there was a divergence of opinion among interviewees as to the appropriateness of larger-scale vs. smaller-scale solutions. The points raised by various parties are roughly contrasted below.

- One view argues for an initial focus on technology and transfer and training, and for a deliberate approach (including pilot projects) to any attempt to develop a comprehensive privatization, commercialization and/or new development plan in a given sector. It places emphasis on the need to analyze the local context in extensive detail, with the fullest possible degree of local input, avoiding any initial bias towards the adoption of either a large project or a more incremental approach to a given problem. Smaller projects are said to minimize the cost of mistakes and to allow time for training of public sector policy-makers and managers. Regarding the regulatory environment, it was pointed out that the higher the standards, the more expensive the projects are likely to be. In addition, some interviewees (including a leading industry representative) suggested that there is a need to create niches for smaller U.S. and local private developers

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and operators, who can often be highly efficient and go straight to the root of a problem.

- The opposing view argues the merits of a larger-scale, consistent approach using proven technology. For example, a number of observers would discourage any sewage system development effort in a given city that is not consistent with a master plan, even if developing or updating such a plan requires a significant investment of time and money by the government. It was suggested that seasoned industry veterans are capable of customizing very large-scale approaches to a particular site and situation. If the objective is to clean up a given site as quickly and efficiently as possible, it is argued that a multiplicity of lower-cost, smaller-scale intermediate solutions is difficult to manage and likely to dilute financial resources. For one observer with a longstanding presence in the country, Indonesia has already been "studied to death" and what is required is a clear commitment to proceeding with concrete action. Finally, some suggested that smaller consulting firms rarely have the breadth of both technical and local knowledge and business experience to produce a plan that can readily be executed, or the financial and management capacity to implement a project.

Given this divergence of opinion, one suggestion was made that any sector planning or project identification work benefiting from USAID support should be undertaken by teams that combine a variety of perspectives and skills: representatives of experienced large project development companies; specialists in developing country infrastructure design and in smaller-scale approaches; regulatory, financial and privatization specialists. However, it is also important to ensure that the resulting plans or policy recommendations are of immediate practical value, so as to avoid a situation where private developers are "driven away" by an overly complex or impractical framework, as has apparently been the case with pricing guidelines recently adopted in the UK power sector.

The interviewees offered a number of other specific suggestions for the PURSE Project:

- A useful exercise would be for USAID to help the government establish a "short list" of the highest priority problems it wishes to resolve. Some preliminary research could be rapidly conducted in this regard, such as identifying and listing the 50 principal sources of pollution.

- It was widely suggested that a given government entity should not undertake too many new projects at once so as not to strain its supervisory and management capacity.

- The process of establishing regulations can be accelerated by applying existing models (e.g. U.S. standards) as a reference point, even if lower standards are adopted.

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- For one observer, the most practical role a "catalyst" could play in the context of the PURSE project would be to help pave the way for U.S. firms to be commissioned to carry out the feasibility studies for specific projects.

- "Demonstration projects" could include:

  - Visits to U.S. facilities.
  - A model sanitary landfill.
  - A small-scale waste to energy system with cogeneration and other suitable components ($300-500,000)
  - A small-scale composting facility ($50-200,000) or a pilot project to produce low or medium BTU gas from organic waste.
  - Any suitable project that would lend itself to a collaborative effort by 3 or 4 compatible smaller US companies in designing and implementing a mid-size project.
  - Technical assistance for waste prevention (for example modifying processes used in a particular industry).
  - Demonstrating on-site sewage systems for private homes.

Finally, industry associations appear ready to provide various forms of support in the United States. For example, the National Solid Waste Management Association expressed an in-principle interest in organizing special workshops at its trade show,[7] and it along with others has helped with other recent USAID initiatives, as discussed in the following chapter.

2.4 PERCEPTIONS OF THE PRIVATE FINANCIAL SECTOR

The various financial institutions contacted tentatively confirmed that long-term commercial debt and equity financing can be mobilized for capital projects in Indonesia. The government's commercial borrowing capacity and credit standing is superior to the Philippines, somewhat lower than Singapore and Malaysia, and about equal to that of Thailand. The key to infrastructure project financing under any structure is that there be an adequate contract with an appropriate government entity or a credible private user-client, or alternatively a full faith and credit government guarantee on loans extended. In both cases, perceived government commitment to completing negotiations is also a major factor in generating interest among financial institutions.

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[7] WasteExpo '92 will be held May 5-9 in New Orleans. Out of 406 companies exhibiting at the 1991 conference, 24 percent indicated that they are active or have an interest in exporting their products and services. The 1991 show included 42 educational programs and 3 industry-related facility tours and workshops. (Waste Age Magazine, June 1991)

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These observers indicated that financing could conceivably be provided on a non-recourse (BOT/BOO) basis for infrastructure projects in Indonesia, whereby lenders would look solely to project cash flows for repayment, backed by appropriate contractual arrangements with the government, rather than rely on a direct government guarantee of the financing extended. The issue of non-recourse lending appears to be in the forefront of lending policy discussions, and more than one bank advised that it and its competitors are "staffing up" in this area.

There does seem to be a fairly low level of confidence in or experience with potential viability of the sectors targeted by the PURSE Project, other than power, particularly in lower-income countries where the infrastructure and services are just starting to be introduced. Non-recourse lenders would expect revenue streams to be guaranteed by the government in their agreements with the private developers and operators, as opposed to relying on cash flows based on billings. In addition, some private investors and international commercial lenders seem uncomfortable with projects that appear certain to require significant government budget allocations for revenues and debt service to be maintained. They prefer projects that are structured in such a way as to recover costs fully from the target population.

In a BOT-BOO project, international lenders would typically expect the construction and project performance risks to be guaranteed by the developers and operators, and these arrangements must be very carefully negotiated between the parties. Of course, some large private firms are capable of financing projects entirely from their own resources or on the strength of their own guarantees and "letters of comfort". However, one banker indicated that these firms are still likely to seek international bank or agency involvement, not necessarily for the financing and risk-sharing they provide, but for the pressure they could potentially bring to bear on the host government to meet financial obligations to the project.

It is important to point out that private sector financing may not necessarily be extended for the capital cost of building an infrastructure project: the "additionality" in financing that the PURSE project is hoping to encourage can result from a contractor making an equity investment or obtaining commercial financing for the equipment and working capital needed to operate infrastructure built, financed and owned by public sector.

In addition, private financing can be facilitated and augmented by multilateral and bilateral agencies who are authorized to provide financing directly or indirectly to BOT-type projects. For example, the U.S. Overseas Private Investment Corporation (OPIC) and the Multilateral Investment Guarantee Agency (MIGA) both offer a wide range of "political risk" guarantees to foreign private investors for debt and equity financing they themselves provide for projects in member countries, with coverage including expropriation, currency transfer problems and breaches of contract by the host government. MIGA's first-ever guarantee was issued in 1990 for a mining project in Indonesia.

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Despite the requirement in its charter that it engage only in sovereign lending, the World Bank's enhanced co-financing (ECO) program is specifically designed to encourage long-term commercial lending to developing countries. In addition, some export credit agencies of the OECD countries have taken non-recourse project risk in the past, and even those who have not are increasingly involved in financing discussions for infrastructure projects.

Finally, private insurance may also be available to cover transfer and other risks for both debt and equity financing in the context of BOT-type projects, as exemplified by Lloyd's contract frustration policies.

3. USAID/USG RESOURCES AND LESSONS LEARNED

USAID/Washington and other agencies such as Eximbank and OPIC have a variety of resources available that can help meet PURSE project objectives, including:

- information dissemination through contact networks in the U.S. and Indonesian business communities;
- technical assistance and training for public and private actors;
- financing for project planning, procurement and working capital needs;
- lessons from experience.

Some of the programs available for Mission consideration are briefly described below.

3.1 RESOURCES

Reflecting their basic mandates as well as the growing Agency-wide interest in environmental projects, several PRE and RHUDO programs are or will be particularly relevant to the PURSE project, with a number of initiatives already underway. These by no means constitute all of the resources available within AID, particularly in the area of technical assistance.

Private Enterprise Bureau:

- The Market Technology and Access Project (MTAP) and the Private Investment and Trade Opportunities (PITO) program it is co-sponsoring with USAID/Jakarta and other missions.

- The Loan Portfolio Guarantee (LPG) program and other applications of the Private Sector Investments Program (PSIP). (formerly the Revolving Fund).

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Office of Housing and Urban Programs and RHUDO offices:

- The Housing Guaranty Program
- The Local Currency Guaranty Program (potential)
- The Capital Project Fund (potential)

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The MTAP II (1988-93) program provides a variety of services that promote "U.S.-LDC business linkages", whether the focus is on international marketing assistance to small LDC exporters or on the transfer of U.S. technology to LDC markets. For example, MTAP co-sponsors the Private Investment and Trade Opportunities (PITO) offices in Indonesia and 4 other ASEAN countries and provides funding for the PITO management contract awarded to the US-ASEAN Council for Business and Technology, Inc. The Council is organizing a U.S. Environmental Technology Trade Mission to ASEAN in November, 1991 and has already registered a number of participants. This initiative follows a market study that determined that the "environmental" sector is a particularly promising one for U.S. private initiative in the ASEAN region.[8]

MTAP also helps finance direct business development costs, ranging from initial market reconnaissance to feasibility studies or components thereof,[9] notably through the NASDA/AID Business Development Seed Fund with the National Association of State Development Agencies. Finally, MTAP technical assistance, provided in coordination with the Bureau of Science & Technology and others, includes:

- Policy and regulatory requirements.
- Institutional alternatives for trade and technology initiatives.
- Specific trade and technology promotion techniques or model schemes.
- Developing sub-sector-focused trade and investment efforts.

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[8] See also the brochure in Annex B hereto and the March, 1991 report of Richard M. Williams (IMCC), "Strengthening U.S.-Indonesia Trade and Technology Ties: Suggested Linkages between MTAP and the USAID-Jakarta Trade and Investment Policy Project"

[9] An MTAP grant to Washington State is funding an agribusiness development mission to Indonesia, while in other cases funding has been provided for specific components of project studies.

The PSIP program and LPG facilities sponsored by PRE primarily target financial intermediaries providing credit to small enterprises. The standard Loan Portfolio Guarantee (LPG) facility guarantees 50 percent of principal amounts up to total loan and guarantee amounts of only $150,000 and $75,000, respectively, for maximum facility amounts of $3 million to qualifying financial intermediaries (no more than 20% government-owned). Target authorizations for new guarantees for FY92-93 are in the range of $65-75 million. PRE can also provide direct loans to financial intermediaries and specific projects, and had a $15 million direct loan authorization in FY91.

There are currently 6 PRE facilities in Indonesia[10], with two more being presented for approval in FY91. Two definitions of small enterprises are in use, depending on the facility (net fixed assets of either $250,000 or $500,000, excluding land and buildings), and apparently the latter is among the highest of any country in which this PRE program operates. PRE has recently taken an interest in and may pursue further discussions with a private Indonesian foundation--Dana Mitra Lingkungan--which has started funding small-scale environmental projects from the income of its $400,000 endowment.

PRE's global Environmental Enterprises Assistance Fund of $2.4 million, operated by Winrock International, was established through a direct loan, the proceeds of which are lent to eligible projects. In this case there is no restriction on the size of the individual loan or sub-borrower, and a loan is currently being considered for a small hydro-electric plant in Sumatra. This particular fund could readily be expanded or a series of new ones established at the country level if PRE were to determine that there is sufficient project-driven demand.

PRE may seek legislative or internal policy exemptions to increase its facility size and sublimit level in a given context: for example, it was exceptionally authorized to establish two $10 million facilities in FY91, resulting in a $10 million Global Privatization Facility and a related $10 million facility for Jamaica. PRE is considering a broad range of ideas for future larger facilities.[11]

Finally, PRE offers intensive one-week training courses in small business lending to officers of financial institutions participating in its guarantee programs, provided by Management Advisory Services of Seattle. By design, these workshops are not intended

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[10] The facilities are with Bank Niaga ($2 million), Pan Indonesia Bank ($2 million), Bank Bali ($1 million), Nusa Bank ($500,000), Bank Unum Nacional ($2.35 million for rural areas) and Healthlink ($300,000 combined with Thailand).

[11] One such idea, a facility to help spread franchise businesses, could be applied to small-scale recycling technologies, such as recovering tires for the manufacture of a variety of household products and low-cost equipment and furnishings, or the small-scale, low-cost recovery of lubricating oil.

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to promote specific sectors, although they do include a brief review of environmental impact issues.

The RHUDO-operated Housing Loan Guaranty Program has provided 100 percent guarantees for the funding of over $2 billion in loans by U.S. financial institutions since 1964, and has the ability to provide some grant funding for related technical assistance. All RHUDO financing must bear the full faith and credit guarantee of the host central government, even if the borrower is a lower-level state entity or a private entity, and there is no indication that this policy will change. The Program imposes a lending limit of $25 million per country per year: larger projects can be financed on a phased basis.

A Capital Project Fund is being developed for FY92 or FY93, which would be a centralized funding mechanism to leverage Mission and private funds. An initial Senate bill has reportedly proposed initial funding of $1 billion. It appears likely that the Fund would chiefly provide grants and loan guarantees to central governments for onlending to the private sector through private financial institutions, rather than take private project risk directly.

The RHUDO Local Currency Guarantee Fund is still in the design stage. Two constraints that have been mentioned are (a) the current legislative requirement that RHUDO financing be channeled through U.S. financial intermediaries, and (b) limited local currency liquidity in some of the developing countries where design research has been conducted.

Some of the other well-known U.S. government programs that are relevant to the PURSE Project are presented below.

- The Trade and Development Program (TDP), an independent agency, is authorized to fund up to 100% of the cost of feasibility studies requested by government and/or a private party in a developing country, on a grant basis. It also shares the cost of feasibility studies sponsored by U.S. private investors or suppliers seeking to develop a project on an unsolicited "sole source" basis. TDP's principal objective is to help generate U.S. exports, preferably for an amount 50 to 100 times greater than the cost of the study. It may require that the requesting government obtain proposals from U.S. firms on a competitive basis for both the study and the subsequent supply contract. However, there are no hard and fast rules, and the critical determination is whether TDP's upfront investment will lead to substantial exports.

- The U.S. Eximbank currently has no restrictions on the availability of its loan and guarantee facilities for exports to Indonesia, where it has a well-performing $1.2 billion portfolio. Eximbank will typically cover 85 percent of the cost of an export contract (services included) and it offers 10-year terms. There is no specified limit on the amount of a particular guarantee. Under its "Engineering Multiplier

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Program", Eximbank also finances 85 percent of the amount of pure services contracts (including feasibility studies), but would normally offer shorter terms (5 years). However, in this regard Eximbank has a special program that can guarantee local currency costs not exceeding 15 percent of a total contract value, which effectively permits it to guarantee 100 percent of study costs.

An important issue that has been before Eximbank for some time is whether or not it is prepared to accept non-recourse private corporate risk (e.g. BOT company risk). Eximbank has traditionally provided guarantees only on the basis of either a full faith and credit government guarantee or a local commercial bank guarantee. It is however highly aware of the trend towards participating in BOT-type financing structures among other OECD export credit agencies, and is not prohibited by law from accepting this category of risk.

OPIC provides political risk insurance as well as direct loans and grants to U.S. private investors. The agency appears to have no BOT-type projects in its portfolio and to have had virtually no experience in the "environmental" sectors. However, OPIC has sponsored the establishment of a $100 million Environmental Investment Fund, whose objective will be to make venture capital available for high-return projects in the developing world, whether environmentally sound production projects or engineering and infrastructure services. The Fund will be managed by Kidder Peabody and is in the organization stages. It is clear that the Fund will operate on a strictly commercial basis, but its unique focus on developing country markets makes it a logical institution to approach should a highly profitable opportunity emerge for a U.S. investor during the life of the PURSE Project.

OPIC has organized a U.S. Investors' Mission to Indonesia, scheduled for September, 1991. It has been referring "environmental sector" firms to the US-ASEAN Business Council's Environmental Mission in November, but the outcome of the first mission should provide fresh insights into the climate for U.S. direct investment in Indonesia, and some of the firms involved specialize in relevant sectors (e.g. construction and power).

A number of centrally-funded technical assistance contracts in areas such as environmental project design (Appropriate Technology International), privatization (Price Waterhouse) and private sector development (Ernst & Young) can supplement AID/Jakarta funds, and their experiences in other countries can be reviewed. For example, ATI is currently examining small textile plants in India in the hope of devising cost-effective ways to clean up and prevent the serious pollution they cause: approaches will include common effluent treatment for clusters of plants, financial and technical support to individual units for primary treatment, and the introduction of environmentally sounder industrial processes.

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3.2 LESSONS LEARNED

AID and other donors are clearly stepping up their efforts to promote the privatization and private financing and provision of infrastructure and urban services in developing countries. These experiences are and will be providing lessons that AID/Jakarta will wish to monitor during the course of the PURSE project (for example, the extent to which the World Bank's ECO co-financing program will be used for BOT projects). Of course, private actors have been and continue to be involved most often as contractors and suppliers in infrastructure development worldwide, and this also constitutes an essential backdrop to the project.

While the objective of helping Indonesia develop the infrastructure it requires as efficiently as possible remains the same, the concepts of privatization and private sector "additionality" can be defined in many ways. The development objectives and performance of the PURSE Project will best be served by recognizing that the qualitative elements of private sector involvement (such as technical and management talent and establishing links between the foreign and local business communities) may be just as constructive as the strictly financial.

Project Structures and Quality

A 1988 World Bank publication[12] takes note of the following privatization transactions completed or in negotiation at the time:

Public Offering:	Austria (power), Chile (power), France (power), Korea (power), Spain (power), Thailand (power), UK (water distribution)
Fragmentation/Public Offer:	UK (power)
Fragmentation:	Singapore (proposed for water, gas and electricity)
Private Sale:	Canada (power), Chile (power), Grenada, Japan (power), UK (power)
Employee Buy-Out:	Chile (power)
Lease:	Cote d'Ivoire (water distribution), Guinea (water distribution)

[12] Vuylsteke, Charles, Techniques of Privatization of State-Owned Enterprises, Volume I, Methods and Implementation, World Bank Technical Paper 88, 1988, pp. 64-65

Management Contract/Lease: France (water distribution), Malaysia (water supply), Spain (water distribution).

A continuous update of and closer look at cases in the water and waste sectors will provide a source of important background information to be exploited during the course of the PURSE Project.
Out of 38 BOT projects recorded (in developing countries only) by the World Bank in a recent survey, only 2 were in water (Cote d'Ivoire and Malaysia, both of them operating), while there were 4 power projects operating or under construction (China, Philippines, Malaysia, Turkey) and 4 more in negotiations or agreed (three in Pakistan and one in Turkey).

This evidence shows (a) that both privatization and new BOT-type development in power and water are recent phenomena in both developed and developing countries (b) that the two can certainly complement each other in their many forms. For example, the combined lease-management contract approaches to water privatization in Malaysia and Cote d'Ivoire also involved BOT financing for new investment, as can be assumed for many of the power projects.

Whether a given project involves privatization and/or new BOT operations, or private involvement in public sector financed and/or operated schemes, the quality of the project must remain the fundamental focus. Among the remnants of "white elephant" projects, one finds both installed facilities that were completely abandoned for lack of operating funds and adequate management, as well as major items of equipment that were never installed (for example as reported by a recent visitor to Mexico City). The selection of inexperienced or unscrupulous suppliers who nevertheless completed the sale of such projects without further responsibility, is a non-negligible cause of these failures. It argues for careful vetting of the technical solutions proposed and the management capabilities of potential project suppliers and developers, and also provides a strong argument for the BOT-type approach, where the private participants accept long-term responsibility for project performance.

Finally, the "common wisdom" regarding BOT-type projects suggests that they can ultimately be more costly than public investment and do little to relieve the host government of the risks it would normally assume under a traditional public investment approach, while exposing the private firms to high transaction costs and uncertainty that negotiations will be satisfactorily completed.
In this context, both sides should welcome USAID support at various stages of the process to help mitigate these risks.

Promotion Efforts

USAID is starting to obtain superior results by working with trade associations and other contact networks that can efficiently advertise opportunities and help identify the most qualified and potentially interested firms in their industry. Other agencies, such as the United Nations Environment Program and IFC, are starting to develop industry data bases to be matched with developing country requirements for specific services.

The recent USAID initiatives in the Thailand waste water sector have undoubtedly been reviewed by AID/Jakarta, where the Mission attempted to flesh out a waste water opportunity at the request of a local government, advertised the opportunity directly to US firms, initially failed to generate a positive response, and finally has redirected its efforts to commissioning a feasibility study through a public tender. The valuable lessons learned from this experience include the following:

- Provide sufficient accurate information with considerable lead time, through efficient contact networks in relevant business sectors in both countries, with maximum feedback on and efforts to improve the information provided.

- Adopt a deliberate pace, especially until the host government has decided what options it is looking for. Provide support in relation to the degree of commitment the government shows, and be prepared to shift approaches.

- Be prepared to fund early project planning or development work as much as possible, using industry expertise for well-defined tasks.

A number of industry representatives and observers were aware of and interested in the ongoing Thailand waste water initiative. Judging from that experience, several specifically recommended that the PURSE Project be as flexible as possible to allow the Mission to provide intensive support for the most promising opportunities that arise over the next few years.

4. PROJECT DESIGN DISCUSSION AND RECOMMENDATIONS

The following discussion and recommendations are derived in large part from the findings of the informal industry survey, including the perceptions of opportunities (section 2.2) and specific suggestions for the PURSE Project (section 2.3).

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4.1 BASIC STRATEGY

The PURSE Project can help promote U.S. and Indonesian private sector involvement in developing and/or operating Indonesia's urban infrastructure in a number of ways. These efforts would benefit from the clearest possible understanding of what can be achieved and what is required for such involvement, judging from both the Indonesian context and experiences elsewhere, as well as from a strategic emphasis on facilitating access to other USAID, official and private resources.

For a variety of reasons, including the complexity and high cost of most infrastructure projects, the PURSE Project might take as its primary goal the promotion of all reasonable forms of private sector involvement, with private project financing a secondary but still central objective. The latter might best be pursued through a handful at most of highest-priority "demonstration projects", as well as by technical assistance that further readies the government and financial market.

USAID should not underestimate the preparedness of U.S. firms to respond to specific priorities and opportunities: generating those opportunities and alerting U.S. firms should be a major focus of the project. In addition, for each set of needs and potential solutions on the agenda, USAID should be prepared to help the Indonesian government assess whether a major project by a large firm is best called for, or whether a smaller scale, incremental approach is preferable.

The nature of USAID support is likely to vary according to the type of project and private party involved. For example, smaller firms may need an extraordinary amount of hand-holding, whether in vetting and building relationships with local private partners or in understanding the regulatory and institutional environment: some form of orientation capability is needed. On the other hand, while large firms do not necessarily need direct financial or logistical support, they particularly welcome actions that help improve the overall business climate, as well as USAID expressions of support for the U.S. firm. A number of large and small firms expressed compliments for the work of the USAID Resident Advisor in the energy sector, which they see as encompassing both types of assistance.

In terms of supporting specific projects, whether large or small, AID should encourage the government to focus on a limited number of highest priority requirements. There may be a higher pay-off here than in sponsoring activities in many sectors or in emphasizing broad-ranging sector plans. Sponsoring one or two concrete successes may be more valuable than a great deal of sector-wide planning work.

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4.2 IMPROVING MARKET READINESS

From the point of view of promoting U.S. and Indonesian private involvement in the PURSE target sectors, actions could be considered on several fronts to increase the level of interest and capabilities. These might include:

- Priority-setting exercises for the central and local authorities.
- Strengthening government regulation, enforcement and sector management capacity in areas where specific projects can be targeted for private involvement.
- Training and development of Indonesian companies for the provision of services, with the support of U.S. know-how.
- Support to the government for the initial design of the specific mechanics of privatization and financing to be sought for potential projects.
- Technology transfer through workshops and site visits in the U.S., such as program for Indonesian public and private sector representatives at Waste Expo '92.
- Improving the readiness of U.S. companies to consider and pursue opportunities in Indonesia through information and training.

Project activities aimed at identifying priority problems and defining concrete projects would not only be a pragmatic way to build commitment to specific objectives, but would also help USAID and the Government target the most specialized firms available to undertake the needed project planning and development work. As suggested earlier, the more preliminary the work, the more helpful it might be to organize planning teams that bring together diverse perspectives, under the leadership of a specialized firm capable of looking closely at local conditions and reviewing a broad range of options.

Technical assistance focusing on the regulatory environment will undoubtedly include some attention to procedural matters. Judging from the experience in the United States, where obtaining permits and completing other formalities can be extremely time-consuming and costly, streamlining these steps in appropriate sectors or for specific projects in Indonesia could in and of itself generate considerable interest among U.S. firms. It would also facilitate replication of small-scale activities that can be pursued largely through Indonesian private sector initiative.

Training and technical assistance that focuses on Indonesian management capacity could include components directed at both the public and the private sectors. The "demonstration project" approach should lend itself very well to this objective, since it can provide a concrete setting for both sets of Indonesian actors to build their capabilities, from planning on through to project development and operation. As

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emphasized by many industry representatives, the quality of a given project will stand to gain immensely from the earliest and greatest possible contribution of the Indonesian participants.

It is safe to conclude from the industry research that U.S. firms are wary of initiating projects where they anticipate difficulties in receiving effective support from local business partners, sub-contractors or public sector managers. An important concern is to avoid having to invest an inordinate amount of senior management time and other human resources to a given project. USAID support would make it possible to provide any required training and technical assistance to these Indonesian participants as a separately compensated and specially-staffed component of the project, rather than on an more or less ad hoc basis by the U.S. firm responsible for project development and operation. Consulting or training firms can be retained to provide this support, including special units or subsidiaries of the principal demonstration project developer and manager. The latter should in any case help define the types of training and technical assistance that would be of most practical benefit.

USAID technical assistance in specific privatization or BOT-type financing techniques will undoubtedly be welcomed by various parties at the earliest possible stage. Whether the focus is on general preparatory training or on developing initial structuring options for specific projects, USAID might consider retaining not only independent financial and legal advisors who are familiar with the limited body of experience worldwide in the targeted sectors, but also line officers of U.S. firms who have directly participated in such transactions elsewhere and have an interest in and knowledge of Indonesia. Indeed, some large engineering firms expressed a willingness to provide consulting services in the concept stages, provided that this would not cause a conflict of interest preventing them from bidding on any resulting project.

Although Indonesian government entities would normally be the principal focus of this assistance, there may be opportunities for USAID to assist potential smaller private sector participants who lack experience in formulating privatization or BOT-type project proposals or the means to retain suitable advisors.

4.3 PROJECT PROMOTION AND DEVELOPMENT

As "market readying" components of the PURSE Project begin generating project ideas and proposals from the Indonesian government and/or private parties, and as the organization of "demonstration projects" gets underway, AID/Jakarta will be seeking to involve and support U.S. private participants as appropriate.
Important considerations for maximizing the effectiveness of these efforts are briefly reviewed below.

Some of the comments and suggestions discussed earlier can serve as useful guidelines for project promotion activities.

- Whenever possible, the purpose of the communication should be to solicit proposals for specific AID-funded actions requested of U.S. firms (e.g. a pre-feasibility study), rather than an open-ended "advertisement" of an opportunity.

- The maximum amount of information should be provided at the outset, which presupposes that some form of project identification work has been completed.

- The information can be disseminated most efficiently with the assistance of U.S. trade associations who can reach a broad audience and/or help direct the Mission to the most specialized firms in a given field.

While the Mission's capacity to support project development work (marketing expenses, feasibility studies, detailed planning, contract negotiations, etc) may be limited in relation to the total cost of these activities, it can nevertheless play a central role in mobilizing additional resources from other AID, U.S. and multilateral agency programs such as described in Section 3.1.
For example, a significant portion of the project budget could be reserved for Mission buy-ins, perhaps identified as a "project development fund". Such a fund might have two or three "windows", potentially (a) for large-scale projects, (b) for smaller-scale projects to be developed and/or managed by a U.S. firm and (c) for projects with no U.S. involvement beyond advisory support or equipment supply for an Indonesian private entity wishing to pursue a privatization opportunity.

Depending on the number of proposals likely to be entertained, a Resident Advisor might be appointed to manage such a fund, perhaps backed by an "advisory board" with representatives of USAID and private U.S. and Indonesian firms present in Indonesia and already involved in the target sectors. The RA role would be to draw up guidelines, vet proposals and establish a strong liaison with the principal programs from which the bulk of the funding will be sought.

Although smaller consulting firms may not expect to play a long-term role in building or operating projects, other potential participants in a design exercise (engineering firms, contractors, etc) are more likely to consider carefully whether their commercial interests and prospects would be improved or jeopardized by participating in early project development work. To the greatest extent possible, the Mission should seek to include a clear and authoritative statement of AID procurement regulations as they relate to the contemplated follow-up to an initial RFP. If necessary, the Mission could develop a special procurement model that helps protect the legitimate commercial concerns of potential participants and thereby increases the likelihood that the most qualified firms will respond. One approach that has been suggested is that tenders be issued and the work co-financed by the government or other entity.

AID daily compensation limits are another commercial consideration that could preclude highly specialized firms or individuals from responding to a traditional RFP in certain disciplines (e.g. privatization contract law or BOT financing structures). If some of these types of assistance ultimately prove to be in greatest demand and to make the greatest contribution to PURSE Project objectives, the fixed price approach typically used for commodity procurement might provide the needed flexibility.

4.4 PROJECT FINANCE

While the PURSE Project presumably will not provide direct financing for capital investments, the Mission could consider funding or otherwise sponsoring a number of related technical assistance activities. Also, a greater degree of involvement on this front may be appropriate for any "demonstration projects" largely initiated and sponsored by the Mission.

The industry survey indicates that U.S. firms can generate funds internally and from various public and private lending institutions for carefully structured large BOT/BOO projects. However, such syndications must be competitive vis-a-vis blended grant, concessional and commercial financing that other suppliers can offer. In this respect the Mission can work closely with the Embassy, Eximbank and other agencies to alert U.S. firms to the full range of financing programs available, as well as assist the Indonesian government, the private project sponsors and/or the potential financing agencies complete their evaluations of the various technical, regulatory or other aspects of projects that the Mission is familiar with.

To the extent that a number of small-scale activities prove to be commercially viable and of interest to private investors, the Mission could provide training or technical assistance to Indonesian financial institutions in such areas as:

- evaluating business and financing plans in sectors with which they are unfamiliar;
- providing assistance to project sponsors in preparing these documents;
- gaining access to various official financing programs (Eximbank, FCIA, PRE etc) so as to structure and provide complete financial packages; and
- monitoring the performance of the resulting projects.

In addition, further dialogue and concerted action between the Mission and PRE could ultimately lead to the establishment of a larger-scale PRE facility specifically for privatization or new development of infrastructure projects in Indonesia, along the lines of the $10 million privatization facilities (Global and Jamaica) completed in FY91, bearing in mind that PRE's primary concern would normally be the likelihood that such a facility would be utilized.

The PURSE Project could help fund the intervention of specialized privatization and BOT-type financing advisors at critical stages in the structuring and negotiation of a given project, with either the Indonesian government or a private firm as the beneficiary.

Finally, it can be assumed that in addition to private financing, many of the projects that will arise in the target sectors during the next few years will require public investment. The Mission can help review opportunities and constraints for the mobilization of long-term finance by the relevant authorities, notably through capital market initiatives.

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ANNEX A - 7

LEGAL AND REGULATORY ANALYSIS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

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Working Paper B

A REVIEW OF INDONESIAN LAWS AND REGULATIONS CONCERNING PRIVATE SECTOR PARTICIPATION IN URBAN WATER SERVICES

EXECUTIVE SUMMARY

The purpose of this paper is to provide the Government of Indonesia with a comprehensive statement of assumptions and conclusions regarding the laws and regulations of Indonesia which would make the legal and regulatory structure better serve the needs and objectives of the Government regarding water supply activities. The paper includes (a) background information regarding the laws and regulations of Indonesia which are relevant to private sector participation in water supply activities and (b) an analysis of deficiencies in, and recommendations regarding changes to, the legal and regulatory structure. The paper provides information for prospective private sector participants in Indonesia's water supply activities to understand the investment and contracting opportunities permitted and welcomed by the Government as well as the possible legal pitfalls which may be encountered.

Specific legal issues with regard to private participation in water supply are reviewed within the context of the full legal history of Indonesia. This includes the types of laws and regulations in Indonesia which have legal authority and their place in the hierarchy of laws and regulations, the relevant offices and agencies of the Government which issue and implement laws and regulations, and practical aspects of implementation and enforcement, including a description of the judicial system. The organizational structure of public water supply utilities and the legal authorities under which BPAMs, PDAMs, and PDABs operate are included.

The paper deals generally with the laws and regulations applicable to private sector commercial activities in Indonesia, e.g., the Commercial Code and the Government of Indonesia's treatment of "facilitated" "domestic" investments. There is also a brief treatment of other laws and regulations that may be of interest to private sector investors, e.g., taxes, customs tariffs, immigration, land ownership and use, and health and environmental matters. More specifically, however, the paper examines the regulation of foreign investments in Indonesia by BKPM and Law No. 1 of 1967.

Private sector participation in other Government and governmentally-promoted activities is examined. In particular, private sector participation in petroleum-related activities is considered in light of the analogous treatment accorded private sector participation in the area of water supply under some Indonesian regulations, i.e., the use of concession. A conclusion is drawn that the analogy between petroleum and water supply activities as they relate to private sector participation is flawed because the financial parameters which define

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private sector activities in these two fields are so different. The issue of whether the "private sector" should be defined to include governmentally-owned or -related parties is briefly considered. Further, legal authorization for private sector participation in public utilities under Indonesian laws and regulations is identified, including references to any which would seem to exclude or limit that participation.

Consideration is given to the award of service contracts—especially those awarded to the private sector by water utilities. The regulations authorizing the award of such service contracts are examined in detail. The contents of those regulations, including a recitation of critically important elements which they do *not* contain, is given. Particular emphasis is also given to the authorizations for, and restrictions on, the participation of the private sector and PDAMs in joint ventures provided by Law No. 5 of 1962 and No. 1 of 1967 and Regulation of the Minister of Home Affairs No. 3 of 1986 and No. 4 of 1990. Also considered are the means by which water tariffs are approved, with an examination of the specific language of the relevant regulations. Some attention is given to BOTs, but this treatment is cursory since no laws or regulations (except those issued by Pertamina) concerning or authorizing BOTs were found. The study also notes a number of variations which may be made—or which have been made in Indonesia—on the basic BOT format.

The conclusions are based upon two fundamental assumptions. The first is that existing laws and regulations must be adequate to inform prospective private sector participants of investment and contracting opportunities available in Indonesia. The second is that consumers of water and essential public policies of Indonesia must be protected through the regulation of activities if the private sector is to be permitted to participate in the water supply field. The paper concludes that current laws and regulations lack clarity and precision. This is of critical importance in attracting the private sector because a lack of clarity increases the perception of risk. It also concludes that those laws and regulations are inconsistently applied and that rights granted to private parties under them are largely unenforceable through the courts or elsewhere. The result is a perception of unpredictability by the private sector which diminishes its interest in participation in the water supply field. Inadequate measures exist to assure that the private sector is subject to the rigors of competition or to protect the interests of consumers and Government were the private sector to participate in water supply services. Particularly critical deficiencies in current laws and regulations are the conflicts among them which may prohibit or restrict private sector participation in ways which the Government does not intend. Also of importance is the absence of any law or regulation which would authorize or regulate BOTs in the water supply sector and the existence of water tariff rate-making procedures which do not adequately assure the private sector of a reasonable return on investment through the application of fair and detailed standards by independent rate-making bodies.

The paper suggests that Indonesian laws and regulations be made clearer and more precise and detailed. It also recommends that these laws and regulations be consistently applied and that the private sector be assured of its ability to enforce its rights provided under those laws

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and regulations. More specifically, it is recommended that the current apparent conflicts among the laws and regulations regarding the ability of the private sector to participate in the water supply field be clarified by new laws and regulations and by authoritative legal interpretations which will eliminate these conflicts. BOTs in the water supply field should be explicitly authorized and regulated. New or amended regulations should be issued that will clarify under what circumstances private sector participation is welcome and unwelcome in the water supply field and that will provide detailed terms for award of service contracts, entering into joint ventures, and administration of water tariffs.

Finally the paper provides a list and short description of all relevant Indonesian laws and regulations, proposed drafts of new laws and regulations, and the full texts of selected relevant laws and regulations.

WORKING PAPER B

A REVIEW OF INDONESIAN LAWS AND REGULATIONS CONCERNING PRIVATE SECTOR PARTICIPATION IN URBAN WATER SERVICES

1. GENERAL BACKGROUND TO THE INDONESIAN LEGAL SYSTEM

The history; the cultural and religious diversity; the governmental organization; and the great size and insular dispersion of Indonesia have all contributed to a very complex legal structure in Indonesia. In some respects, Indonesia has several distinctly different legal systems whose jurisdictions are restricted largely to nonoverlapping sectors. In other respects, several legal and regulatory provisions and schemes will apply to a single sector. These may sometimes be inconsistent or even contradictory. Finally, Indonesia's legal system is in many ways incomplete, and in a current state of formulation and revision.

Within the last half century, Indonesia has been governed under four very different forms of government. The first was the colonial administration of the Dutch East Indies under the control of the Government of the Netherlands. The second was the Japanese military occupation. The third was the "Old Order" rule of President Sukarno who pursued nationalistic and socialistic goals under national policy and law. The fourth was (and is) the current "New Order" government which is pragmatic and generally more receptive to the participation of private and/or foreign capital in the Indonesian economy. Each of these governments issued and implemented laws and regulations. Most of the old laws and regulations have not been rescinded (although new laws and regulations may state that any contrary prior laws and regulations are revoked). All unrevoked earlier laws and regulations continue to be valid. They were issued in support of philosophically disparate policies.

Although there is a national legal system for Indonesia, different ethnic and religious groups are subject to their traditional (*adat*) legal systems which are applicable to most aspects of personal law and—to varying degrees—to the laws of land ownership and custom.

Indonesia is a unitary state. Power is centralized in the national government. The Basic Law of 1945 is the constitution of Indonesia and is the paramount law of the land. The President has the dominant role in practice in establishing and implementing national policies and laws. He may—and often does—achieve this through the issuance of presidential proclamations [*Keputusan Presiden* ("Keppres")], and instructions.

Within the President's Cabinet, individual ministries have been assigned responsibility for prescribed sectors of national interest. Each ministry may itself issue decrees and regulations with regards to its assigned sector, but the application of such decrees and regulations often

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infringes on sectors assigned to other ministries. Other governmental agencies and coordinating boards which are not under any ministerial control also issue decisions and policy statements. Ministries may issue regulations in the form of decrees, called *Peraturan Menteri* ("Permen"), and ministerial decisions called *Keputusan Menteri* ("Kepmen"). They may jointly issue decrees called *Surat Keputusan Bersama Menteri*. A decision of the Chairman of the Investment Coordinating Board is called a *Surat Keputusan Ketua BKPM*. Ministries and agencies may also issue circular letters (*Surat Edaran Menteri*), instruction letters (*Instruksi Menteri*), and other guidelines and policy statements.

There is a national legislature which enacts national laws. The national legislature is the *Dewan Perwakilan Rakyat* [People's Representative Council ("DPR")], some of whose members are elected but the majority of whom are appointed. It normally only considers bills submitted to it by the National Government and drafted by the ministries. When enacted by the DPR, bills become laws after being signed by the President, after which they are published in the State Gazette (Lembaran Negara). These are the only formal Indonesian statutes (except for preexisting Dutch East Indies laws with continuing validity).

Below, and theoretically completely subservient to, the national government are provincial and local governments. These regional governments, through their executives and legislatures also issue rules and regulation. The National Government has also promulgated measures for the official decentralization of some power to lower levels of government.

Within the 27 provinces including three special provinces of Jakarta, Aceh and Yogyakarta (referred to as "level one" or *tingkat satu* governments), the chief executive is called a governor (*gubernur*). A governor may issue a decree, called a *Surat Keputusan Gubernur* ("SK Gubernur"). A governor may also issue instructions to a *walikota* or *bupati* (local government executives) and his subordinate *kepala dinas* through a decree called an *Instruksi Gubernur*. In each province, there is a provincial legislature [*Dewan Perwakilan Rakyat Daerah Tingkat I* ("DPRD TK. I")] made up of elected and appointed members. A DPRD enactment—called a *Peraturan Daerah* ("PERDA")—is drafted and submitted by the governor to the DPRD TK. I and is subject in its final form to central government Minister of Home Affairs legalization. When this is accomplished, it becomes part of the law (although it is referred to as a "regulation") of the province. In each province and special province there are organizations—called *dinas*. There are also *Kantor Wilayah* ("KANWIL") which are the provincial offices of some central government's ministries. Their heads report both to the provincial governor and to the appropriate central government minister through its relevant director general.

Within the provinces, local ("level two" or *tingkat dua*) government is exercised in each urban and rural area by a mayor (*walikota*) of the city (*kotamadya*) or (in less urbanized and in rural areas) by the regent (*bupati*) of the regency area (*kabupaten*). At this level, there are also legislatures [*Dewan Perwakilan Rakyat Daerah Tingkat II* ("DPRD TK. II")] made up of appointed and elected members. In each level two government there are *dinas* who act as

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technical agencies to the *walikota* or *bupati* and some local offices of national ministries [*Kantor Departemen* ("KANDEP")] which report both to the local government executive and the KANWIL of the relevant ministry. Although they will play little or no role in private sector participation in Indonesian water supply activities, there are lower government units within level two which are called *kecamatan* (whose executive is a *camat*), and generally speaking the lowest level is the *kelurahan* (whose executive in an urban area is a *lurah* and in a rural area is a *kepala desa*).

The implementation and enforcement of these laws, regulations, and rules may also be undertaken at various levels of government by their executives, or agencies.

Indonesia's judicial system is composed, from lowest to highest levels, of Courts of First Instance (*Pengadilan Negeri*) which are located in judicial urban and rural regencies areas within provinces and special provinces, Courts of Appeal (*Pengadilan Tinggi*) which are located in the capital city of each province and special province, and a Court of Cassation or Supreme Court (*Mahkamah Agung*) located in Jakarta. In criminal cases only, further appeals may be made to the President for pardons or reduced sentences. A law to create Courts of Administrative Law (*Pengadilan Tata Usaha Negara*), which will for the first time provide a forum through which private parties have legal recourse against the Government of Indonesia and its agencies, was enacted under Law No. 5 of 1986 and will be effective in 1991.

The laws of Indonesia are now becoming more regularized. An effort has been made to coordinate or harmonize these laws and regulations through the *Badan Pembinaan Hukum Nasional* ("BPHN"), but this process is far from complete and progress has been slow. The Indonesian Government is formulating a broad range of new laws and regulations to cover existing gaps in the laws. The Commercial Code of the Dutch East Indies is now in the process of being modernized and adapted to meet current Indonesian needs and conditions. Within the past decade, great efforts have been made to collect, collate, and index the existing body of Indonesian law and to make that information available to lawyers, judges, and the public. This task has been the special focus of attention of the legal documentation center of the Law Faculty of the University of Indonesia. There are two of its offices in Jakarta which maintain current laws and regulations indexed by subject and relatively current indexed collections of laws and regulations issued by or pertaining to specific central government departments or agencies. New laws and government regulations must be issued in the official State Gazette (*Lembaran Negara*). New laws and regulations are also regularly published by specialized commercial papers which may also publish English-language translations of them. Copies of back issues of these papers are obtainable from their offices for a price that increases with the age of the back issue.

A matrix of the hierarchy of Indonesian laws, regulations, and rules, with the prevailing authority in case of conflicts being that which is found highest and furthest to the left on the matrix, is presented in Figure 1.

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Figure 1

Hierarchy of Sources of Indonesian Laws and Regulations

	NATIONAL	PROVINCIAL (LEVEL 1)	LOCAL (LEVEL 2)
CONSTITUTION	Basic Law of 1945		
STATUTES	1. Dutch colonial laws 2. Laws drafted by ministries, submitted by the President, and enacted by the DPR	PERDA TK. I (Classed as regulations) Drafted by dinas, submitted by a governor and enacted by a DPRD TK. I	PERDA TK. II (Classed as regulations) Drafted by a dinas, submitted by a walikota / bupati and enacted by a DPRD TK. II
GOVERNMENT REGULATIONS AND EXECUTIVE ORDERS	1. Government Regulations 2. Keppres (Decree) 3. Inpres (Instructions)	1. Governor's Regulations 2. Governor's Decrees 3. Governor's Instructions	1. Regulations of a walikota or a bupati 2. Decree of a walikota or or a bupati 3. Instructions of a walikota or a bupati
MINISTERIAL DECREES AND REGULATIONS	1. Joint Ministerial Decree 2. Permen (Regulations) 3. Kepmen (Decision) 4. Guidelines and Policy Statement 5. Circular Letter 6. Instruction Letter		

Note :
Sources are of increasing authority the higher and further to the left that they appear on the chart.

2. THE LEGAL ISSUES CONCERNING BPAMS, PDAMS, AND PDABS

The organization of, and delegation of authority within, the Indonesian Government with regards to water utilities involves many tiers of law- and regulation-making and enforcing bodies.

The principal ministries involved in water utility matters are the Ministry of Public Works [*Departemen Pekerjaan Umum* ("PU")] and the Ministry of Home Affairs [*Departemen Dalam Negeri* ("DEPDAGRI")]. Under PU is the Directorate General of Human Settlement (*Direktorat Jenderal Cipta Karya*), which is over the Directorate for Clean Water [*Direktorat Air Bersih* ("DAB")]. Also under PU but concerned only with irrigation and similar water and water resources issues rather than with BPAMs and drinking water is the Directorate General of Water Resources [*Direktorat Jenderal Pangairan* ("DITJENAIR")]. Under DEPDAGRI is the Directorate General of Regional Development Affairs [*Direktorat Jenderal Pembangunan Daerah* ("BANGDA")] and the Directorate General of General Governmental Affairs and Regional Autonomy [*Direktorat Jenderal Pemerintahan Umum dan Otonomi Daerah* ("PUOD")]—which is in turn over the Directorate for the Development of Regional Enterprises (*Direktorat Bina Perusahaan Daerah*).

Other ministries and agencies which have partial or occasional involvement in water utilities issues or regarding foreign loans to water utilities in Indonesia are the Ministry of Finance [*Departemen Keuangan* ("DEPKEU")] and its Directorate Generals of Budget (*Direktorat Jenderal Anggaran*) and Monetary Fund (*Direktorat Jenderal Moneter*); the Ministry of Health [*Departemen Kesehatan* ("DEPKES")]; the Ministry of Industry [*Departemen Perindustrian* ("DEPERIN")]; the Ministry of Mining and Energy (*Departemen Pertambangan dan Energi*) which is responsible for authorizing the use of groundwater resources; the State Secretariat [*Sekretariat Negara* ("SEKNEG")]; the State Minister for Environmental and Population Affairs [*Menteri Negara Kependudukan dan Lingkungan Hidup* ("KLH")]; the Investment Coordinating Board [*Badan Koordinasi Penanaman Modal* ("BKPM")]; the National Planning and Development Board [*Badan Perencanaan Pembangunan Nasional* ("BAPPENAS")] which is over the Coordination Team for Urban Development [*Tim Koordinasi Pembangunan Perkotaan* ("TKPP")]; and the Indonesian Central Bank (*Bank Indonesia*).

Under Indonesian regulations and practice, municipal water utilities are initially constructed by PU. Each is planned, built, and operated by PU as a *Badan Pengelola Air Minum* ("BPAM"). A BPAM is not a legal entity but is an embryonic project under the national development budget. A BPAM is subject to the administrative overview of a provincial level office of DAB, called *Proyek Peningkatan Sarana Air Bersih* ("PPSAB"). Once a municipal water utility is built, has proven in practice to be running according to design, and is running at "break-even," it is transferred by PU to a level two government. The BPAM's assets will be transferred to an entity in the form of *Perusahaan Daerah Air Minum* ("PDAM")

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following DPRD TK. II legal action and approval of the provincial governor (although somewhat different procedures apply where the PDAM is at level one). A PDAM is subject to the administrative overview of its board of directors (whose members are selected by the *walikota* or *bupati* for their technical expertise). Its board of supervisors (*Dewan Pengawas*) which is made up of the *walikota* or *bupati* and appropriate designated level two *dinas* offices, and a provincial *Proyek Monitoring and Development Unit* ("PMDU") which advises the provincial governor and provides technical advice and assistance to the PDAMs at *kotamadya* and *kabupaten* level two. In East Java a new type of level one organization was formed in 1987. It is called a *Perusahaan Daerah Air Bersih* ("PDAB"). Its purpose is to develop multi-use water sources and to resell water from those sources to a number of local PDAMs who, in turn, make distribution to ultimate consumers. The PDAB seems likely to be a form of enterprise which will be adopted for use in other provinces in the near future.

PDAMs, PDABs, and BPAMs are the operational entities used by the Government of Indonesia for water supply services. They are created by the provincial/local government (or the central government for BPAMs) and operate under the guidelines and constraints of the central government. They (excluding BPAMs) are classified as "regional enterprises" (*Perusahaan Daerah*). This category also includes, *inter alia*, agricultural markets, hotels, transportation, banking municipal parking lots, slaughtering houses, etc.

PMDUs have operated under the authority of a joint ministerial decree since 1986. There are now 21 PMDUs scattered throughout Indonesia. The principal objectives of PMDUs are to: (a) assist the management and boards of directors of PDAMs to achieve objectives set for them by national and regional authorities and (b) monitor progress in the Indonesian water supply sector in order to permit the central and provincial governments to determine and implement effective policies for future development and operations. PPSABs may sometimes in practice also advise and assist PDAMs and thereby compete with or duplicate the efforts of PMDUs.

About 140 Indonesian urban water supply programs are operated as BPAMs. Another 151 of them are operated as PDAMs. PDAMs are meant to be operated as independent and financially viable companies. Nonetheless, their operations and tariff rate structures are prescribed in general terms by national law and policy and their specific tariff rate schedules are approved by politically-appointed boards and officials. Those tariff rates make inadequate provision for, replacement and future development costs. From its revenues, a PDAM is normally required by law to distribute 55% of its after tax revenues to the level two local or level one provincial government in which the PDAM is located. The Minister of Home Affairs in 1975 left to the discretion of the level one and two executives the decision as to whether to release PDAMs from their obligation to make contributions of 55% of their net earnings to local\provincial governments when such funds are required to be used for later PDAM investments, developments, maintenance, and operations. The legal right of PDAMs to contract for services and otherwise cooperate with third parties has been significantly

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augmented in recent years, although the nature and extent of this legal authority remains unclear.

Significant efforts have been made to decentralize water supply and other public sector functions in Indonesia. Decentralization has in practical terms, however, been only incompletely achieved. The relationship between the central government and provincial and local governments is most commonly characterized by centralized regulatory control, institutionally weak local and provincial governments, and intensive involvement by the central government in the implementation of central government water policies through provincial and local governments and institutions. Implementation of urban development through the Integrated Urban Infrastructure Development Program ("IUIDP") is a central government effort to coordinate the programs of a number of central government ministries into a single development program that is responsible to local governments. The IUIDP attempts to prepare the local governments to assume their newly assigned roles in urban development. It also integrates funding sources in order to provide greater latitude in project selection by local governments.

An important issue in this effort to decentralize water supply authority and accountability is the question of the continuing availability to PDAMs of central government funding and financial support. The central government have encouraged PDAMs to become more responsible for their own financing. As PDAMs do so, they will need to adjust their operations and possibly tariff schedules. As this is a new policy, PDAMs appear to continue to rely on central government funding and financial support. This may have ramifications for PDAMs' enthusiasm for private sector participation.

A diagram of the organization and government agencies regulating BPAMs, PDAMs, and PDABs is presented in Figure 2.

The principal laws and regulations relevant to BPAMs, PDABs, and PDAMs are:

(a) The Basic Law of 1945 (the Indonesian Constitution), particularly Article 33 which provides that "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, *water* and other ground resources have to be managed/utilized by the government for the maximum benefit of the people."

(b) Law No. 5 of 1962 which is concerned with the establishment of government enterprises at provincial/local levels of government. It serves as the fundamental legal basis for the establishment of PDAMs and PDABs. The current status of this Law is ambiguous. It was revoked by Law No. 6 of 1969, but revocation was made contingent

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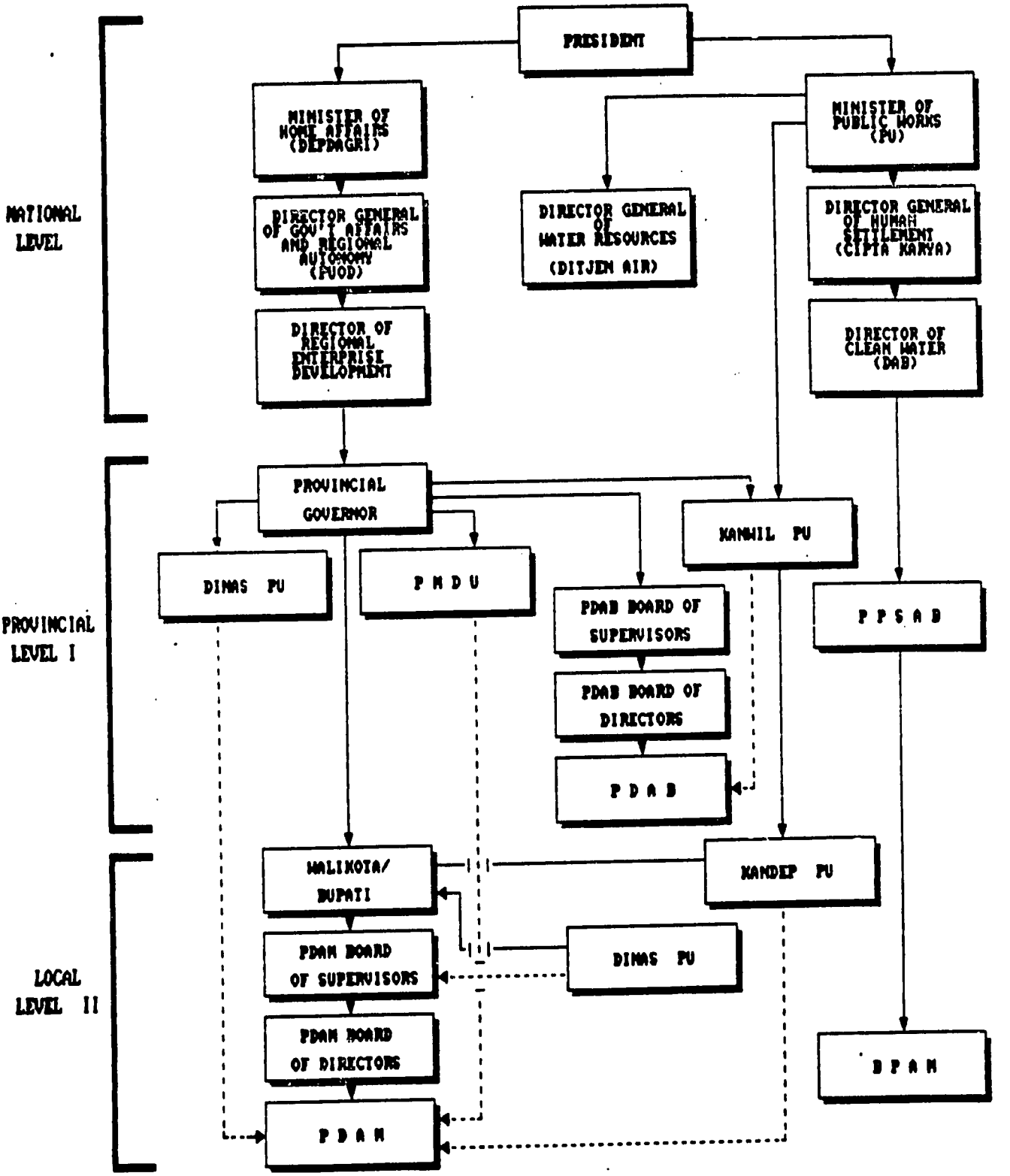
Figure 2

Organizational Structure for the Regulation of, and the Provision of Assistance to, BPAMs, PDAMs, and PDABs by the Government of Indonesia



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upon the enactment of a new law to replace Law No. 5 of 1962. No such superseding law was ever enacted.

(c) Law No. 11 of 1974 regarding water resources and which has a wide applicability to other public water utility issues.

(d) Government Regulation No. 22 of 1982 regarding water management as it concerns sourcing of water supplies from streams and groundwater.

(e) Presidential Decree No. 21 of 1989 concerning the exhaustive list of 75 economic sectors that are closed for designated forms of new foreign and domestic private investment. "Water supply" or "drinking water" are not listed as closed sectors. This may supersede Article 6 of Law No. 1 of 1967 which designates nine economic sectors—including "drinking water"—as being closed to foreign investment because they are of strategic national importance for which the Government of Indonesia will retain exclusive authority. However (see Figure 1 and later discussion in Sections 8 and 11 of this Paper), a presidential decree may not properly supersede a law because of the relative levels of their legal authority. This Decree supersedes Presidential Decree No. 15 of 1987 which, in turn, superseded Presidential Decree No. 22 of 1986 which both established nonexhaustive lists of economic sectors open to new foreign and domestic private investment and which listed "drinking water" as an open sector.

(f) Joint Ministerial Decree of the Ministers of Home Affairs, Public Works, and Finance Nos. 160 of 1978, 281 of 1978, and 360/KMK.011 of 1978 regarding the execution and development of clean water construction projects with central government aid.

(g) Joint Ministerial Decrees of the Ministers of Home Affairs and Public Works Nos. 3 of 1984 and 26 of 1984 and 4 of 1984 and 27 of 1984 regarding the establishment of local drinking water enterprises and the development of PDAMs. These Decrees assigned the Ministry of Public Works responsibility for initial water supply planning and development and assigned the Ministry of Home Affairs the principal responsibility for developing the nontechnical aspects of water enterprises. Joint responsibility was assigned to the Ministries of Home Affairs and Public Works for formulating guidelines for the organizational structure of PDAMs.

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(h) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 5 of 1984 and 28 of 1984 concerning guidance about the calculation of drinking water tariffs and regarding the organization, accounting systems, structure, and cost calculations of water utilities.

(i) Decree of the Minister of Finance No. 540/KMK.011 of 1979 regarding the management of central government funds for the financing of PDAM projects.

(j) Decree of the Minister of Public Works No. 269/KPTS of 1984 regarding BPAMs which provides for a shorter period before they are changed to PDAM status.

(k) Regulation of the Minister of Mining and Energy No. 03/P/M/ Pertamben of 1983 requiring licensing of all private use of ground and spring water and of water drilling by the provincial governor acting upon the binding advice of the Directorate General of Geology within the Ministry of Mining and Energy.

(l) Regulation of the Minister of Home Affairs No. 690-536 of 1988 dealing with guidelines for the pricing of water to consumers by a PDAM. This provides that water prices charged to consumers must be decided by the head of the local government and be subject to gubernatorial approval following a proposal from the management of the water company and the favorable considered judgement of its supervisory board. This eliminated the requirement for ratification by DPRD TK. II provided in Regulation of the Minister of Home Affairs No. 690-1572 of 1985.

(m) Regulation of the Minister of Public Works No. 65/KPTS of 1989 establishing the Joint Technical Team for Water Supply Capital Investment.

(n) Circular Letter of the Minister of Home Affairs No. 690/7072/SJ dated July 10, 1985, to all level one governors, all *bupatis* and *walikotas* of level two, and all directors of PDAMs regarding the possible release by level one and two governments of PDAMs from the duty to provide 55% of their net profits to those governments as provided under Article 25 of Law No. 5 of 1962.

(o) Circular Letter of the Minister of Home Affairs No. 690-1595 of 1985 which authorized the creation of PMDUs.

(p) Instruction Letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of all regional government enterprises to one or the other of two forms of legal entity, i.e., PERUMDA (*Perusahaan Umum Daerah* or Regional Public Company) and PERSERODA (*Perusahaan Perseroan Daerah* or Regional Limited Liability Company), following enactment of a law to replace Law No. 5 of 1962.

(q) Guidelines on the Accounting System of PDAMs of August 1990 issued by the Minister of Home Affairs.

(r) Organizational structure of PDAMs (undated) issued by the Minister of Home Affairs.

(s) Implementing Guidelines for Regulation No. 690-536 of 1988 (Interim Report) (undated) regarding the calculation of drinking water tariffs by PDAMs.

(t) Decree of the Governor of the Special Province of Jakarta No. D.IV-a.12/1/49 of 1974 on the regulation of digging and drilling for groundwater in Jakarta Special Province.

(u) Decision of Jakarta Governor No. 664 of 1980 concerning the organization, structure, and work division of the drinking water company of the Special Municipality of Jakarta ("PAM Jaya").

(v) Provincial Regulation of East Java No. 6 of 1980 amending the provincial water regulation of East Java of 18 November, 1938, on the use of water.

(w) Provincial Regulation of East Java No. 5 of 1985 concerning drilling and the use of underground water in East Java.

(x) Provincial Regulation of East Jaya No. 2 of 1987 regarding the establishment of PDABs.

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3. REVIEW OF INDONESIAN LAWS AND REGULATIONS REGARDING FOREIGN AND DOMESTIC PRIVATE SECTOR INVESTMENTS

The legal structure for private sector commercial activities in Indonesia is based on the Commercial Code of the Dutch East Indies of 1847. This Commercial Code is a civil law code derived from the Dutch Commercial Code. This was in turn derived from the Roman Justinian Code. This Commercial Code continues in full force and effect in Indonesia except where its provisions have been specifically revoked by Indonesian law or are otherwise incompatible with Indonesian independence and public policy. This Commercial Code is currently being revised to accommodate modern and specifically Indonesian conditions, needs, and practices, but no date of completion has been announced and it may not be accomplished in the near future. Corporate practices and procedures are prescribed by the Commercial Code. The most common form of corporate entity for private commercial use in Indonesia is the *Perseroan Terbatas* or "P.T." The P.T. is a limited liability company whose form and legal rights and obligations are similar to, and modeled closely after, those established by most civil code jurisdictions.

Indonesia, under the government which preceded the New Order, adopted an anticapitalistic policy. Even during this period, however, private sector activities continued, e.g., in agriculture and the vending of consumer goods and services. Following the fall of the Old Order government, a change in national economic and social policy was made under the New Order to the *Pancasila* philosophy. *Pancasila* stresses cooperative efforts and a commitment to the amelioration of poverty and social problems through government activities. *Pancasila* continues to be the official Indonesian national ethos and ideology.

This is reflected in some official public policies and enactments of Indonesia. Under these, private sector participation in the economy is frequently only permitted with the special authorization of the government, the private sector's activities are sometimes subject to close regulation and monitoring.

In many instances, the Indonesian laws which refer to "domestic capital" are misleading in their use of this term. In this context, "domestic capital" initially principally referred to flight capital. The "domestic investment" laws were designed to encourage the repatriation and local investment of this flight capital. BKPM licensed "domestic investments" are now those investments of Indonesian capital which seek or require special government incentives—particularly through special customs treatment of some or all of their imported assets.

To a great degree, the general Indonesian population is permitted—and even encouraged—to engage in economic activity through the use of private capital. To the extent that this is regulated at all, regulation is implemented through general licensing and other laws which will not be considered in this Paper.

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The agency of the Indonesian Government most directly involved with specially licensed private sector investments in Indonesia is BKPM. In the two years immediately following the institution of the New Order, foreign and domestic private investments were encouraged and were generally unrestricted. Beginning in 1967, however, the Government of Indonesia—through predecessor institutions of BKPM—initiated a policy of critically reviewing private foreign capital investment proposals. In 1968, that review was extended to "facilitated" "domestic capital" investments, i.e., returning flight capital regarding whose origins the Government of Indonesia tacitly agreed to not examine closely and registered as a Domestic Investment Company [*Penanaman Modal Dalam Negeri* ("PMDN")] which received investment inducements from the government. BKPM was organized in 1973 to formally review and license foreign and domestic investment applications. BKPM does not review investment proposals regarding financial institutions, which are regulated by other ministries and agencies of the Government of Indonesia. It also does not consider private investments related to the petroleum industry or review private sector contractual relationships with the Indonesian national oil company, which is called *Perusahaan Pertambangan Minyak dan Gas Bumi Nasional* ("Pertamina"). All such investments and contracts are handled exclusively by Pertamina itself. BKPM approval is now required for all domestic investments for which special "facilities," e.g., preferential import customs tariffs, are requested. No special tax facilities have been granted to private investors by BKPM since 1983.

Although all foreign investments and all facilitated domestic investments must be reviewed and approved by BKPM, there are a few significant differences in the way foreign and domestic investments may—and must by law—be treated by BKPM. Domestic investments may be licensed upon the approval of the Chairman of BKPM, but all foreign investments also require the formal approval of the President. Domestic, but not foreign, investments may obtain financing through government-owned banks. Domestic investors may engage in the direct distribution of products, but foreign investors may only engage in the distribution within Indonesia of their own products and then only through separately approved Indonesian joint venture companies. Once a foreign investor's equity participation in an Indonesian company is below 50% and Indonesian investors hold the majority of the equity, a company must by law be treated in every respect as the same as a company formed using only domestic private investment.

Initially, private sector investment applications were considered cautiously. Those investments that were approved were approved only with severe limitations and then only as exceptions to the general rule against foreign and "domestic" private sector investments in Indonesia. Over time, BKPM and the Government of Indonesia have grown increasingly receptive to private sector investment applications. Restrictions imposed on investments are now more limited than was previously the case. The annual number of approved investment applications and the speed with which investment applications are dealt with has increased over the period. The likelihood of any investment application being approved has improved over the years.

Since 1977, BKPM has provided a "one stop" review and licensing center for all private sector investment applications over which it has authority (except for forestry, fishing, and mining investments, which require the direct participation of other ministries and agencies). The Chairman of BKPM has been delegated the authority to issue investment approvals (excluding those listed above) without the formal review and approval of those investment applications by other ministries and agencies.

Nonetheless, Indonesian Government investment application review and licensing procedures continue to be officially expressed in negative terms, i.e., they state that all investments are excluded until official approval has been granted. This belies to a degree the current reality that there is a presumption of approval for investment applications barring some special reason for refusal.

The procedure for seeking investment approval by BKPM is to submit an application, complete with detailed plans for the investment, to BKPM. BKPM will then review the application (and may seek extensive clarification of the application from the investor). Following that review, BKPM may choose to approve the application as submitted, reject the application in its entirety, or accept in part the application subject to changes and restrictions imposed by BKPM. Following approval of an investment, any significant changes to that investment are also subject to BKPM notification and approval.

The Government of Indonesia established a policy in the early 1970s of nonexhaustively listing those sectors of the Indonesian economy in which new private sector investment would be permitted. "Drinking water" was added to this list beginning in 1986. In 1989, this policy was changed. In that year, an *exhaustive* list was published of those Indonesian economic sectors from which certain forms of new private sector investment is excluded. Private investment is permitted in all other economic sectors—including "drinking water." Nonetheless, Article 3 states that such investments are only permitted in accordance "with the provisions of prevailing laws and regulations." Consequently, as shall be described in greater detail in a later section of this Paper, those sectors opened for private investment by the Decree may arguably be closed for some such investments through the operation of other laws and regulations. There are now 75 economic sectors in Indonesia which are closed to specified forms of new private sector investment.

The principal relevant Indonesian laws and regulations concerning the participation in the Indonesian economy of the private sector are:

(a) Dutch East Indies Commercial Code of 1847.

(b) Law No. 6 of 1968 concerning domestic investments.

(c) Law No. 12 of 1970 amending and supplementing Law No. 6 of 1968.

(d) Presidential Decree No. 54 of 1977 concerning regional basic provisions on investment procedures.

(e) Presidential Decree No. 26 of 1980 concerning regional investment coordinating boards [*Badan Koordinasi Penanaman Modal Daerah* ("BKPMD")].

(f) Presidential Decree No. 35 of 1985 amending Presidential Decree Nos. 33 of 1981 and 78 of 1982 regarding the status, duties, and organizational structure of BKPM.

(g) Presidential Decree No. 21 of 1989 concerning the exhaustive list of economic sectors that are closed for specified forms of new private investment. It does not include "drinking water." It replaces the earlier nonexhaustive list of economic sectors open to new private sector investment of Presidential Decree No. 15 of 1987 which, in turn, replaced Presidential Decree No. 22 of 1986 which contained a similar list.

(h) Presidential Instruction No. 5 of 1984 concerning guidelines for the simplification and control of business licensing.

(i) Decree of the Minister of Finance No. 862/KMK.01 of 1987 regarding the issuance of securities through a stock exchange.

(j) Decision of the Chairman of the Investment Coordinating Board No. 5/SK of 1987 regarding local equity participation requirements in joint ventures with foreign investors. This Decision followed and implemented the provisions of Article 27 of Law No. 1 of 1967, Circular Letter from the Chairman Nos. 1195/A/BKPM/X of 1974 and B 109/A/BKPM/II of 1975, and BKPM Internal Guidelines of 1981. The Decision was further modified by Decisions of the Chairman Nos. 08/SK and 16/SK of 1989.

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4. REVIEW OF INDONESIAN LAWS AND REGULATIONS REGARDING FOREIGN INVESTMENTS

Until the institution of the New Order in 1966, foreign investments in Indonesia were generally discouraged. Between the time of Indonesian national independence and 1966, a number of existing foreign investments—particularly those owned by the Dutch—were nationalized. Foreign investment in Indonesia was largely unrestricted during 1966 and 1967. Indonesia initiated a policy of restricted authorization for foreign investments in 1967.

Since then, local participation with foreign investors has been officially encouraged. In virtually all cases after 1974, foreign investments have been permitted only when made in conjunction with local venture parties. Following the initial foreign investment, the incremental transfer of majority equity ownership to local participants was at first encouraged and later required by the end of a fixed period (initially of ten years, later extended to fifteen years with provision for a discretionary extension of a further five years). Upon the transfer of majority ownership in an enterprise by the foreign investors to local participants, the enterprise will be treated under Indonesian law as a domestic investment.

All foreign investments (except for those concerning financial institutions and petroleum-related sectors) must be authorized by BKPM and be approved by the President. Special customs tariff treatment may be authorized by BKPM, but special tax treatment for foreign investments has not been granted since 1983. Foreign investments may not have access to Indonesian Government bank financing and may only distribute in Indonesia their own products and then only through separately incorporated Indonesian joint venture distribution companies. The procedures for applying to, and receiving authorization from, BKPM for investments which were described in the previous section are generally applicable to foreign investments as well as subject domestic investments. Foreign investments are made in the form of a Foreign Investment Company [*Penanaman Modal Asing* ("PMA")].

It should be noted that foreigners may also invest in Indonesia by buying shares in existing Indonesian companies through purchases on the Indonesian Stock Exchange or through private purchases of equity and shares. They may also list their Indonesian companies on the Indonesian Stock Exchange.

Since 1967, the Government of Indonesia has become increasingly receptive to foreign investment. Foreign investment applications are now routinely processed and approved by BKPM relatively quickly and in large numbers. Nonetheless, foreigners are explicitly excluded from making investments in nine specific Indonesian economic sectors (including drinking water) under the provisions of Article 6 of Law No. 1 of 1967. This is examined in greater detail in Sections 8 and 11 of this Paper. Foreigners may not have proprietary rights in Indonesian real property according to the terms of the Indonesian Agrarian Law. Indonesian laws and regulations by their literal terms treat foreign investment as an activity that is only

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permitted selectively and cautiously, although in reality the Government of Indonesia now encourages foreign investment and rejects few legitimate
foreign investment proposals. Government of Indonesia receptiveness to foreign investment may be expected to continue and even increase in the future.

The principal Indonesian laws and regulations of relevance to foreign investments and foreign investors are:

(a) Law No. 1 of 1967 regarding foreign investments.

(b) Law No. 11 of 1970 which amended and supplemented Law No. 1 of 1967.

(c) Government Regulation No. 24 of 1986 concerning the 30 year licensing period for foreign investment companies.

(d) Presidential Decree No. 17 of 1986 requiring that Indonesian investment entities in which a majority equity ownership is held by local participants be treated the same as domestic investments under Indonesian law. This Decree was amended by Presidential Decree No. 50 of 1987.

(e) Decision of the Chairman of the Investment Coordinating Board No. 17/SK of 1986 concerning foreign share participation in business companies already in operation.

(f) Those relevant laws and regulations listed in the preceding section.

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5. REVIEW OF INDONESIAN LAWS AND REGULATIONS REGARDING TAXES, CUSTOMS TARIFFS, FISCAL MATTERS, AND OTHER LEGAL ISSUES

A multitude of other Indonesian laws, regulations, and policies will strongly affect private sector investors considering making investments in Indonesia.

The tax laws of Indonesia will affect the net profitability of any private sector investment in Indonesia. There are Indonesian taxes, *inter alia*, on income, real property and the sale of luxury goods. There is a value added tax on the sale of goods and services. There are many licensing fees, document taxes, user fees, and other government exactions which are imposed by the national government and/or its subordinate levels of government. Since 1983, Indonesia has not offered tax holidays or incentives for investors. The assessment of taxes in Indonesia is not made on a clear and accepted accounting basis. Final levels of taxation may, without any suggestion of impropriety, be determined through self-assessment and subsequent negotiations between taxpayers and Indonesian tax officials. This uncertainty and flexibility in Indonesian tax law is often unsettling for foreign investors.

Customs tariffs (except for imported household goods and goods with only a nominal value) are imposed under Indonesian law but are at present administered and collected under contract by a private Swiss company. The result has been a greatly enhanced efficiency and clearer adherence to established procedures. This contract is scheduled to expire soon. For favored investments, BKPM may authorize duty free or reduced duty importation of some or all items. In some cases—i.e. petroleum exploitation imported machinery may immediately become the property of the Indonesian Government or later reexportation of the equipment from Indonesia may be prohibited.

The Government of Indonesia, through its central bank (*Bank of Indonesia*) and BKPM licensing, may impose foreign currency exchange controls (although those controls are now suspended) and restricts the repatriation of investment capital and profits. Special authorization must be obtained through BKPM for the right to make such currency exchanges and capital and profit repatriations on acceptable terms. The national currency, the Indonesian Rupiah, is freely convertible to other currencies.

The Indonesian Agrarian Laws prohibit foreign ownership of, or proprietary rights in, Indonesian land. This may create difficulties for some investors.

Indonesian immigration law and BKPM investment authorizations greatly limit the ability of foreign investors to use expatriate staff resident in Indonesia. Over time, the number of expatriate personnel granted residence and work permits for a particular investment may be reduced. All residents of Indonesia require an official departure authorization (exit permit) each time that they wish to temporarily or permanently leave Indonesia.

Particularly regarding private investments in the water supply sector, laws and regulations regarding pollution controls, environmental matters, and health standards for potable water will be of importance.

The principal relevant laws regarding the above areas include:

(a) The Indies Tariff Law (*Indische Tariefwet*) (Staatsblad 1873 Number 35), as amended and supplemented most recently by Government Regulation No. 6 of 1969.

(b) Law No. 4 of 1982 regarding environmental protection.

(c) Law No. 6 of 1983 concerning general tax matters.

(d) Law No. 7 of 1983 concerning income taxation.

(e) Law No. 8 of 1983 concerning value added taxation on goods and services and a sales tax on luxury goods.

(f) Law No. 12 of 1983 regarding customs.

(g) Law No. 13 of 1983 regarding real estate taxation.

(h) Government Regulation No. 20 of 1990 regarding water pollution control.

(i) Presidential Decree No. 23 of 1990 concerning the establishment of a national pollution board.

(j) Presidential Instruction No. 4 of 1985 concerning policies to expedite the flow of goods in support of economic activities.

(k) Decree of the Minister of Health No. 2180/YANKES/INSTAL/XI of 1981 regarding the establishment of water quality standards and an environmental team.

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6. DECENTRALIZATION OF, PRIVATIZATION OF, AND GENERAL PRIVATE SECTOR PARTICIPATION IN GOVERNMENTAL AND GOVERNMENTALLY-PROMOTED ACTIVITIES IN INDONESIA

Indonesia was established and has been operated as a unitary state. All power emanates from the central government—to subordinate officials and levels of government. This was true for a number of historical reasons. The Dutch had administered the Dutch East Indies in this fashion. The new Republic of Indonesia was threatened with separatist forces which might fragment the country were not central control maintained. The first government of the Republic of Indonesia perceived its principal tasks as nation building and economic development. The number of competent technicians and administrators in the new government was limited and those persons were concentrated in the central government. The cultural tradition in Indonesia generally favored centralized authority and decision-making.

As Indonesia has developed economically and become more politically sophisticated, the concentration of power at the center has become increasingly inappropriate as a means of successfully and efficiently serving the country's needs. With experience and training, a larger body of qualified persons is now available at lower levels of government which is capable of assuming greater responsibilities.

The implementation of privatization and of a general shift in national economies from the public to the private sector have in many cases proven to have provided significant benefits to countries and their governments. As a consequence, the Indonesian Government has declared in PELITA V (its current five year economic plan) that it favors privatization in some forms and economic sectors. It is now actively exploring the suitability of privatization for Indonesian conditions and needs. Privatization may take many forms.

The purest form of privatization, which has been implemented in Western Europe—particularly in the United Kingdom—is divestiture. Under divestiture, public enterprises which are engaged in commercial activities will have their assets or their equity participation shares sold or transferred in whole or in part to private sector investors.

The leasing of government-owned assets to the private sector which will then operate those assets during the lease period, retain all earnings from the operation of those assets, and return those assets to the government at the end of the lease period in exchange for periodic payments by the private sector to the government is another type of private sector participation. Current Indonesian laws and regulations regarding water utilities do not seem to contemplate such leasing schemes nor does Government of Indonesia policy seem to favor such a form of privatization (unless the term "profit-sharing cooperation" in Regulation of the Minister of Home Affairs No. 4 of 1990 contemplates such leases). In other sectors, the only example of government-owned asset leasing discovered is the leasing of capital assets, e.g., drilling rigs, by the Indonesian national oil company to its private sector contractors.

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Other types of privatization (which will be referred to in this Paper as "private sector participation"), i.e., service contracts; joint ventures; and build, operate and transfer investments, are considered in detail in later sections of this Paper.

Private sector participation in governmentally-promoted activities has a long history in Indonesia. The private sector has participated in the operation of plantation agriculture, the exploitation of forestry, the operation of the national customs system, and other areas since, in some cases, the early days of the Republic.

The most noteworthy example of such participation is in the exploitation of petroleum and natural gas. Under certain regulations, private sector participation in the water supply field has been treated in part as though it were directly analogous to the exploitation of Indonesian petroleum and natural gas. Consequently, the practice of private sector participation in the petroleum industry is of particular interest. This analogy has been drawn principally because, under Article 33 of the Basic Law, both petroleum and water are required to be managed exclusively by the government for the use and benefit of the people of Indonesia.

Petroleum exploitation in Indonesia by foreign and domestic private participants is based on the constitutional principle that all resources found beneath the surface of the lands (and seas) of Indonesia are the property of the people. As part of the national patrimony, these natural assets are controlled and exploited exclusively by the national government. Consequently, exploitation of Indonesian petroleum resources is the exclusive right of the Indonesian national oil company, Pertamina. Following the expropriation of foreign interests in the petroleum sector during the first few decades of Indonesian independence, the Government of Indonesia determined that it required the technology and worldwide marketing capabilities of foreign participants. Pertamina awards contracts to private foreign participants to explore for, develop, and extract Indonesian petroleum. Foreign parties are required to provide all technology, capital investments, and other facilities for their activities in the petroleum sector. All capital equipment which is entered into Indonesia for this purpose becomes immediately the property of the Republic of Indonesia and is leased to the foreign participants which originally purchased and imported the capital equipment. All risks and costs of exploration are for the account of the foreign participant. All extracted petroleum is the property of Pertamina. The foreign participant, through production or profit sharing contracts, is permitted to take a part of the extracted petroleum as its payment for its participation and to compensate it for its costs of exploration and exploitation. In many instances, the foreign participant is also permitted to market abroad additional portions of its petroleum production on behalf of Pertamina.

The analogy between petroleum production and water supply activities is flawed. It fails to take into account the social policy concerns of governments which are applicable to water supply and the essential differences in the economic dynamics of petroleum production and water supply activities. Foreign participants are willing to participate in the Indonesian

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petroleum industry under the terms established by the Indonesian Government because of the international dollar-denominated market for petroleum, the high per unit price which petroleum brings on those markets, and the needs of the foreign participants for secure supplies of petroleum to serve their international refining and marketing requirements.

In the case of water, all water produced from Indonesian sources (with the possible exception of some proposed sales of water to Singapore) will be consumed in Indonesia and will be sold at prices denominated in Indonesian rupiahs. Consequently, if private sector participants incur non-rupiah expenses and financing costs they will be reluctant to accept currency exchange rate risks in meeting those costs and expenses through rupiah sales. Further, they will be dependent for profits from their exploitation of Indonesian water resources on the strength of the Indonesian demand for the water and on the ability of Indonesian consumers to purchase the water. In addition, the prices charged for the water they sell may in some cases be established by Indonesian Government institutions under regulatory structures which may not assure a recovery of their investment and a reasonable profit on that investment.

A confusing factor in any evaluation of private sector participation in government-related activities in Indonesia is the fact that many so-called "private sector" participants are in fact not purely "private." They may be quasi-government institutions or may have other close ties to the government. For example, the letting of a service contract by the PDAM of Surabaya for bill collection has been frequently cited as an example of "private sector participation." In fact, the "private" party that was awarded the contract was a provincial government-owned bank which, in turn, admittedly subcontracted collection work to genuinely "private" sector bill collectors. Similarly, foreign government and multilateral noncommercial institutional financial participation is often considered to be "private sector participation" as long as such financing moves the investment out of the Government of Indonesia's budget, even though foreign governments and multilateral noncommercial institutions are hardly private sector investors in any other sense.

The principal Indonesian laws and regulations which are relevant to decentralization, privatization, and private sector participation in governmental and governmentally-promoted activities in Indonesia are:

(a) Basic Law of 1945, particularly Article 33 which states "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people."

(b) Law No. 8 of 1971 regarding Pertamina's right to license private sector participants in the Indonesian petroleum-related economic activities.

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(c) Law No. 5 of 1974 which is concerned with decentralization and the establishment of autonomous authority in the provincial and local governments regarding administrative matters.

(d) Government Regulation No. 14 of 1987 regarding the delegation of part of the central government's authority in the field of public works to the provincial Level I and Local Level II Governments.

(e) Presidential Decree No. 21 of 1989 concerning the list of economic sectors that are closed for prescribed forms of new private investment and revoking Presidential Decree No. 15 of 1987 which, in turn, revoked Presidential Decree No. 22 of 1986.

(f) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation by a regional enterprise with a third party. This made possible the establishment of joint cooperation undertakings between a regional enterprise and a private sector investor.

(g) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

(h) PELITA V, the current Indonesian five year economic plan which refers to the Government of Indonesia's plans for private sector participation in its public sector activities.

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7. GENERAL REVIEW OF INDONESIAN REGULATION OF PRIVATE SECTOR PARTICIPATION IN PUBLIC UTILITIES

Public utilities are commercial (but not necessarily profit-making or even fully self-supporting) operations which provide essential services and products to consumers and which are, by the very nature of their means of production and distribution, compelled to operate as monopolies within their geographical marketing areas if they are to achieve maximum—or even reasonable—efficiencies and economies of scale. Examples of public utilities are water, telephone, and electric companies. The essential nature of the services and products they provide make public policy considerations of great importance in assuring that the public is adequately served with those services and products at prices that are reasonable and—in some cases—that are at subsidized prices for more remote or for poorer consumers of those services and products.

The existence of natural monopolies in the provision of public utility services and products necessarily creates a conflict between any private sector participation in those utilities and public policy considerations. Private capital seeks to maximize its profits. Where free market competition exists, it assures that private capital will so function as to maximize efficiencies and provide the consumers the best service or product at the lowest competitive price. Where there is no competition or where competition is imperfect—which must necessarily be the case for public utilities, private capital will be driven by its own internal dynamics to maximize its profits, which may be to the detriment of consumers and public policy if there are no ameliorating limits imposed by competitors or the free market.

This is true for public utilities in all countries. Consequently, in countries where private capital has been permitted to participate in public utilities, governments have established independent utility rate-making regulatory bodies which operate under clear and consistently applied rules. These permit the private sector to realize the recovery of its investment and a reasonable rate of return on that investment and to conduct its activities on a business-like basis without the imposition of unnecessary and disruptive government interference while assuring that the consuming public receives adequate service at reasonable prices and that public policies are protected and implemented.

Indonesia has no history of private sector participation in public utilities. It has not established any independent utility rate-making regulatory bodies (or rules to govern the operations and activities of those bodies) which would permit private sector investors to operate efficiently and realize reasonable profits while protecting the public and promoting public policies. The existence of such independent regulatory bodies—and the rules under which they operate—are not only important from the standpoint of the government because they protect consumers and assure the proper implementation of public policy. They are also important to private sector investors because they will make investing in public utilities less speculative—and therefore more attractive—and will provide private investors with an assured forum through which to pursue and enforce their legal rights.

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The Government of Indonesia has permitted private sector participation in water utilities since 1986. This was originally authorized through the publication of nonexhaustive lists of economic sectors open to private investment. In 1989, an *exhaustive* negative list was issued which recited all those economic sectors in Indonesia in which specified forms of new private investments would not be permitted. Water supply/drinking water and a number of other public utility operational areas were not on this negative list. Nonetheless, Article 3 of the relevant Decree states: "(1) The licensing of investment within the framework of the Domestic Investment Law shall be implemented by the Chairman of the BKPM on behalf of the minister responsible for the investment concerned *in accordance with* his authority and *the provisions of prevailing laws and regulations*; (2) The licensing of investment outside the Foreign Investment Law and the Domestic Investment Law shall be handled by the minister responsible for the investment concerned *in accordance with* his authority and with *the provisions of prevailing laws and regulations*; ..." Consequently, these sectors opened to private investment by the Decree may still be closed through the operation of other laws and regulations. Law No. 15 of 1985 explicitly permitted private sector investment in electric utilities. Law No. 3 of 1989 gave a similar formal authorization for private sector participation in telecommunications.

Little interest has been shown by the private sector in participating in water supply during this period, but greater interest has been expressed in investing or obtaining service contracts in other public utility sectors, e.g., waste removal and disposal, electric power generation, and telecommunications. In at least one area, i.e., the construction and operation of toll roads, the private sector has not only displayed an interest in making investments but has completed a number of major investments in projects which are now operational. Nonetheless, the legal procedures for seeking and obtaining authorization to make such private investments in public utilities and the terms and conditions under which such investments will be permitted are unclear. The charges or tariff rates which private investors in public utilities may demand of the public are often established or approved by appointed bodies.

With particular reference to private sector participation in public water utilities, the legal status of that participation is especially unclear. Article 33 of the Basic Law states that the State must control the "production branches" which provide for the "needs of the people" and that water may only be managed and utilized by the government for the maximum benefit of the people. If these are not absolute prohibitions regarding private sector investments in water supply activities, they minimally establish a requirement for a high standard of government regulation of any private sector activities in this area. Of greater concern is Law No. 1 of 1967 which states in Article 6 that nine economic sectors are closed to foreign investment which is "exercising full control." These include telecommunications, electricity, and *drinking water*. Paragraph 2 excludes *absolutely* foreign investment in other economic sectors. Although foreign investment in electricity and telecommunications has been explicitly permitted by later laws, foreign participation in the drinking water sector has been authorized only through presidential decrees and ministerial

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regulations (see the list of relevant laws and regulations at the end of this Section). If a law prevails over any conflicting language of presidential decrees and ministerial regulations—as seemingly it must (see Figure 1), the definition of what constitutes "exercising full control" is of critical importance. This term is as yet undefined.

The principal laws and regulations relevant to private sector participation in Indonesian public utilities are:

(a) Basic Law of 1945 (Indonesian Constitution), particularly Article 33 which states "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people."

(b) Law No. 1 of 1967 regarding foreign investments.

(c) Law No. 15 of 1985 regarding private sector participation in electricity.

(d) Law No. 3 of 1989 regarding private sector participation in telecommunications.

(e) Presidential Decree No. 21 of 1989 concerning the list of sectors that are closed for specified forms of new private sector investment, superseding Presidential Decree No. 15 of 1987 which, in turn, superseded Presidential Decree No. 22 of 1986.

(f) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation by a regional enterprise with a third party. This made possible the establishment of joint cooperation undertakings between a regional enterprise and a private sector investor.

(g) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

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8. INDONESIAN LAW REGARDING PRIVATE SECTOR SERVICE CONTRACTS AWARDED BY UTILITIES AND GOVERNMENTAL ENTITIES

Indonesian public utilities and governmental entities have for a long time awarded service contracts to private sector participants. Private sector participants perform under service contracts in petroleum-related activities which are worth millions of dollars annually. Garuda Airlines has in the past privately contracted out some of its aircraft maintenance. A private Swiss company has contracted with the Indonesian Government to collect and administer customs tariff operations for goods entering Indonesia.

In the field of water supply public utilities, private sector service contracts have been awarded under more limited circumstances and less frequently. In two cases, i.e., Medan and Surabaya, the collection of the payment from at least some water consumers has been contracted out to other parties. At least in the case of Surabaya, the contract was awarded to a bank owned by the provincial government and not to a genuine private sector bidder (although private sector bill collectors were subcontracted to actually perform the service).

In the water utility sector, authorization for the award of service contracts is principally provided by Regulation of the Minister of Home Affairs No. 4 of 1990. That Regulation states that service contracts may be awarded by regional enterprises to the private sector through "management cooperation," "operational cooperation," "management contract," "agency, usage and distribution," or "technical assistance cooperation." Regulation of the Minister of Home Affairs No. 3 of 1986 also permits, *inter alia*, regional enterprises to enter into service contracts with third parties regarding "management and operation assistance." These terms are not defined in the regulations. No clear procedures are established for evaluating bidders or for awarding contracts. No standard contract terms or formats were prescribed.

To assure that private sector performance of services under contract to government entities is provided at the lowest possible cost and with the greatest efficiency, there must be competitive bidding by qualified bidders for such contracts, such service contracts must be regularly rewarded through competitive bidding, and the performance of private sector service contracts must be subject to continuous monitoring and evaluation. Of course, the benefits to be derived from awarding water supply service contracts to the private sector may only be achieved if the private sector itself has the competence and resources to fulfill such contracts. This must be determined prior to initiating a program of awarding such contracts. There are currently no rules in the water utility sector for the publication of announcements of a request for bids, the preparation of the terms of service contracts for which bids will be accepted, the formal qualification of competent bidders, the submission of sealed bids, the selection of the most competitive bidder, public disclosure of the winning bid, the right of losing bidders to challenge the bid award through the courts, a requirement that service contracts be for only limited periods and that they be rewarded competitively, or the

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mechanics for monitoring and evaluating the performance under service contracts of winning private sector bidders.

Those principal laws and regulations which are relevant to the award by public utilities and government entities to private sector participants of service contracts are:

(a) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation of a regional enterprise with a third party.

(b) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party which revoked the Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

(c) Surabaya PDAM President Director's Decree No. KPTS/29/411.61 of 1985 regarding private sector service contracts for bill collection.

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9. INDONESIAN LAW REGARDING PRIVATE/PUBLIC SECTOR JOINT VENTURES

The answer to the question of whether a public sector regional enterprise may legally enter into a joint venture with a private sector investor, particularly in the area of water supply, remains unclear. Regulation of the Minister of Home Affairs No. 4 of 1990 and Regulation of the Minister of Home Affairs No. 3 of 1986 explicitly authorize such joint ventures. Instruction letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of regional government enterprises into one or the other of two types of legal entity, i.e., PERUMDA (Regional Public Company) and PERSERODA (Regional Limited Liability Company), following enactment of a law to replace Law No. 5 of 1962 would make such joint ventures more easily accomplished. Because of the peculiarly ambivalent status of Law No. 5 of 1962, which is neither quite revoked nor quite inoperative, the ability of PDAMs or PDABs to enter into joint venture agreements with private sector investors remains in doubt. In Law No. 5 of 1962, Article 5(4), provides that: "The important/main branches of the region which affect the well-being of the region must be *managed* by the regional enterprise ..." Article 7(2) states: "The capital of a regional enterprise may not consist of shares." The continuing overhang of the limitations imposed by Law No. 5 of 1962 (as well as the previously quoted Article 33 of the Basic Law) may be argued by some to make some or all such joint ventures illegal. These Articles require that control and/or management of essential services (including water supply) be the exclusive right of the State which is exercised for the benefit of the people. For foreign investors, the restrictions of Article 6 of Law No. 1 of 1967 would seemingly limit the participation of foreigners to a noncontrolling minority without management rights in any such joint venture and prevent the foreign investor from exercising control over the investment.

The clearest authorization for public/private sector joint ventures in the water supply area is found in Regulation of the Minister of Home Affairs No. 4 of 1990. It explicitly permits regional enterprises to participate with the private sector in joint ventures (as well as quasi-joint ventures, i.e. "profit-sharing cooperation," "financing cooperation," "production-sharing cooperation" and "facilities-sharing contracts." Regional enterprises may also purchase equity in existing private sector enterprises or sell stocks and bonds (seemingly contrary to the provisions of Law No. 5 of 1962) under this Regulation. The other provisions of the Regulation clearly have joint ventures as their principal focus and deal with a number of their aspects, e.g., the joint venture agreement under Article 6. Nonetheless, the provisions of the Regulation as it concerns joint ventures are neither clear nor detailed.

Under Regulation of the Minister of Home Affairs No. 4 of 1990, regional enterprises are permitted to cooperate, *inter alia*, with a foreign country government, a foreign private enterprise, a cooperative, a national private enterprise, and/or a national and/or foreign financial institution. "Cooperation" means any activities resulting from a formal binding contract between a regional enterprise and a third party to jointly execute any business activity to accomplish a specified objective. Cooperation is permitted to increase the

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efficiency, productivity, and effectiveness of a regional enterprise, to make a regional enterprise more financially viable, and to "accelerate the mobilization of business." Those terms are undefined. This may be accomplished by (a) developing an existing business or (b) establishing new enterprises based on anticipated mutual benefits. The role and responsibility of each party is to be linked to their relative risks. The "cooperation" with a third party *may not*, under Article 6, *change the legal entity status of the regional enterprise*. Article 8 specifies the qualifications of an eligible third party. The level of final Government of Indonesia approval required for any "cooperation" is based on the size of the investment (which clearly contemplates only joint ventures) as prescribed in Article 9.

Regulation of the Minister of Home Affairs No. 3 of 1986 permits the purchase of shares in an existing corporation by a regional enterprise, the establishment of a new corporation by a regional enterprise, and the award of contracts by a regional enterprise for, *inter alia*, profit-sharing, production-sharing, and shared facility arrangements.

Under Law No. 5 of 1962 and Regulation of the Minister of Home Affairs No. 3 of 1986, DPRD TK. II approval is required for joint ventures between regional enterprises and third parties. This requirement does not exist under Regulation of the Minister of Home Affairs No. 4 of 1990.

Regulation of the Minister of Home Affairs No. 690-536 of 1988 states in Chapter II, Article 2, that revenue projections from water sales must be clearly calculated based on the establishment of tariffs for water which will recover personnel costs, electricity costs, costs for chemicals, operation and maintenance costs, general administration costs, depreciation of assets, and any interest payments. No provision is made for set-aside funds for planned new infrastructure developments. Infrastructure replacement funding is only provided to the extent that is covered by depreciation of assets. The tariff schedules must: permit any member of the community to afford to pay for water; provide for higher tariffs for wealthier consumers to subsidize below cost of water sales to poorer consumers; and encourage the efficient use of water. There are drafts of accountancy rules for PDAMs and a detailed methodology for the determination of tariffs which are only available in Indonesian-language versions. They were not examined in detail for the preparation of this Paper. Different tariff rates will be established for the following categories customers in accordance with Chapter III, Article 4: (a) nonprofit public institutions, e.g., hospitals and mosques, (b) noncommercial customers, e.g., residential customers, (c) industrial customers, and (d) special commercial customers, e.g., hotels and restaurants. There is no provision for regularly scheduled periodic or specially requested reviews or revisions of the tariff schedules. Proposed tariff schedules are prepared and submitted by the board of directors to the board of supervisors of a PDAM/PDAB. The board of supervisors may modify the proposed tariff schedule. It submits its proposed tariff schedule to the head of the level of government under which the PDAM/PDAB operates. The government executive may modify the proposed tariff schedule and will formally issue the tariff schedule through a *Surat Keputusan*. No provision is made

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for public hearings on the tariff schedule or for legal challenge to any tariff schedule which is formally issued.

The principal relevant laws and regulations regarding joint ventures between private sector participants and public sector enterprises are:

(a) Basic Law of 1945, particularly Article 33 which states "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people.

(b) Law No. 5 of 1962, particularly Article 5(4) which states, "The important main production branches of the region which affect the well-being of the region must be managed by the regional enterprise ..." and Article 7(2) which states, "The capital of a regional enterprise may not consist of shares."

(c) Law No 1 of 1967 on foreign investment, particularly Article 6 which prohibits foreign investors from "exercising full control" over any activities regarding "drinking water."

(d) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning the cooperation of a regional enterprise with a third party.

(e) Regulation of the Minister of Home Affairs No. 690-536 of 1988 dealing with guidelines for the pricing of water to consumers by a PDAM. This provides that water prices charged to consumers must be decided by the head of the local government and be subject to gubernatorial approval following a proposal from the management of the water company and the favorable considered judgement of its supervisory board. This eliminated the requirement for ratification by DPRD TK. II provided in Regulation of the Minister of Home Affairs No. 690-1572 of 1985.

(f) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This Regulation revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

(g) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 5 of 1984 and 28 of 1984 concerning guidance about the calculation of drinking water tariffs and regarding the

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organization, accounting systems, structure, and cost calculations of water utilities.

(h) Instruction letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of regional government enterprise into one or the other of two types of legal entity, i.e., PERUMDA (Regional Public Company) and PERSERODA (Regional Limited Liability Company), upon enactment of a law to replace Law No. 5 of 1962.

(i) Guidelines on the Accounting System of PDAMs of August 1990 issued by the Minister of Home Affairs.

(j) Implementing Guidelines for Regulation No. 690-536 of 1988 (Interim Report) (undated) regarding the calculation of drinking water tariffs by PDAMs.

10. INDONESIAN LAW REGARDING BUILD, OPERATE AND TRANSFER INVESTMENTS

Build, Operate and Transfer (BOT) private sector investments have been made in Indonesia in hotels, commercial buildings, toll roads, petroleum-related supporting institutions and elsewhere.

In a BOT, the private sector investor first plans and constructs ("BUILD") the investment capital project using its own capital and resources. It then operates the project on a commercial basis ("OPERATE") for a fixed term or until it has recovered its investment costs and a reasonable rate of return. At the end of the period of operation by the private investor, the assets of the investment capital project will be transferred ("TRANSFER") to the government or one of its entities.

It is the preference of the private sector, and occasionally it has been proposed, that private investors *not* ultimately transfer the assets but retain them indefinitely as their own private property. This has been characterized as a Build, Operate, and Own/Operate ("BOO") investment.

Of critical importance from the standpoint of the Government of Indonesia in evaluating the beneficial nature of BOTs is a determination of: (a) whether a BOT constitutes a cheaper form of financing for projects which serve public policy goals; (b) whether a shortage of available funds to the Government of Indonesia would prevent construction of the project without the participation of private BOT capital; (c) whether a BOT would provide urgently needed water supply services more expeditiously or more thoroughly or reliably than would or could the public sector; (d) whether the operation of the BOT would be contrary to essential Government of Indonesia public policies or whether the BOT could be so regulated as to operate in accordance with those essential public policies; and/or (e) whether the BOT capital investment project infrastructure will be so maintained during the period of private sector operation that the infrastructure will have some intrinsic value to the Government of Indonesia upon its transfer.

No examined BOTs in Indonesia seem to fit the classical BOT format. Under some BOT investments, the transfer of the assets may not take place completely on some fixed date but the title to the assets may be transferred to the government incrementally and over time. In some cases the project assets are transferred immediately upon completion of the infrastructure construction and the operations themselves are handled by the public sector with the investor retaining nothing but a right to a portion of the revenue stream from the investment. In the petroleum sector in Indonesia, such immediate transfers of investor assets are the norm. It is noted that in case of the proposed Umbulan Spring project in East Java, the drafted legal agreement characterized the cooperation as a "production sharing cooperation"—a term derived exclusively from Government of Indonesia-private sector dealings in petroleum-related activities.

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There are no laws in Indonesia which are specifically applicable to BOTs in the area of water supply. Regulation of the Minister of Home Affairs No. 4 of 1990 makes no reference to BOTs among those enumerated acceptable means by which the private sector may cooperate with regional enterprises in the public sector in water supply activities. The law of Indonesia regarding BOTs in the water supply area must therefore be determined by an extrapolation from current practice. The only laws or regulations of Indonesia dealing with BOTs which were discovered are Presidential Decree No. 42 of 1989 and Regulation of the Ministry of Mining and Energy No. 03P/39/M.PE of 1989 which deal with BOTs in the supporting sector, e.g., refineries, of the petroleum industry. On the basis of current practice, nonetheless, it is clear that BOTs have an accepted and legitimate legal basis under Indonesian law for private sector investments because so many of them are in operation and because BOTs in Indonesia have been built and operated for so long. What is less clear is on what basis and through what administrative procedures the Government of Indonesia will receive, approve and deny applications for BOTs and how such applications will be evaluated by the Indonesian Government. Because all examined Indonesian BOTs differ from the standard definition and perception of what constitutes a BOT, it is uncertain whether classic BOTs as such are permitted by Indonesian law generally or in the water supply sector.

The only relevant Indonesian laws and regulations discovered regarding BOTs are the following.

(a) Presidential Decree No. 42 of 1989 regarding BOTs in the petroleum-related support sector.

(b) Regulation of the Minister of Mining and Energy No. 03/39/M.PE of 1989 regarding BOTs in the petroleum-related support sector.

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11. ANALYSIS OF THE ADEQUACY OF EXISTING INDONESIAN LAWS AND REGULATIONS

Some laws and regulations of Indonesia regarding private sector participation in water supply activities are clear in their statement of policy that such participation is encouraged, but these may conflict with Article 33 of the Basic Law, Law No. 5 of 1962 may restrict PDAMS'/PDABS' cooperation with the private sector, and Law No. 1 of 1967 would seem to prohibit at least a controlling interest or management by foreign participants in Indonesian water supply activities. They are far less clear in stating on what basis the private sector may so participate, what standards the Government of Indonesia will apply in evaluating any application by the private sector to participate, and how the Government of Indonesia will assure that its public policy aims in the water supply area will not be unacceptably frustrated as a result of any private sector participation.

Current Indonesian law regarding private sector participation in water supply activities creates perceived risks in the minds of private sector participants because of its lack of clarity and uncertain application. Where financing or capital costs are incurred in currencies other than rupiah, the lack of guaranteed currency conversion from rupiah to other currencies at assured rates adds to this perceived risk.

From the standpoint of the Indonesian Government, private sector participation in a natural or *de facto* monopoly—such as water supply—poses great risks unless that participation is clearly defined and limited by law and unless provision is made for continuous oversight of such private sector participation under clear and consistently applied standards by Indonesian regulatory bodies. Where there are few competing investors or enterprises which wish to participate in water utility activities; where those investors have a limited competence to undertake roles in the water supply area; or where some investors or enterprises are inappropriately supervised and obtain an unevaluated role in water supply activities, private sector participation provides uncertain benefits. Effective and beneficial private sector participation demands competent and competing private sector parties and prudent government regulation.

Figure 3 lists the respective needs of the private and public sectors if private sector participation in Indonesian water supply activities is to prove mutually beneficial to both parties. Applicable laws and regulations must be formulated to meet the needs of both parties and to provide assurances that fulfillment of those needs is based on enforceable rights at law. If the private sector's needs are not satisfied, it will not participate. If the public sector's needs are not satisfied, it may be displeased with the participation of the private sector. If standards and procedures are not clearly articulated under laws and regulations, both the private and public sectors may lose time and money and incur lost opportunity costs by pursuing possible projects under terms that one or the other party will ultimately find unacceptable. Current Indonesian laws and regulations regarding private sector participation

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Figure 3

Private and Public Sector Needs

PRIVATE SECTOR NEEDS

A. PREDICTABILITY

(1) CLARITY
(2) CONSISTENCY
(3) ENFORCEABILITY

B. PROFITABILITY

(1) CALCULABLE RISKS
(2) CALCULABLE COSTS
(3) A REASONABLE EXPECTATION OF A COMMERCIAL RATE OF RETURN ON THE INVESTMENT

PUBLIC SECTOR NEEDS

A. BENEFITS

(1) EFFICIENCIES
(2) FINANCIAL ASSISTANCE
(3) A DESIRED SHIFT IN PRIVATE / PUBLIC SECTOR BALANCE

B. PUBLIC POLICY IMPLEMENTATION

(1) INCREASED SERVICES/CHEAPER SERVICES
(2) ASSURED / SUBSIDIZED SERVICES TO MORE REMOTE OR TO POORER CONSUMERS
(3) RESPONSIVENESS TO NEW OR CHANGED PUBLIC POLICIES

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in water supply activities do not provide clear and detailed standards and procedures nor do they satisfy the real needs of either the private or the public sector.

Generally, relevant Indonesian laws and regulations are unclear and are not detailed. Terms used in them are undefined and are not self-defining. No procedures are clearly provided through which private parties may enforce their legal rights through courts or independent bodies. Standards for decision-making are expressed only in vague terms. Administrative procedures are not stated in sufficient detail to serve as guidance for implementing agencies of the Government of Indonesia or to advise the private sector of exactly what opportunities are offered to it and how it should proceed to explore those opportunities. The laws and regulations should do all these things. To the degree that this lack of clarity and precision reflects the fact that the Government of Indonesia has not yet thoroughly determined its public policies in this area, implementation should not be attempted until such public policy decisions are made and are reflected in Indonesian laws and regulations.

Current Indonesian laws and regulations establish no clear standards for evaluating the desirability of specific private sector participation proposals in the water supply area or for evaluating their compatibility with essential public policy aims. There are also no legal standards for evaluating the awards of water supply service contracts, the competence of bidders to adequately perform those contracts, the assurance that contracts are awarded on a competitive basis to the bidder who best meets the articulated standards of the Government of Indonesia for a particular contract, or for the form of contract to be used in making such awards. No legal authority for, or laws and regulations concerning, BOTs in Indonesia's water supply sector exist. In particular, there is uncertainty about the time at which a transfer of BOT assets will be made. Although PDAMs and other agencies of the Government of Indonesia will *implement* the laws and regulations of Indonesia concerning private sector participation in water supply activities by proposing, evaluating, and authorizing such participation in *specific projects*, the laws and regulations themselves must give detailed guidance in terms of general policy, standards, and procedures to those implementing agencies if they are to be able to implement them in specific cases. Those laws and regulations must also be sufficiently explicit, detailed, and clear to reassure and give guidance to prospective private sector participants. The current laws and regulations do not satisfy these requirements.

There is not any independent regulatory body now established by the Indonesian Government or its subordinate levels of government which operates under clear and consistently applied rules and whose function is to provide a mechanism for permitting private sector investors in monopoly public utilities the opportunity to obtain a reasonable return on their investments while assuring that essential public policy goals of Indonesia are pursued and attained. Members of such independent rate-making bodies should be impartially selected and should sit for limited terms of office. The procedural methodologies of such bodies should operate through explicit and detailed rules which are transparent to the public. The procedures should permit private parties to submit information and arguments and might

allow private parties to personally appear before the regulatory body. The standards they apply in setting rates should also be clear and expressed with sufficient precision to assure the public, the private investors, and the Government of Indonesia of a predictable outcome. The decisions of the regulatory body must be subject to the review of the courts upon the request of private parties.

In summary—

- Indonesian laws and regulations authorizing private sector participation in water supply activities are in apparent conflict.

- Current laws and regulations satisfy neither private sector nor public sector needs although they must satisfy both if they are to be at all effective.

- Applicable Indonesian laws and regulations are not clear and are undetailed and may reflect the fact that the Government of Indonesia has not yet formulated specific relevant public policies.

- In some cases, particularly with regards to BOTs, there is a complete absence of applicable laws and regulations.

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12. RECOMMENDED CHANGES TO, AND ADDITIONAL, INDONESIAN LAWS AND REGULATIONS

The private sector requires clarity in any legal description of its legal rights and the standards under which its activities will be regulated by the Indonesian Government. It also requires the consistent and predictable administration by the Government of Indonesia of the existing laws and regulations applicable to its investments. Finally, the private sector must feel assured that its rights are legally recognized and enforceable at law through the courts against the Indonesian Government and its agencies. There are some historical reasons why the private sector may have legitimate concerns that those requirements are not now met regarding its present and prospective investments in Indonesia. It is recommended that the Government of Indonesia continue its current program of providing greater assurances to the private sector that these requirements are, and will continue to be, met. Specifically, applicable laws and regulations should be made clearer and more detailed, with essential terms used in them defined to a thorough and practical degree.

Specifically, Law No. 5 of 1962 should be replaced as proposed by Law No. 6 of 1969 by a new law that will clarify the legal ability of PDAMs and PDABs to contract with private parties or to enter into joint ventures, BOTs, and service contracts with private parties for water supply activities. If such a replacing law cannot be issued, a new law clarifying private sector participation authorization in water supply activities and eliminating the requirement for DPRD approval of each such private sector participation should be promulgated.

The restrictions imposed on foreign investments in the water supply sector by Article 6 of Law No 1 of 1967 should be clarified. If they are significant, they should be eliminated through new legislation.

A new law should be promulgated or the legal opinion of the Minister of Justice should be sought regarding the significance of Article 33 of the Basic Law on private sector activities in the water supply field.

Ministry of Home Affairs Regulation Nos. 3 of 1986 and 4 of 1990 should be amended to specifically provide legal authorization for BOTs, to clarify the nature of production and profit sharing contracts in the water supply sector and to distinguish the nature of such contracts from those which are used in the petroleum sector to eliminate the requirement for DPRD approval of each private sector participation, and to clarify and provide details of the nature of other permitted forms of private sector participation in the water supply area.

The possible conflicts of law regarding the legal authority of, and restrictions on, private sector participants to engage in water supply activities in Indonesia are listed and juxtaposed in Figure 4.

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Figure 4

Possibly Conflicting Authorities—
Private Sector Participation in Indonesian Water Supply Activities

PROHIBITED OR RESTRICTED	PERMITTED
Basic Law of 1945, Article 33 Production branches which are important to the State and provide for the needs of the people must be under the control of the State and water is to be managed and utilized by the government for the maximum benefit of the people.	**Presidential Decree No. 21 of 1989** The private sector is permitted to participate in the water supply sector because "water supply" or "drinking water" is not listed as an area from which any form of new private sector investment is excluded.
Law No. 5 of 1962 PDAMs (see Article 5) have no authority to cooperate with the private sector if this would relinquish "management" by the PDAM.	**Regulation of Minister of Home Affairs Nos. 4 of 1990 and 3 of 1986** Permits, inter alia, cooperation of prescribed types between regional enterprises and the private sector.
Law No. 1 of 1967 Foreign investment may not (see Article 6) "exercise full control" in activities in the drinking water sector, although [see para. (2)] foreign investment in this sector is not absolutely prohibited.	

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The legally mandated methodology for rate-making and the setting of tariffs for the sale of water should be based on clear and readily calculable determinations of the cost of delivered water. Such tariff schedules should be legally defined. Tariffs should preferably be established by independent bodies which are free from political influences which must act in accordance with precise and clearly articulated standards. Tariff rate schedules must be reviewed and adjusted on a regularly scheduled and/or specially requested basis in order for the tariffs to reflect changed circumstances. The tariff rate determinations of those independent bodies must be subject to judicial scrutiny and judicial modification based on their inconsistency with the legally established standards by which those independent bodies are required to conduct their proceedings.

Laws, policies, and guidelines should clearly state where and how private sector participation in the water supply sector will be welcome, where it will be unwelcome, and on what terms it will be judged. This will permit private sector investors/contractors to realistically evaluate investment opportunities and only pursue those where they and the Government of Indonesia are likely to find mutually acceptable accommodation.

For any government, the participation by the private sector in economic activities where the private sector will attain complete or localized officially-recognized or *de facto* monopoly powers poses a serious threat to its ability to effectively pursue its public policy objectives. Further, such monopolies in private sector hands also pose a potential threat of exploitation by the private sector of consumers through the private sector's monopolistic control of the provision of services and goods. Water utilities are classic cases of such monopolies. Any possible adverse effects of private sector participation in monopolies may generally be avoided through carefully administered government regulation.

The Government of Indonesia has an essential interest, which must be protected by law and through established administrative
procedures, to assure that its fundamental public policy goals are not frustrated by the participation of private sector parties in the water supply sector. This must be accomplished by the clear articulation of the administrative methods—including which ministries and agencies of the Indonesian Government have review and approval authority—through which applications by the private sector to participate in water supply activities will be considered and the standards under which any such applications will be evaluated. It must include continuing oversight of the activities of private sector investors/contractors to assure that they do not improperly exploit their monopoly economic position.

Evaluation of private sector activities in the water supply area must also be the subject of continuous monitoring to assure that private sector participation generates those benefits which originally justified the authorization for its participation and to assure that competing private sector participants are provided regular and fair competitive opportunities to participate in permitted water supply activities. This may only be accomplished through the

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creation of a new agency or the delegation of power to an existing governmental body to perform such a role in accordance with clearly established administrative procedures and the consistent application of explicit standards.

Standard contractual forms should be created to be used for the award of service contracts by public water utilities. Standards should be established to evaluate the competence of prospective bidders on such contracts and to assure that the bidder which most completely satisfies those standards is ultimately awarded the contract. Bidders who have not been awarded a contract but who think they should have been awarded the contract under the applicable standards should have the right of recourse to the courts for a reevaluation of the contract award process. The courts should have the power to overturn the award where it has been improperly made.

In summary, it is recommended that—

- Applicable Indonesian laws should be written clearly and in a detailed fashion and that they should be implemented and enforced consistently and rigorously.

- A new law or laws should be promulgated to replace Law No. 5 of 1962 and/or to clearly authorize private sector participation in Indonesian water supply activities; to clarify/eliminate conflicts of law regarding that participation and Article 33 of the Basic Law, Law No. 5 of 1962, and Law No. 1 of 1967; and to eliminate any requirement for DPRD TK. I approval of each such participation.

- Regulation of the Minister of Home Affairs Nos. 3 of 1986 and 4 of 1990 should be amended or a new regulation issued to authorize BOTs and to provide needed details, definitions, and clarifications regarding other permitted forms of, and procedures for, private sector participation in Indonesia's water supply activities.

- Where a private sector investor is dependent on revenues based on a tariff schedule for water to cover its costs and realize a reasonable rate of return on its investment, tariff rate-making methods must be clearer, more detailed, reflective of the needs of the private sector investor, frequently subject to review and revision, and subject to enforcement by the private sector investor through the courts.

- In general, Indonesia must establish a regulatory system for its water utilities which satisfies the needs of both the private and public

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sectors; provides for continuous monitoring and evaluation of private sector performance; and the continuous reformulation of government objectives and public policies based on recent and continuing empirical experience.

13. DRAFT LAW

Regarding: A law to clarify the permitted activities of the private sector in Indonesian water supply activities.

In Consideration of: A. basic law of 1945, particularly Article 33; B. Law No. 5 of 1962, particularly Article 5; and C. Law No. 1 of 1967, particularly Article 6.

Chapter I—Article 1—The provisions of the basic law of 1945, Article 33, state that "Production branches which are important to the state and provide for the needs of the people must be under the control of the State" and "Water is to be managed and utilized for the needs of the people by the government."

Article 2—These restrictions are unchanged by this law, but—in clarification—it is sufficient to satisfy the above requirements if the private sector engages in activities in Indonesia's water supply functions which are explicitly authorized by the State and remain under the control of the State.

Chapter II—Article 1—Law No. 5 of 1962, Article 5, prohibits regional enterprises from cooperating with third parties in any way which would relinquish "management" over those activities for which it is responsible.

Article 2—This prohibition is unchanged by this law, but—in clarification—it is sufficient to satisfy the above requirement if any transfer of a PDAM's/PDAB's assets to third parties is made with the explicit authorization of the Ministry of Home Affairs or a person to whom he has delegated this function and if any cooperation with a third party by a PDAB/PDAB is made under a written contract entered into in accordance with the relevant rule and regulations of the Minister of Home Affairs.

Chapter III—Article 1—Law No. 1 of 1967, Article 6, prevents foreign investment in the drinking water sector where the foreign investor would "exercise full control."

Article 2—This prohibition is unchanged by this law, but—in clarification—it is sufficient to satisfy the above requirement if any foreign investment in the drinking water sector is authorized by BKPM and if it remains under the continuing regulation of the Minister of Home Affairs.

Chapter IV—Article 1—Domestic and foreign private sector investments in build, operate and transfer ("BOT") infrastructure in the drinking water sector are hereby authorized when such investments are made in compliance with the rules and regulations and under the continuing regulation of the Minister of Home Affairs and/or if each such investment is explicitly authorized by the _____.

Article 2—No formal approval or ratification shall be required of any private sector participation in drinking water activities, to include cooperation with PDAMs/PDABs or related tariff rate-making, by any DPRD TK. I or II.

Minister of Home Affairs Regulation No. ____ of 199__.

Regarding: The award of service/management contracts by PDAMs/PDABs to third parties.

Chapter I—PDAMs/PDABs are hereby authorized to make awards of service/management contracts to third parties where to do so would result in cost savings, greater efficiency, improved service to customers, or similar benefits.

Chapter II—No such contracts will be awarded unless they are: (a) awarded competitively as provided below; (b) concluded through a written contract which is approved by the _____ or some delegated authority; (c) for a limited term; and provide compensation to the third party commensurate with the benefits to be realized; and (d) subject to continuing monitoring and control by the PDAM/PDAB to assure compliance by the third party with any contractual terms and conditions.

Chapter III—Article 1—Any service/management contract which is proposed to be awarded by a PDAM/PDAB must be drafted by the PDAM/PDAB regarding its specific terms and conditions before it is announced for bids.

Article 2—The proposed award of such contract and requests for tender bids by third parties for the contract must be advertised conspicuously in at least two regularly published general circulation newspapers and provided to commercial attaches or all major foreign embassies at least _____ days prior to any award.

Article 3—A copy of the proposed contract draft must be provided by any party which requests it.

Article 4—Third parties wishing to compete for the contract must submit sealed bids for the context on or before a data specified by the above advertisements and no bids may be accepted after that date. Sealed bids must be accompanied by sufficient information to demonstrate that the third party has the competence and the resources to perform under the contract. All sealed bids must remain sealed and in a secure place under the constant control of the PDAM's/PDAB's officer responsible for the contract.

Article 5—The qualifications of bidders will be reviewed by the PDAM/PDAB and those bidders found to be unqualified will be so notified promptly and in writing, to include the reasons for disqualification, by the PDAM/PDAB officer responsible for the contract.

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Article 6—In a public place with third parties permitted to be present and at an announced place and time, the PDAM's/PDAB's officer responsible for the contract will open all the sealed bids of qualified bidders in the sequence in which they were received, and shall read each of them aloud. At that time, the contract will be provisionally awarded to the maker of the lowest qualified bid, contingent upon finalization of a formal written contract.

Article 7—Where there is only one qualified bidder, no award of a contract will be made until the bidder's tender has been specially reviewed and approved by the _____ or his delegated official.

Article 8—Any bidder which has been disqualified or which was not awarded the contract may have recourse to an appropriate court of law for judicial review of the contract award with these and other relevant regulations, rules and procedures.

Minister of Home Affairs Regulation No. _____ of 199__.

Regarding: The water tariff rate-making where a private sector party is dependent on such tariffs for its revenues from its legally authorized activities.

Chapter I—All water tariff rate-makings where a private sector party is dependent on such tariffs for its revenues from its legally authorized activities shall be conducted in accordance with these regulations and with other rules formally promulgated for such rate-makings where not inconsistent with this regulation.

Chapter II—All such rate-makings shall be based on calculations and revenue projections derived from full, sufficient and reliable information and using the formal accounting rules specially promulgated for PDAMs/PDABs or generally accepted accounting rules where other rules are unclear, imprecise, or silent on a point or do not exist.

Chapter III—Revenue projections and tariff rate-making shall result in the full recovery by the private party of all its legitimate costs plus a reasonable rate of return on its investments. A reasonable rate of return will be commensurate with prevailing commercial rates of return on investments of similar risk and will exceed current rates on commercial depository instruments.

Chapter IV—The private party may attend and participate in any rate-making bodies' proceedings.

Chapter V—Tariff rates shall be reviewed and revised annually and will be reviewed and revised specially upon the private party's request where justified by significant and unanticipated changes in circumstances.

Chapter VI—All decisions of water tariff rate-making bodies shall be subject to challenge by the private party in a court of law and will be subject to judicial review for compliance with applicable rules and regulations.

14. LISTING WITH BRIEF DESCRIPTIONS AND SELECTED TRANSLATIONS INTO ENGLISH OF PRINCIPAL RELEVANT INDONESIAN LAWS, REGULATIONS, AND OTHER OFFICIAL DOCUMENTS

(a) Basic Law of 1945, particularly Article 33 which states "Production branches which are important to the country and which provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people." The Basic Law is the Indonesian constitution. It is superior to all other Indonesian laws and legal authorities.

(b) Dutch East Indies Commercial Code of 1847. This is the essential law regulating commercial and corporate legal activities and transactions. It is now being revised. It is invalid to the extent it is incompatible with Indonesian independence or conditions or is revoked by subsequent Indonesian law. It is based on the Roman Code of Justinian and is similar to continental European civil codes.

(c) The Indies Tariff Law (*Indische Tariefwet*) (Staatsblad 1873 Number 35), as amended and supplemented most recently by Government Regulation No. 6 of 1969. It is the basic law regulating customs tariffs and administration.

(d) Law No. 5 of 1962 which is concerned with the establishment of regional government enterprises at provincial/local levels of government. It serves as the fundamental legal basis for the establishment of PDAMs and PDABs. The current status of this Law is ambiguous. It was revoked by Law No. 6 of 1969, but revocation was made contingent upon the enactment of a new law to replace Law No. 5 of 1962. No such superseding law was ever enacted.

CHAPTER II: CHARACTERISTIC, OBJECTIVE AND FIELD OF ACTIVITY

Article 4:

(1) A Regional Government Enterprise (of Level I or II Governments) is established under a Regional Government Regulation (*Peraturan Daerah* = PERDA), based on this Law.

(2) The Regional Government Enterprise as meant in paragraph (1) is a Legal Entity, the status of which is obtained with the existence of this Law.

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(3) The Regional Government Regulation as meant in paragraph (1) will come into force upon legalization by the appropriate government executive (For Special Regions of Level I Government, the President; For Provincial Level I Government, the Minister of Home Affairs; For Local Level II Government, a governor of Level I).

Article 5:

(1) The Regional Government Enterprise is a production unit with the characteristic of:
   a. providing service
   b. serving public needs
   c. gaining revenue

(2) —

(3) —

(4) The important/main production branches for the Region which effect the well-being of the community of the Region concerned are to be managed by Regional Government Enterprises whose capital wholly or partly must be part of the separated assets of the Regional Government.

CHAPTER III: CAPITAL

Article 7:

(1) The capital of a Regional Government Enterprise consists of assets wholly or partly belonging to a Regional Government, which forms a separated asset.

(2) The capital of a Regional Government Enterprise may not consist of shares.

(3) —

(4) —

CHAPTER V: THE MANAGEMENT

Article 11:

(1) A Regional Government Enterprise will be managed by a Board of Directors, whose number and composition is stipulated in its Establishment Deed (Articles of Association).

(2) Members of a Board of Directors must be Indonesian nationals appointed and dismissed by the appropriate government executive.

(3) Appointment as meant in paragraph (2) is for a period of 4 (four) years at the most. After the said period ends, a member may be reappointed.

Article 15:

(1) The Board of Directors shall make decisions on the management policy of the Regional Government Enterprise.

(2) The Board acts as the executive and manages the assets of the Regional Enterprise.

Article 16:

limited power (authority) of the Board are prescribed in the Regional Enterprise's Articles of Association.

Article 17:

Each Regional Enterprise will have a Supervisory Board which is further subject to regulation by the PERDA (the Regional Government Regulation on the establishment of the Regional Enterprise).

CHAPTER VII: CONTROL

Article 19:

The Board is under the control of the appropriate government executive or the head of an agency appointed by him.

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CHAPTER VIII: STIPULATION ON THE USE OF PROFIT AND THE CONTRIBUTION OF PRODUCTION SERVICE

Article 25:

(1) —

(2) The use of the net profit after deduction of depreciation, reserve and other real deductions within the Enterprise, is determined as follows:

a. for the Regional Development Fund—30%
b. for the Regional Expenditure Budget—25%
c. for General Reserve Fund, social and education fund, production service, and Retirement Fund and Donation, the amount of each is stipulated in the Articles of Association of the Enterprise totalling 45%.

CHAPTER XIV: PERSONNEL

Article 26:

(1) The status, salary, retirement fund and donation and other income of the Board members and personnel/employees of a Regional Government Enterprise is regulated in the PERDA (Regional Government Regulation) and is effective after getting legalization from the Governor for a Level II Government Enterprise and the Minister of Home Affairs for a Level I Government Enterprise, taking into account the stipulations of the prevailing Regional Government Salary Regulation.

(e) Law No. 1 of 1967 regarding foreign investments. It is the basic laws under which all foreign investments in Indonesia are regulated and authorized by BKPM. In Article 6, it list nine economic sectors closed to foreign investors "exercising full control," a term which is not defined. "Drinking water" is one of those listed economic sectors.

Article 2:

Foreign Investment in this Law means:

a. foreign exchange which does not form a part of the foreign exchange resources of Indonesia, and which

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with the approval of the Government is utilized for financing an enterprise in Indonesia.

b. equipment for an enterprise, including rights to technological developments and materials imported into Indonesia, provided the said equipment is not financed from Indonesian foreign exchange resources.

c. that part of the profits which in accordance with this Law is permitted to be transferred, but instead is utilized to finance an enterprise in Indonesia.

Article 3:

(1) An enterprise as intended by Article 2, which is operated wholly or for the greater part in Indonesia as a separate business unit, must be a legal entity organized under Indonesian Law and have its domicile in Indonesia.

(2) The Government shall determine whether an enterprise is operated entirely or for the greater part in Indonesia as a separate business unit.

Article 5:

(1) The Government shall determine the fields of activity open to foreign investment, according to an order of priority, and shall decide upon the conditions to be met by the investor of foreign capital in each such field.

(2) The order of priority shall be determined whenever the Government prepares medium and long-term development plans, taking into consideration developments in the economy and technology.

Article 6:

(1) Fields of activity which are closed to foreign investment exercising full control are those of importance to the country and in which the lives of a great deal of people are involved. such as the following:

a. harbors;

b. production, transmission and distribution of electric power for the public;

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c. shipping;
d. telecommunications;
e. aviation;
f. drinking water;
g. public railways;
h. development of atomic energy;
i. mass media.

(2) Industries performing a vital function in national defence, among others, the production of arms, ammunition, explosives, and war equipment, are absolutely prohibited to foreign investment.

Article 18:

Every permit for investment of foreign capital shall specify the duration of its validity, which shall not exceed 30 (thirty) years.

Article 23:

(1) In the fields of activity open to foreign capital, cooperation may be effected between foreign and national capital, with due consideration given to the provisions of Article 3.

(2) The government shall further determine the fields of activity and the forms and methods of cooperation between foreign and national capital utilizing foreign capital and expertise in the fields of export and the production of goods and services.

Article 27:

(1) Enterprises mentioned in Article 3 of which the capital is entirely foreign, are obligated to provide opportunities for participation by national capital, following a specified period and in a proportion to be determined by the Government.

(2) When participation as intended by Section (1) of this Article is effected by selling existing shares, the proceeds of such sales can be transferred in the original currency of the foreign capital concerned.

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Article 28:

(1) Provisions of this Law shall be implemented by coordination among the Government agencies concerned in order to ensure harmonization of Government policies regarding foreign capital.

(2) Procedures for such coordination shall be subsequently determined by the Government.

(f) Law No. 6 of 1968 concerning domestic investments. This law was originally designed to attract back to Indonesia flight capital and is the authority under which BKPM now licenses "facilitated" domestic investments.

Article 1:

(1) That which is intended by "Domestic Investment" in this Law is a portion of the property of Indonesian society, including rights and goods, owned either by the State or by National Private or Foreign Private Entities domiciled in Indonesia which has been reserved/made available for the operation of an enterprise insofar as such capital is not governed by the provisions of Article 2 of Law No. 1 of 1967 concerning Foreign Capital Investment.

Article 2:

That which is intended by "Domestic Investment" in this Law is the use of property as referred to in Article 1, either directly or indirectly for the operation of a business in accordance with or based upon the provisions of this Law.

Article 3:

(1) A national enterprise is an enterprise of which at least 51% of the domestic investment therein is owned by the State and/or a National Private Enterprise. This percentage shall be increased so that on January 1, 1974, it will amount to not less than 75%.

(2) A foreign enterprise is an enterprise which does not satisfy the conditions of Section (1) of this Article.

(3) Should an enterprise intended by Section (1) of this Article be a limited liability company, then at least the percentage of the total shares as referred to in Section (1) of this Article must be identified by a holder.

Article 4:

(1) All fields of activity are in principle open to private enterprise. State activities in connection with the development of fields of private activity include fields to be initiated or pioneered by the Government.

(2) Fields of State activity include especially those fields of undertaking which the government is obligated to conduct.

(g) Law No. 11 of 1970 which amended and supplemented Law No. 1 of 1967.

(h) Law No. 12 of 1970 which amended and supplemented Law No. 6 of 1968.

(i) Law No. 8 of 1971 regarding Pertamina's right to exclusively license private sector participants in the Indonesian petroleum-related economic sector.

(j) Law No. 5 of 1974 which is concerned with decentralization and the establishment of autonomous authority in the provincial and local governments regarding administrative matters.

Article 2

To organize and establish an Administration, the territory of the Republic of Indonesia shall be divided into Autonomous Regions and Administrative territories.

Article 3:

(1) In the framework of the implementation of the decentralization principle, there shall be organized and established Regions of the First Level and Regions of the Second Level.

Article 7:

A Region has the right, is authorized and is obliged to organize and manage its own services in accordance with the prevailing laws and regulations.

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Article 8:

The additional transfer of governmental affairs to the Region will be stipulated by Government Regulation.

Article 13:

(1) The Regional Government will consist of the Head of the Region and the Regional Legislature.

Article 38:

The Head of Region with the approval of the Regional Legislature shall have the authority to issue Regional Regulations (Perda).

Article 39:

(1) Regional Regulations (Perda) and/or Decisions of the Head of Region may not be in contravention of the general interests and statutes of Regional Regulations of the higher level.

(2) A Regional Regulation shall be signed by the Head of Region and be countersigned by the Chairman of the Regional Legislature.

Article 55:

Sources of Regional Revenue are:

(1) Original revenue of the Regional Government consisting of:
   a. revenue from regional taxes
   b. revenue from regional fees
   c. revenue from Regional Enterprises
   d. other legal regional revenues

(2) Revenue originating as subsidies from the (central) Government consist of:

   a. subsidy from the (central) Government
   b. other contributions regulated by statutes.

(3) other legal revenue.

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Article 59:

(1) The Regional Government may set up a Regional Enterprise of which the execution and maintenance shall be carried out based upon the principle of cost accounting.

(2) Basic stipulations on Regional Enterprises shall be determined by Law (Statute). (Note: See Law No. 5/1962)

(k) Law No. 11 of 1974 regarding water resources and which has a wide applicability to other public water utility issues.

Article 2:

Water and its resources, including the natural wealth contained therein, has a social function and must be used for the maximum welfare of the people.

Article 3:

(1) Water and its resources must be managed/controlled by the State.

(2) The State therefor gives the authority to the Government:

a. to manage and develop the use of water and/or water resources.
b. to formulate, legalize and/or issue licenses according to planning and technical planning of water/water resource management.
c. to organize, legalize and/or issue licenses for the purpose, the use and the supply of water and/or water resources.
d. to organize, legalize and/or issue licenses for the exploitation of water and/or water resources.
e. to determine and arrange legal deeds and legal relations between persons and/or corporate bodies in water and/or water resources matters.

Article 4:

The authority of the Government as meant in Article 3 can be delegated to Government agencies/units, at Central as well as at Provincial and Regional

Level and/or to certain legal entities based upon the requirements and procedures to be determined by Government Regulation.

Article 5:

(1) The Minister, who is given the task of water resources affairs (Ministry of Public Works, Directorate General of Water Resources), is authorized and responsible to coordinate all regulations concerning planning, technical planning, control, exploitation, maintenance, protection and the use of water and/or water resources; with due consideration of the interests of other related Ministries and/or institutions.

Article 11:

(1) The exploitation of water and/or water resources, aimed to enhance its benefit for the welfare of the people, is basically carried out by central as well as Regional Government.

(2) A corporation, social organization, or person exploiting water and or water resources must obtain a license from the Government.

(l) Law No. 4 of 1982 regarding environmental protection.

(m) Law No. 6 of 1983 concerning general tax matters.

(n) Law No. 7 of 1983 concerning income taxation.

(o) Law No. 8 of 1983 concerning value added taxation on goods and services and a sales tax on luxury goods.

(p) Law No. 12 of 1983 regarding customs.

(q) Law No. 13 of 1983 regarding taxation of real property.

(r) Law No. 15 of 1985 regarding private sector participation in electricity.

(s) Law No. 3 of 1989 regarding private sector participation in telecommunications.

(t) Government Regulation No. 22 of 1982 regarding water management as it concerns sourcing of water supplies from streams and groundwater.

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Article 2:

(1) The system of water management should be based on the principles of public benefits, balancing of competing interests, and preservation of a natural resource.

(2) A water right is the right of water-use only.

Article 5:

(2) The Regional Government is responsible for the implementation of authority within the framework of its duty to assist the Central Government with regards to water and/or water resources within its regional boundary.

(3) The authority regarding water and/or water resources crossing more than one regional boundary is still in the hands of the Minister of Public Works.

Article 11:

(1) The exploitation of water and/or water resources with the purpose of improving its benefit for the people's welfare is basically carried out by the Central as well as Provincial/Local Governments.

(2) Legal entities, social organizations, and/or persons exploiting water and/or water resources should obtain licenses from the Government based on the principle of joint and mutual cooperation.

(3) The implementation of this Article will be further stipulated by Government Regulation.

Article 13:

(1) Water used for drinking holds the top priority above all other needs.

Article 16:

(1) Any person has the right to use water for the needs of his daily life and/or the animals under his care.

(2) Use can be made of water derived from water sources as meant in paragraph (1) of this Article as long as it does not resulting in damage to the water source and its environment or projects constructed for the benefit of the public.

Article 19:

(1) The use of water and/or water sources other than for the needs as stated in Article 16 may only be made under a license.

(2) The use of water and/or water sources as meant in paragraph (1) of this Article covers use for the needs of urban activity, agriculture, power, industry, mining, water traffic, recreation, health and other necessities in accordance with development needs.

(u) Government Regulation No. 24 of 1986 concerning the 30 year licensing period for foreign investment companies.

(v) Government Regulation No. 14 of 1987 regarding the transfer of entities and assets, and the delegation of part of the government's authority in the field of public works, to the provincial and local governments.

Article 2:

Without decreasing the duties and responsibilities of the Minister of Public Works, part of Public Works affairs are transferred to Heads of Level I and Level II Governments based upon the stipulations provided in the Government Regulation.

Article 3:

Part of Public Works affairs as meant in Article 2 which are transferred to Provincial/Level I Governments are:

c: in the field of Human Settlement (Cipta Karya):

6: the development of planning, construction. maintenance and management of clean water in the rural areas, piping systems and artesian wells.

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Article 4:

Part of Public Works affairs as meant in Article 2 which are transferred to Local/Level II Governments are:

c: In the field of Human Settlement (Cipta Karya):

10: The construction, maintenance and management of infrastructure and facilities for clean water supply.

Article 8:

(1) The Minister of Public Works organizes technical guidance and controls on the execution/implementation of Public Works affairs which have been transferred to and carried out by Level I Government and Level II Government.

(2) Technical guidance as meant in paragraph (1) shall further be regulated by the Minister of Public Works after obtaining advice and consideration from the Minister of Home Affairs.

(3) Technical control as meant in paragraph (1) shall further be regulated by the Minister of Public Works.

Article 10:

(2) All charges (taxes) in the field of Public Works which have been transferred to Level I and Level II Governments become Level I and Level II Government income and shall further be determined in the Regional Government Regulation (Perda).

(w) Government Regulation No. 20 of 1990 regarding water pollution control.

(x) Presidential Decree No. 54 of 1977 concerning regional basic provisions on investment procedures.

(y) Presidential Decree No. 26 of 1980 concerning regional investment coordinating boards [*Badan Koordinasi Pananaman Modal Daerah* ("BKPMD")].

(z) Presidential Decree No. 35 of 1985 amending Presidential Decree Nos. 33 of 1981 and 78 of 1982 regarding the status, duties, and organizational structure of BKPM.

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(aa) Presidential Decree No. 17 of 1986 requiring that Indonesian investment entities in which a majority equity ownership is held by local participants be treated the same as domestic investments under Indonesian law. This Decree was amended by Presidential Decree No. 50 of 1987.

(bb) Presidential Decree No. 21 of 1989 concerning the exhaustive list of 75 economic sectors that are closed for designated forms of new private investment. "Water supply" and "drinking water" are not listed as closed sectors. This seemingly does—but may not—supersede Article 6 of Law No. 1 of 1967 which designates nine economic sectors—including "drinking water"—as being closed to foreign investment because they are of strategic national importance for which the Government of Indonesia will retain exclusive authority. This Decree also supersedes Presidential Decree 15 of 1987 (which superseded Presidential Decree No. 22 of 1986) which established nonexhaustive lists of economic sectors open to new private investment and which listed "drinking water" as an open sector. Economic sectors open to new private sector investment by the Decree may still be closed or restricted by "prevailing laws and regulations" as stated in the Decree.

(cc) Presidential Decree No. 23 of 1990 concerning the establishment of a national pollution board.

(dd) Presidential Instruction No. 5 of 1984 concerning guidelines for the simplification and control of business licensing.

(ee) Presidential Instruction No. 4 of 1985 concerning policies to expedite the flow of goods in support of economic activities.

(ff) Regulation of the Minister of Mining and Energy No. 03/P/M/Pertamber of 1983 requiring licensing of all private use of ground and spring water and water drilling by the provincial governor acting upon the binding advice of the Directorate General of Geology within the Ministry of Mining and Energy.

(gg) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation by a regional enterprise with a third party. This made possible the establishment of joint cooperation undertakings between a regional enterprise and a private investor.

(hh) Regulation of the Minister of Home Affairs No. 690-536 of 1988 dealing with guidelines for the pricing of water supplies by a PDAM. This provides that water supply prices must be decided by the head of the local government and be subject to gubernatorial approval following a proposal from the management of the water company and the favorable considered judgement of the supervisory board. This eliminated the requirement for ratification by DPRD TK. II provided in Regulation No. 690-1572 of 1985.

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Article 2:

The drinking water tariff will be based upon:

(1) The ability to cover the following expenses:

a. Personnel
b. Electricity
c. Chemicals
d. Organization and Maintenance
e. General Administration
f. Depreciation
g. Rate of interest.

(2) Clear calculations of revenue must be made or the rate of return must be based on a prior calculation.

(3) The price of drinking water must be affordable by all members of the community.

(4) Wealthier consumers must bear part of the cost of providing drinking water to poorer consumers.

(5) The efficient use of water must be promoted.

Article 3:

The system applied for determining a drinking water tariff is the progressive tariff system.

Article 4:

(1) Customer categories are divided into:

Category	I:	Social
	II:	Non-Commercial
	III:	Industry
	IV:	Special—Commercial

(2) The Categories mentioned in paragraph (1) above may also be modified according to the situation and need.

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Article 5:

The tariff of drinking water is determined by the Head of Region with his Decision Letter (Decree = *Surat Keputusan*) upon the proposal of the Board of Directors through the Board of Supervisors.

Article 6:

(1) Prior to submission to the Head of the Region, the proposed tariff should first be discussed and considered by the Board of Supervisors.

(2) The consideration by the Board of Supervisors covers political, social, economic and cultural aspects.

(3) If it is considered necessary, the Board of Supervisors may alter the said proposal with or without the approval of the Board of Directors.

(4) The decision of the Head of the Region regarding the tariff determination becomes effective after it is legalized by:

- the Governor (for PDAM Level II Government)
- the Minister of Home Affairs (for PDAM Level I Government).

Article 7:

(1) The Board of Directors in submitting its proposal for determination of a tariff for drinking water to the Head of the Region, should base the proposal upon full consideration of subjects such as:

a. The objective of tariff determination
b. [AVAILABLE COPY UNREADABLE]
c. Price Calculation of water sale
d. Analysis of water price
e. The method of tariff investigation
f. Final Determination of the Tariff Structure.

(2) —

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(3) The Head of the Region is not bound by the tariff proposal of the Board of Directors.

(ii) Regulation of the Minister of Public Works No. 65/KPTS of 1989 establishing the Joint Technical Team for Water Supply Capital Investment.

(ii) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

Article 2:

The basis for the cooperation between a regional enterprise and a third party shall be mutual interests of both parties which shall be arranged in a joint venture which

a. fully establishes the legal rights and ensures the safety by full adherence to written provisions agreed by both parties,

b. gives equal and appropriate benefits and profits to both parties.

Article 3:

The aims of the cooperation is for increased efficiency, productivity, and effectiveness of the Regional Enterprise in the efforts to continue and to ensure sustainability of the Regional Enterprise and to accelerate mobilization of business by means of:

a. developing existing or already running businesses;
b. establishing new enterprises based on considerations prospects and mutual benefits.

Article 5:

(1) The options for cooperation shall be determined by the conditions and objectives of the Regional Enterprise and the capital agreed in the cooperation.

(2) The cooperation shall be made in forms of:

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a. Management cooperation, operational cooperation, profit-sharing cooperation, joint-venture cooperation, financing cooperation, or production-sharing cooperation;
b. Management contract, production contract, profit-sharing contract, and facilities sharing contract;
c. Purchase of stocks or bonds from a limited liability corporation which has good prospects;
d. Agency, usage, and distribution;
e. Selling of stocks and bonds and going public with stocks and bonds;
f. Technical assistance cooperation at national and/or international levels;
g. Any combination of two (2) or more of the types of cooperation described in paragraphs a, b, c, and/or f.

Article 6:

The said cooperation shall be done without changing the legal entity status of the Regional Enterprise.

(2) In drawing up the cooperation agreement both parties shall definitely agree on the type of cooperation, ratio of capital, sharing of profits and/or rewards, period of the cooperation, obligations, penalties, and termination of agreement and/or the possibility for extension, and other matters as necessary.

(3) The execution of cooperation as defined in Article 5 shall be reported to the Minister of Home Affairs following the appropriate governmental chain of command.

Article 8:

(2) The proposed partner for the cooperation (a Third Party), in addition to having the same objectives as the Regional Enterprise, shall meet the following requirements:

a. Shall meet the requirements of:
— (for an Enterprise)—the status of a legal entity set up in accordance with the effective laws and regulations;

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— (for an Individual)—the NPWP (Taxpayer's Registration Number)
— (for a Foreign Institution/Private Enterprise)—the license/recommendation from the authority in accordance with the effective laws and regulations.

b. Has positive values in terms of its *bona fides* and credibility, concerning:
— good attitude and dedication;
— sufficient competence/experience in the proposed business;
— sufficient capital.

Article 9:

(1) The cooperation with a Third Party shall be executed by the Management of the Regional Enterprise in accordance with the following provisions:

a. For an investment value of up to Rp. 500.000.000,—and with a period of cooperation no longer than one (1) year, the cooperation shall not require approval by the Head of Region/Authority.

b. For an investment value of Rp. 500.000.000,- and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having had approval by the Head of the Region.

c. For an investment value of over Rp. 1.000.000.000,—and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having been approved by the Minister of Home Affairs.

d. For an investment value and period of cooperation which is not as provided in items a, or b, or c, the cooperation shall only be effective after having had the approval by the Authority prescribed of the maximum limit of investment.

(2) The cooperation agreement as defined in paragraph (1) above shall be made in a deed of the Notary Public.

(3) For a Joint Venture cooperation, in addition to meeting the requirements as defined in Article 8, paragraph (2), the parties in the cooperation shall provide the balance sheets

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and the profit and loss accounts in the past three (3) years as already audited by a Public Accountant.

(4) The requirements defined in paragraph (3) above shall not apply to a Third Party which is a newly established corporation formed for the exclusive purpose of the joint venture cooperation.

Article 11:

If considered necessary, the cooperation agreement may be reviewed with the Authority (Minister of Home Affairs for Level I Government and Governor of Level I for Level II Government) before the signing.

Article 12:

(1) Within six (6) months prior to the termination of a cooperation agreement, both parties shall together with the relevant Board of Supervisors of the Regional Enterprise, examine and evaluate all the assets and liabilities related to the cooperation and the prospects of the cooperation, and the possibility of extending the said cooperation period with a Third Party.

(2) If necessary, the Head of Region may set up a Team of Verification and Appraisal consisting of elements of the Regional Government, concerned agencies, Board of Supervisors, and a Consultant competent in his field.

(3) The Management of the Regional Enterprise shall prepare an accountability report to the Head of the Region in connection with the execution of a cooperation, with the attachments of the analysis results and evaluations as defined in paragraph (1) and/or paragraph (3) above in order to get approval of the extension or termination of the cooperation.

(4) The termination of an agreement already approved by the Head of Region as defined in paragraph (3) must be recorded in a "Process Verbal" signed by both parties.

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Article 13:

(1) The extension of a cooperation period must be executed by the Management of the Regional Enterprise after having applied for an approval in principle by the Head of Region and the Authority.

(2) The submission of an application as defined in paragraph (1) above shall have attached a report as defined in Article 12, paragraphs (1) and (2).

(3) The administration process and all its procedures shall be in accordance with the provisions defined in Paragraphs 7, 8, 9, and 10.

Article 15:

General supervision of the execution of cooperation between the Regional Enterprise and Third Parties will be carried out by the Minister of Home Affairs and the respective Heads of Regions.

(kk) Joint Ministerial Decree of the Ministers of Home Affairs, Public Works, and Finance Nos. 160 of 1978, 281 of 1978, and 360/KMK.011 of 1978 regarding execution and development of clean water construction projects with central government aid.

(ll) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 3 of 1984 and 26 of 1984 and 4 of 1984 and 27 of 1984 regarding the establishment of local drinking water enterprises and the development of PDAMs. These Decrees assigned the Ministry of Public Works responsibility for initial water supply planning and development and assigned the Ministry of Home Affairs the principal responsibility for developing the nontechnical aspects of water enterprises. Joint responsibility was assigned to the Ministries of Home Affairs and Public Works for formulating guidelines for the organizational structure of PDAMs.

(mm) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 5 of 1984 and 28 of 1984 concerning guidance about the calculation of drinking water tariffs and regarding the organization, accounting systems, structure, and cost calculations of water utilities.

(nn) Decree of the Minister of Finance No. 540/KMK.011 of 1979 regarding the management of central government funds for the financing of PDAM projects.

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(oo) Decree of the Minister of Health No. 2180/YANKES/INSTAL/XI of 1981 regarding the establishment of water quality standards and an environmental team.

(pp) Decree of the Minister of Public Works No. 269/KPTS of 1984 regarding BPAMs which provides for a shorter period before they are changed to PDAM status.

(qq) Decree of the Minister of Finance No. 862/KMK.01 of 1987 regarding the issuance of securities through a stock exchange.

(rr) Instruction letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of all regional government enterprises to one or the other of two forms of legal entity, i.e., PERUMDA (*Perusahaan Umum Daerah* or Regional Public Company) and PERSERODA (*Perusahaan Perseroan Daerah* or Regional Limited Liability Company) upon enactment of a law to replace Law No. 5 of 1962.

(ss) Circular letter of the Minister of Home Affairs No. 690-1595 of 1985 which authorized the creation of PMDUs.

(tt) Circular letter of the Minister of Home Affairs No. 690/7072/SJ dated July 10, 1985, to all level one governors, all *bupatis* and *walikotas* of level II, and all directors of PDAMs regarding the possible release by level one and two governments of PDAMs from the duty to provide 55% of their net profits to those governments as provided under Article 25 of Law No. 5 of 1962 if such funds are required for projected development and replacement needs.

First: to make preparation of the change of the form/type of the legal entity of all Enterprises owned by the Regional Government, which capital is partly or wholly owned as Regional separated assets, such as a *Perusahaan Daerah* (Regional Government Enterprise), *Perseroan Terbatas* (Limited Liability Company) and/or other business activities which in fact are managed according to sound economic principle, ... except the Bank *Pembangunan Daerah* (Regional Government Bank), into 2 (two) types of Legal Entity, i.e. the *Perusahaan Umum Daerah* (PERUMDA = Regional Public Enterprise) and/or the *Perusahaan Perseroan Daerah* (PERSERODA = Regional Limited Liability Company).

(uu) Decision of the Chairman of BKPM No. 17/SK of 1986 concerning foreign share participation in existing businesses.

(vv) Decision of the Chairman of BKPM No. 5/SK of 1986 regarding local equity participation requirements in joint ventures with foreign investors. This Decision

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followed and implemented the provisions of Article 27 of Law No. 1 of 1967, Circular Letter from the Chairman Nos. 1195/A/BKPM/X of 1974 and B 109/A/BKPM/II of 1975, and BKPM Internal Guidelines of 1981. The Decision was further modified by Decisions of the Chairman Nos. 08/SK and 16/SK of 1989. Also see Decision of the Chairman of BKPM No. 13 of 1986 which amended Decision Nos. 5 of 1986 and 10 of 1985 which largely concerned the procedures for application for approval and facilities for domestic and foreign investments.

(ww) Guidelines on the Accounting System of PDAMs of August 1990 issued by the Minister of Home Affairs.

(xx) Implementing Guidelines for Regulation No. 690-536 of 1988 (Interim Report) (undated) regarding the calculation of drinking water tariffs by PDAMs.

(yy) Organizational structure of PDAMs (undated) issued by the Minister of Home Affairs.

(zz) Decree of the Governor of the Special Province of Jakarta No. D.IV-a.12/1/49 of 1974 on the regulation of digging and drilling for groundwater in Jakarta Special Province.

(a') Decision of Jakarta Governor No.. 664 of 1980 concerning the organization, structure, and work division of the drinking water company of the Special Municipality of Jakarta ("PAM Jaya").

(b') Provincial Regulation of East Java No. 6 of 1980 amending the provincial water regulation of East Java of 18 November, 1938, on the use of water.

(c') Provincial Regulation of East Java No. 5 of 1983 concerning drilling and the use of underground water in East Java.

(d') Provincial Regulation of East Java No. 2 of 1987 regarding the establishment of PDABs.

(e') Surabaya PDAM Regulation No. KPTS/29/411.61 of 1985 regarding private sector service contracts for bill collection.

COLLECTIONS OF, AND COMMENTARIES ON, INDONESIAN LAWS

A collection in the Indonesian language of relevant laws and regulations on regional enterprises (including water supply activities) is contained in a soft cover book entitled *Himpunan Peraturan Perundang-Undangan Perusahaan Daerah* published in 1990 by PUOD.

A collection of laws and regulations in the English language on private sector investments in Indonesia is contained in a soft cover book entitled *Investment Law and Regulations* published by BKPM in an unspecified year after 1985.

A general description of the Indonesian legal system in the English language is contained in a soft cover book entitled *Law in Indonesia* by Professor R. Subekti, S.H., published by Gunung Agung, Jakarta, in 1973.

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15. LIST OF ACRONYMS, ABBREVIATIONS, AND INDONESIAN LANGUAGE TERMS COMMONLY USED (SEE WORKING PAPER G)

ANNEX

THE COLLECTED TEXTS OF SELECTED RELEVANT INDONESIAN LAWS, REGULATIONS AND OTHER DOCUMENTS

SHORT DESCRIPTION OF SELECTED PARAGRAPHS/ARTICLES OF INDONESIAN LAWS & REGULATIONS TO PSPUWS

1. *Basic/Constitutional Law—1945*

Article 33:

2. *Law No. 5 Year 1974*

Regarding: "Basic Principles of Administration in the Region (Level I and II Government)".

Objective: The implementation of a real and responsible autonomy of the Region (means Province/Level I and Local/Level II Government) which may secure the progress and development of the Region.

Selected Articles:

Article 2

To organize and establish an Administration, the territory of the Republic of Indonesia shall be divided in Autonomous Regions and Administrative territories.

Article 3:

(1) In the framework of the implementation of the decentralization principle, shall be organized and established Region of the First Level and Region of the Second Level.

Article 7:

The Region has the right, is authorized and is obliged to organize and manage its own services in accordance with the prevailing laws & regulations.

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Article 8:

The additional transfer of governmental affairs to the Region will be stipulated by Government Regulation (see further below as example: G.R. No.14 year 1987).

Article 13:

(1) The Regional Government consists of the Head of the Region and the Regional House of Representative.

Article 38:

The Head of Region with the approval of the House of Representative issues the Regional Regulation (Perda).

Article 39:

(1) Regional Regulation (Perda) and/or Decisions of the Head of Region may not be in contravention with the general interest and statutes of Regional Regulations of the higher level.

(2) The Regional Regulation shall be signed by the Head of Region and counter signed by the Chairman of the Regional House of Representative.

Article 55:

Sources of Regional Revenue are:

a. Original revenue of the Regional Government consisting of:

1. revenue from regional tax
2. revenue from regional retribution
3. revenue from Regional Enterprise
4. other legal regional revenue

b. Revenue originating from subsidy from the (central) Government consisting of:

1. subsidy from the (central) Government
2. other contributions regulated by statutes.

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c. Other legal revenue.

Article 59:

(1) The Regional Government may set up a Regional Enterprise of which the execution and maintenance shall be carried out based upon the principle of cost accounting.

(2) Basic stipulations on Regional Enterprise shall be determined by Law (Statute).

Note: See Law No. 5/1962.

3. *Law No. 5 Year 1962 on Regional Government Enterprise*

CHAPTER II: CHARACTERISTIC, OBJECTIVE AND FIELD OF ACTIVITY

Article 4:

(1) Regional Government Enterprise* is established with Regional Government Regulation (Peraturan Daerah = PERDA), based on this Law.

(2) The Regional Government Enterprise as meant in para (1) is a Legal Entity, the status of which is obtained with the existence of this Law.

(3) The Regional Government Regulation as meant in para (1) comes into force after getting legalization from the superiors (For Special Regions of Level I Government is the President, For Provincial Level I Government is the Minister of H.A., For Local Level II Government is the Governor of Level I).

Article 5:

(1) The Regional Government Enterprise is a production unit which have the characteristic of:

a. providing service

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*It can mean: — Provincial (Level I) Government Enterprise
— Local (Level II) Government Enterprise.

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b. to organize public need
c. to gain revenue

(2) —

(3) —

(4) The important/main production branches for the Region which have the effect on the life of the community of the Region concerned, is managed by the Regional Government Enterprise, which capital wholly or partly belongs to the separated asset of the Regional Government.

CHAPTER III: CAPITAL

Article 7:

(1) The capital of the Regional Government Enterprise consists of assets wholly or partly belongs to the Regional Government, which forms a separated asset.

(2) The capital of the Regional Government Enterprise does not comprise of shares.

(3) —

(4) —

CHAPTER V: THE MANAGEMENT

Article 11:

(1) The Regional Government Enterprise is managed by a Board of Directors, which number and composition is stipulated in its Establishment Deed (Articles of Association).

(2) Members of the Board of Directors are Indonesian Nationalities to be appointed and dismissed by the Head of Regional Government*

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* — the Governor for Regional Enterprise of Provincial Level I Government.
— the Walikota (Mayor) for Regional Enterprise of Kotamadya/City Local Level II Government.

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(3) The appointment as meant in para (2) is for a period of 4 (four) years at the latest. After the said period ends, the said member of the B.o.D. may be re-appointed.

Article 15:

(1) The Board of Directors (B.o.D.) makes decision on the management policy of the Regional Government Enterprise (RGE).

(2) The B.o.D. executes and manages the asset of the RGE.

Article 16:

The stipulations on the limited power (authority) of the B.o.D. are regulated in the R.G.E's Articles of Association.

Article 17:

In each RGE is to be established a Supervisory Board. Which is further regulated in the PERDA (the Regional Government Regulation on the establishment of RGE).

CHAPTER VII: CONTROL

Article 19:

The B.o.D. is under control of the Head of the Region or an Agency appointed by him.

CHAPTER VIII: STIPULATION ON THE USE OF PROFIT AND THE CONTRIBUTION OF PRODUCTION SERVICE

Article 25:

(1) —

— the Bupati for Regional Enterprise of Kabupaten/rural Local Level II Government.

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(2) The use of the net profit after deduction of depreciation, reserve and other real deductions within the Enterprise, is determined as follows:

a. for the Regional Development Fund 30%
b. for the Regional Expenditure Budget 25%
c. for General Reserve Fund, social and education fund, production service, Retirement Fund & Donation, the amount of each is stipulated in the Articles of association of the Enterprise, with a total of 45%.

CHAPTER XIV: PERSONNEL

Article 26:

(1) The status, salary, retirement fund & donation and other income of the B.o.D. members and personnel/employee of the Regional Government Enterprise is regulated in the PERDA (Regional Government Regulation) and is effective after getting legalization from the Governor for Level II Government Enterprise and the Minister of H.A. for Level I Government Enterprise, taking into account the stipulations of the prevailing Regional Government Salary Regulation.

4. *LAW on WATER RESOURCE No. 11 Year 1974*

Article 2:

Water and its resources, including the nature richness contained therein has social function and used for the maximum welfare of the people.

Article 3:

(1) Water and its resources is managed/controlled by the State.

(2) The State therefor gives the authority to the Government:

a. to manage and develop the use of water and/or water resources.
b. to formulate, legalize and/or issue license according to planning and technical planning of water/water resource management.

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c. to organize, legalize and/or issue license for the purpose, the use and the supply of water and/or water resources.

d. to organize, legalize and/or issue license for the exploitation of water and/or water resources.

e. to determine and arrange legal deeds and legal relations between persons and/or corporate bodies in water and/or water resources matters.

Article 4:

The authority of the Government as meant in art. 3 can be delegated to Government agencies/units, at Central as well as at Provincial and Regional Level and/or to certain legal entities based upon the requirements and procedure to be determined by Government Regulation.

Article 5:

(1) The Minister, who is given the task of water resources affairs (Ministry of P.W., Directorate General of Water Resources), is authorized and responsible to coordinate all regulations concerning planning, technical planning, control, exploitation, maintenance, protection and the use of water and/or water resources; with due consideration of the interest of other related Ministries and/or Institutions.

Article 11:

(1) The exploitation of water and/or water resources, aimed to enhance its benefit for the welfare of the people is basically carried out by central as well as Regional Government.

(2) Corporate Body, Social Organization and or person exploiting water and or water resources, must obtain license from the Government.

5. *Law No. 1 Year 1967*

Article 2:

Foreign Investment in this Law means:

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a. foreign exchange which does not form a part of the foreign exchange resources of Indonesia, and which with the approval of the Government is utilized for financing an enterprise in Indonesia.

b. equipment for an enterprise, including rights to technological developments and materials imported into Indonesia, provided the said equipment is not financed from Indonesian foreign exchange resources.

c. that part of the profits which in accordance with this Law is permitted to be transferred, but instead is utilized to finance an enterprise in Indonesia.

Article 3:

(1) An enterprise as intended by Article 2, which is operated wholly or for the greater part in Indonesia as a separate business unit, must be a legal entity organized under Indonesian Law and have its domicile in Indonesia.

(2) The Government shall determine whether an enterprise is operated entirely or for the greater part in Indonesia as a separate business unit.

Article 5:

(1) The Government shall determine the fields of activity open to foreign investment, according to an order of priority, and shall decide upon the conditions to be met by the investor of foreign capital in each such field.

(2) The order of priority shall be determined whenever the Government prepares medium and long-term development plans, taking into consideration developments in the economy and technology.

Article 6:

(1) Fields of activity which are closed to foreign investment exercising full control are those of importance to the country and in which the lives of a great deal of people are involved, such as the following:

a. harbors;

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b. production, transmission and distribution of electric power for the public;
c. shipping;
d. telecommunications;
e. aviation;
f. drinking water;
g. public railways;
h. development of atomic energy;
i. mass media.

(2) Industries performing a vital function in national defence, among others, the production of arms, ammunition, explosives, and war equipment, are absolutely prohibited to foreign investment.

Article 18 :

Every permit for investment of foreign capital shall specify the duration of its validity, which shall not exceed 30 (thirty) years.

Article 23:

(1) In the fields of activity open to foreign capital, cooperation may be effected between foreign and national capital, with due consideration to the provisions of article 3.

(2) The government shall further determine the fields of activity, forms and methods of cooperation between foreign and national capital, utilizing foreign capital and expertise in the fields of export and the production of goods and services.

Article 27:

(1) Enterprises mentioned in article 3 of which the capital entirely foreign, are obligated to provide opportunities for participation by national capital, following specified period and in proportion to be determined by the Government.

(2) When participation as intended by section (1) of this article is effected by selling pre-existent shares, the proceeds of such sales can be transferred in the original currency of the foreign capital concerned.

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Article 28:

(1) Provisions of this Law shall be implemented by coordination among the Government agencies concerned in order to ensure harmonization of Government policies regarding foreign capital.

(2) Procedures for such coordination shall be subsequently determined by the Government.

6. *Law No. 6 Year 1968 Concerning Foreign Investment*

Article 1:

(1) That which is intended by "Domestic Investment" in this Law is a portion of the property of Indonesian society, including rights and goods, owned either by the State or by National Private or Foreign Private domiciled in Indonesia, which has been reserved/made available for the operation of an enterprise insofar as such capital is not governed by the provisions of article 2 of Law No. 1 of 1967 concerning Foreign Capital Investment.

Article 2:

That which is intended by "Domestic Investment" in this Law is the use of property as referred to in article 1, either directly or indirectly for the operation of a business in accordance with or based upon the provisions of this Law.

Article 3:

(1) A national enterprise is an enterprise of which at least 51% of the domestic invested therein is owned by the State and/or National Private Enterprise. This percentage shall be increased so that on January 1, 1974 it will amount to not less than 75%.

(2) A foreign enterprise is an enterprise which does not satisfy the conditions of section (1) of this article.

(3) Should an enterprise intended by section (1) of this article be a limited liability company, then at least the percentage of the

total shares as referred to in section (1) of this article must be identified by holder.

Article 4:

(1) All fields of activity are in principle open to private enterprise. State activities in connection with the development of fields of private activity include fields to be initiated or pioneered by the Government.

(2) Fields of State activity include especially those field of undertaking which the government is obligated to conduct.

7. *Government Regulation No. 14 Year 1987*

Article 2:

Without decreasing the task and responsibility of the Minister of P.W., part of Public Works affairs are transferred to Heads of Level I and Level II Government, based upon stipulations provided in the Government Regulation.

Article 3:

Part of Public Works affairs as meant in art. 2 which are transferred to Provincial/Level I Government, are:

c: in the field of Human Settlement (Cipta Karya):

6: the development towards planning, construction, maintenance and management of clean water in the rural areas, piping system and artesian wells.

Article 4:

Part of Public Works affairs as meant in art. 2, which are transferred to Local/Level II Government are:

c: in the field of Human Settlement (Cipta Karya):

10: The construction, maintenance and management of infrastructure, facility of clean-water supply.

Article 8:

(1) The Minister of P.W. organizes technical guidance and control on the execution/implementation of Public Works affairs which have been transferred to and carried out by Level I Government and Level II Government.

(2) Technical guidance as meant in para (1) shall further be regulated by the Minister of P.W. after obtaining advise and consideration from the Minister of H.A.

(3) Technical control as meant in para (1) shall further be regulated by the Minister of P.W.

Article 10:

(2) All charges (taxes) in the field of Public Works which have been transferred to Level I and Level II Government become Level I and Level II Government income and shall further be determined in the Regional Government Regulation (Perda).

8. *Government Regulation No. 22 Year 1982 on "Water Management"*

Article 2:

(1) In the system of water management should be based on the principle of public benefit, balancing and everlasting.

(2) Water right is the Right of water-use.

Article 5:

(2) The Regional Government is responsible for the implementation of authority within the frame of "duty to assist the Central Government" towards water and/or water resources within his regional boundary.

(3) The authority towards water and/or water resources crossing more than one regional boundary is still in the hands of the Minister of P.W.

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Article 11:

(1) The exploitation of water and/or water resources with the purpose of improving its benefit for the people welfare, is basically carried out by the Central as well as Provincial/Local Government.

(2) Legal Entity, Social Body and/or Person exploiting water and/or water resources should obtain license from the Government and based on the principle of joint and mutual operation.

(3) The implementation of this article will be further stipulated by Government Regulation.

Article 13:

(1) Water for the need of drinking forms the top priority above other needs.

Article 16:

(1) Any person has the right to use water for the need of his daily life and/or the animals under his care.

(2) The use of water derives from water source as meant in para (1) of this article can be benefitted as long as not resulting damage on water source and its environment or public building concerned.

Article 19:

(1) The use of water and/or water source besides for the needs as meant in article 16 must obtain license.

(2) The use of water and/or water source as meant in para (1) of this article, covers the use for the needs of urban activity, agriculture, power, industry, mining, water traffic, recreation, health and other necessities in accordance with development.

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9. *Regulation of Minister of Home Affairs No. 4/1990*

Article 2:

The basis for the cooperation (RGE & DSP) shall be for mutual interests of both parties which shall be arranged in a joint which:

a. fully establishes the legal rights and ensures the safety by full adherence to written provisions agreed by both parties,

b. gives equal and appropriate benefits and profits to both parties.

Article 3:

The aims of the cooperation is for increased efficiency, productivity, and effectiveness of the Regional Enterprise in the efforts to continue and to ensure sustainability of the Regional Enterprise and to accelerate mobilization of business by means of:

a. developing existing or already running businesses;

b. establishing new enterprises based on considerations prospects and mutual benefits.

Article 5:

(1) The options for cooperation shall be determined by the conditions and objectives of the Regional Enterprise and the capital agreed in the cooperation.

(2) The cooperation shall be made in forms of:

a. Management cooperation, operational cooperation, profit-sharing cooperation, joint-venture cooperation, financing cooperation, production-sharing cooperation;
b. Management contract, production contract, profit-sharing contract, and business-area-sharing contract:
c. Purchase of stocks, bonds from a Limited Liability corporation which has good prospects;
d. Agency, usage, and distribution;

e. Selling of stocks, bonds, and going public with stocks and bonds;

f. Technical assistance cooperation in national and/or international levels;

g. Combination of two (2) or more of the types of cooperation described in paragraphs a, b, c, and f.

Article 6:

The said cooperation shall be done without changing the legal entity status of the Regional Enterprise.

(2) In drawing up the cooperation agreement both parties shall definitely agree on the type of cooperation, ratio of capital, sharing of profits and or rewards, period of the cooperation, obligations, penalties, and termination of agreement and or possibility for extension, and other matters as necessary.

(3) The execution of cooperation as defined in Article 5 shall be reported to the Minister of Home Affairs following the hierarchy.

Article 8:

(2) The proposed partner for the cooperation (a Third Party), in addition to having the same objectives as the Regional Enterprise, shall meet the following requirements:

a. Shall have meet the requirements of:
   - (for an Enterprise)—the status of a legal entity set up in accordance with the effective laws and regulations;
   - (for an Individual)—the NPWP (Taxpayer's Registration Number)
   - (for a Foreign Institution/Private Enterprise)—the license/recommendation from the authority in accordance with the effective laws and regulations.

b. Has positive values in terms of bonafidity and credibility, concerning:
   - good attitude and dedications;
   - sufficient competence/experience in the proposed business;

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— sufficient capital.

Article 9:

(1) The cooperation with a Third Party shall be executed by the Management of the Regional Enterprise, in accordance with the following provisions:

a. For an investment value of up to Rp. 500.000.000,-; and with a period of cooperation no longer than one (1) year, the cooperation shall not require approval by the Head of Region/Authority.

b. For an investment value of Rp. 500.000.000,-; and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having had the approval by the Head of the Region.

c. For an investment value of over Rp. 1.000.000.000,-; and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having had the approval by the Minister of Home Affairs.

d. For an investment value and period of cooperation which is not as provided in items a, or b, or c; the cooperation shall only be effective after having had the approval by the Authority means:
   — Minister of Home Affairs for Level I Government,
   — Governor of Level II for Level II Government,
   with due observation of the maximum limit of investment.

(2) The cooperation agreement as defined in paragraph (1) above shall be made in a deed of the Notary Public.

(3) For a Joint Venture cooperation, in addition to meeting the requirements as defined in Article 8 paragraph (2), the parties in the cooperation shall provide the balance sheets and the profit and loss accounts in the past three (3) years as already audited by a Public Accountant.

(4) The requirements defined in paragraph (3) above shall not apply to a Third Party/an Newly established corporation for the exclusive purpose of the joint venture cooperation.

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Article 11:

If considered necessary, the cooperation agreement may be consulted with the Authority means:

- Minister of Home Affairs for Level I Government,
- Governor of Level II for Level II Government, before the signing.

Article 12:

(1) Within six (6) months prior to the termination of a cooperation agreement both parties shall together with the related Board of Supervisors of the Regional Enterprise shall look through and evaluate all the assets and liabilities related with the cooperation and the possibilities related with the cooperation and the possibilities to extend the said cooperation period with a Third Party.

(2) If necessary, the Head of Region may set up a Team of Verification and Appraisal consisting of elements of the Regional Government/concerned agencies, Board of Supervisors and a Consultant competent in his field.

(3) The Management of the Regional Enterprise shall prepare a accountability report in the execution of a cooperation to the Head of Region, with the attachments of the analysis results and evaluations as defined in paragraph (1) and/or paragraph (3) above in order to get the approval for extensions or termination of the cooperation.

(4) The termination of an agreement as already approved by the Head of Region as defined in paragraph (3) shall be recorded in a Process Verbal signed by both parties.

Article 13:

(1) The extension of a cooperation period shall be executed by the Management of the Regional Enterprise after having applied for an approval in principle by the Head of Region and the Authority.

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(2) The submission of application as defined in paragraph (1) above shall be attached with the report as defined in Article 12 paragraph (1) and (2).

(3) The administration process and all its procedures shall be in accordance with the provisions defined in Paragraphs 7, 8, 9, and 10.

Article 15:

General supervision to the execution of cooperation between the Regional Enterprise and Third Parties is carried by the Minister of Home Affairs and the respective Heads of Regions.

Article 16:

With the effectiveness of this regulation, Minister of Home Affairs Regulation No. 1/1983 is declared as invalid.

10. *Minister of Home Affairs Regulation No. 690-536 dated 30 June 1988*

Regarding: The Guidance on Water Tariff Determination by PDAM

Article 2:

To determine the amount of drinking water tariff is based upon:

a. The ability to cover the following expenses:

1. Salary of the personnel
2. The use of PLN electricity
3. Chemicals
4. O & M
5. General Administration
6. Depreciation
7. Rate of interest.

b. Clear calculation of revenue to be obtained or the rate of return based on prior calculation.

c. Tariff of drinking water can be reached by any member of the community.

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d. The pattern of National Tariff Structure is "the strong help the weak".

e. The pattern of the efficient use of water.

Article 3:

The system applied for determining drinking water tariff is the progressive tariff system.

Article 4:

(1) Customer category is divided:

Category	I :	Social
	II :	Non-Commercial
	III :	Industry
	IV :	Special– Commercial

(2) The Categories as mentioned in para (1) above, may also be specified according to situation and need.

Article 5:

The tariff of drinking water is determined by the Head of Region with his Decision Letter (Decree = Surat Keputusan) upon the proposal of the Board of Directors through the Board of Supervisors.

Article 6:

(1) Prior submission to the Head of the Region, it should first be discussed and considered by the Board of Supervisors.

(2) The consideration by the Board of Supervisors covers the political, social, economic and cultural aspects.

(3) If it is considered necessary, the Board of Supervisors may alter the said proposal with or without the approval of the Board of Directors.

(4) The decision of the Head of the Region regarding the tariff determination becomes effective after it is legalized by:

— the Governor (for PDAM Level II Government)

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— the Minister of H.A. (for PDAM Level I Government).

Article 7:

(1) The Board of Directors in submitting its proposal for tariff determination of drinking water to the Head of the Region, should be covered with complete considerations/ suggestions, such as:

a. The objective of tariff determination
b. Photocopy not clear
c. Price Calculation of water sale
d. Analysis of water price
e. The method of tariff investigation
f. Final Determination of the Tariff Structure.

(2) —

(3) The Head of the Region is not bound with the tariff proposal of the Board of Directors.

11. *Instruction Letter of the Minister of Home Affairs No. 5/1990 dated 19 March 1990 to all Governors of Level I and Bupatis/ Walikotas of Level II*

Regarding: The change of the form (type) of Regional Government Enterprise into 2 (two) forms/types of Legal Entity, i.e. PERUMDA (Regional Public Company) and PERSERODA (Regional Limited Liability Company).

First: to make preparation of the change of the form/type of the legal entity of all Enterprises owned by the Regional Government, which capital is partly on wholly owned and as Regional set aside assets, such as Perusahaan Daerah (Regional Government Enterprise), Perseroan Terbatas (Limited Liability Company) and/or other business activity which in fact are managed according to sound economic principle, etc..... etc. except the Bank Pembangunan Daerah (Regional Government Bank) into 2 (two) types of Legal Entity, i.e. the Perusahaan Umum Daerah (PERUMDA = Regional Public Enterprise) and/or the Perusahaan Perseroan Daerah (PERSERODA = Regional Limited Liability Company).

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ANNEX B

ENVIRONMENTAL ANALYSIS

'rivate Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

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INITIAL ENVIRONMENTAL EXAMINATION

(A) PROGRAM COUNTRY: INDONESIA

(B) PROJECT TITLE: PRIVATE PARTICIPATION IN UTILITIES AND URBAN SERVICES (PURSE)

(C) FUNDING: $20 Million

(D) PERIOD OF FUNDING: FY 1991 - FY 1998

(E) STATEMENT PREPARED BY: William Frej, USAID/Jakarta

(F) ENVIRONMENTAL ACTIONS RECOMMENDED:

(1) Categorical Exclusion under A.I.D. Regulation 16, Section 216.2 (C) (2) (c) (1) (i), (iii) and (xiv) is proposed for Technical Assistance, Policy Studies, Public Awareness and Training, and

(2) Deferral of Initial Environmental Examinations (IEEs) and/or Environmental Assessment (EAs), as appropriate, is proposed for all Pilot/Demonstration Projects until each activity is sufficiently developed that likely impacts can be identified. Environmental reviews will be completed at the earliest time during the planning process at which the review can be meaningful prior to implementation (See Annex 5, Environmental Analysis of the PURSE Project, for a discussion of actions proposed for compliance with USAID and GOI environmental revie requirements).

(G) ACTION REQUESTED BY: William Frej, USAID/Jakarta

(H) ENVIRONMENTAL OFFICER CLEARANCE: Jerry Bisson, USAID/Jakarta

(I) DECISION OF DIRECTOR, USAID/JAKARTA:

APPROVED: _____

DISAPPROVED: _____

DATE: 8/30/91

(J) DECISION OF APRE ENVIRONMENTAL OFFICER:

APPROVED: U. Kirk - APRE/DR - per addition on p. 7 attached

DISAPPROVED: _____

DATE: 9-7-91

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ANNEX B

ENVIRONMENTAL ANALYSIS OF THE PURSE PROJECT

I. Executive Summary and Recommendations

The PURSE project will provide assistance to the Government of Indonesia (GOI) and to the Indonesian private sector to increase private participation in water supply, wastewater treatment, and solid waste management. Project activities will include technical assistance, training, and demonstration projects. Demonstration projects will involve the construction of new water, sewage, and solid waste facilities as well as possible service contracts for the operation and maintenance of such facilities.

USAID regulations require that all projects or project activities that have the potential for causing significant environmental harm be subjected to an environmental review. An environmental review generally includes an Initial Environmental Examination, followed in appropriate cases by a more extensive Environmental Assessment. An environmental review is not required for certain types of project activities. For other types of activities, an Environmental Assessment is mandated and the Initial Environmental Examination can be eliminated.

Indonesian law also prescribes environmental review procedures for projects that will have an impact on the environment. The GOI regulations correspond in large measure to USAID requirements; satisfying USAID requirements should generally produce sufficient information and documentation to satisfy GOI requirements. In some cases, additional information and analysis may be required under GOI procedures. The PURSE team and USAID/Jakarta should understand and satisfy such additional requirements when they exist.

Actions that the PURSE team and USAID/Jakarta should take to comply with USAID and GOI environmental review requirements are summarized in Table 1.

II. Summary Description of the PURSE Project

A. Goal and Purpose of the Project

The goal of the PURSE project is to increase the stock of infrastructure essential for Indonesia's economic growth and to improve Indonesian citizens' access to efficiently delivered services that contribute to an improved urban environment. The project will support this goal by expanding the participation of private firms in selected urban services through direct investment and service contracts.

The PURSE project will offer assistance to the Indonesian private sector and the Government of Indonesia (GOI) for designing, testing and implementing a program to increase private sector participation in water supply, wastewater treatment, and solid waste management. The project will help the GOI develop new policies, regulatory standards, and organizational models for private participation that can be replicated throughout Indonesia. The project will help the Indonesian private sector identify opportunities and develop the capacity required for participating in the delivery of urban services.

B. Project Inputs

The PURSE project staff will undertake the following types of activities.

1. Technical assistance to the GOI for analyzing, reformulating, and drafting policies, standards, and regulations pertaining to private participation in selected urban services.

2. Technical assistance to the private sector to strengthen its institutional capacity to finance, deliver, and maintain urban services.

3. Training for public and private sector participants to develop, respectively, their regulatory and service delivery capacity.

4. Demonstration projects to obtain practical experience in establishing public/private partnerships in water supply, wastewater treatment, and solid waste management.

For demonstration projects, the PURSE project team will work with the GOI to identify locations at which private sector firms may construct, own and operate new facilities, and to identify opportunities for private firms to improve the operation and maintenance of existing facilities through service contracts. The team will be involved in all phases of project development: identifying potential projects; analyzing their technical feasibility and commercial viability; identifying potential investors/contractors; facilitating agreements

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between relevant GOI agencies and private firms; monitoring project implementation; evaluating the success of projects; and using lessons learned from demonstration projects to help the GOI develop new policies, regulations, guidance, and model contracts.

III. Environmental Analysis of PURSE Project Inputs

A. USAID Procedures for Environmental Review

The U.S. Agency for International Development (USAID) requires that its officials consider the potential environmental consequences of projects during project development and approval.[1] An environmental review is required for all projects or project activities that have the potential for causing significant environmental harm. An environmental review generally includes an Initial Environmental Examination (IEE), followed in appropriate cases by a more extensive Environmental Assessment (EA).

An IEE must be prepared for most projects.[2] An IEE is a rather cursory examination to determine whether a project will have a "significant effect on the environment."[3] If the IEE indicates that the project, or a specific project activity, will have a "significant effect on the environment," USAID must prepare an EA prior to deciding whether to approve the project or activity.[4] An EA is a thorough evaluation of the likely environmental effects of the project or activity as proposed.[5] An EA must evaluate the potential for minimizing adverse effects by adopting an alternative design for the project or by incorporating measures for mitigating environmental harm into the proposed design.[6]

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[1] 22 CFR Part 216 (1990).

[2] Id. Part 216.3(a).

[3] Id. Part 216.3(a)(1) & (2).

[4] Id. Part 216.3(a)(2)(iii). An Environmental Assessment is required if the anticipated environmental effects will occur in one or more countries other than the U.S. Id. Part 216.1(c)(4). An Environmental Impact Statement is required if the anticipated effects will occur in the U.S., "the global environment," or areas outside of any national jurisdiction; see id. Parts 216.1(c)(5) & 216.7.

[5] See generally id. Part 216.6.

[6] Id. Part 216.6(c)(3).

The USAID regulations state that "a proposed action has a significant effect on the environment if it does significant harm to the environment."[7] Thus, an EA is required if a project is likely to cause any significant environmental harm, even if the project will also produce environmental benefits. The environmental benefits of urban services -- increased physical capacity and coverage of piped water supply, sewage treatment, and solid waste management systems -- will far outweigh the project's potential adverse impacts. However, the balance between potential benefits and adverse impacts is not relevant to deciding whether an EA will be required for project activities. An EA is required for those project activities that have the potential for causing "significant harm" to the environment.

B. Technical Assistance and Training

Three of the four inputs of the PURSE project are Technical Assistance and Training. These activities are eligible for a categorical exclusion from USAID environmental review requirements, because they are included among the types of activities that are presumed not to have significant environmental effects.[8] Neither an IEE nor an EA will be required for these three components of the PURSE project.

C. Demonstration Projects

C.1 Appropriateness of Environmental Review

The fourth input of the PURSE project is a set of demonstration projects in water supply, sewage treatment, and solid waste management. Some of the demonstration projects will involve construction of new facilities: water and sewage treatment plants, water distribution and sewage collection networks, and solid waste transfer stations and landfills. Other demonstration projects will merely involve service contracts under which private firms will provide operations, maintenance, and management support for government-owned facilities. Each of the demonstration projects may cause significant adverse environmental effects; examples of potential adverse effects are presented in Table 2.

Water and sewage treatment systems are among the class of activities that USAID has concluded "generally" have a significant effect on the environment.[9] An EA is required for these activities, without the preliminary step of conducting an IEE.[10] USAID may prepare an IEE for potable water and sewerage projects if "the originator of the

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[7] Id. Part 216.1(c)(11).

[8] Id. Parts 216.2(c)(2)(i) & (vii). An EA is required if such programs include construction or other activities "directly affecting the environment." Id.

[9] Id. Part 216.2(d)(1)(xi).

[10] Id.

project believes that the project will not have a significant effect on the environment;"[11] in such circumstances, it appears that an EA is not required if the IEE demonstrates that the project will not cause significant environmental harm.

Given the types of potential adverse environmental effects that may be associated with demonstration projects (see Table 2), USAID/Jakarta should anticipate that an EA will be required for each PURSE demonstration project that involves construction activities. Operation, maintenance, and management activities at water supply and sewage treatment facilities may also have significant environmental effects; thus, an IEE should be prepared for demonstration projects involving service contracts.

Solid waste management facilities are not included among the list of projects presumed to have significant environmental effects, for which an EA is required.[12] Thus, USAID should prepare an IEE for all demonstration projects in solid waste to determine whether an EA is needed. The IEE will distinguish between solid waste management facilities that handle toxic and non-toxic wastes and the level of safety requirements needed for each.

C.2 Timing of IEEs and EAs

For most projects subject to USAID's environmental procedures, the IEE should be included with the Project Identification Document[13] and an EA, if needed, should be developed concurrently with the Project Paper.[14] The potential environmental impacts of a project, however, cannot be evaluated until a project or specific activity is sufficiently well-defined that its likely environmental impacts can be identified. For this reason, environmental reviews (IEEs and EAs) may be delayed until after authorization of a project for those activities that are "unidentified at the time of authorization."[15] When an environmental review is deferred, it must be completed prior to authorization of the specific activities at issue.[16]

The PURSE Project Paper includes a list of potential demonstration projects that may be conducted during the project. It is impossible at this time, however, to identify the

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[11] Id. Part 216.2(d)(2).

[12] Id.

[13] Id. Part 216.3(a)(1).

[14] Id. Part 216.3(a)(6).

[15] Id. Part 216.3(a)(7)(i).

[16] Id.

specific demonstration projects that will be implemented. Specific demonstration projects will be selected during the course of the project based on interest shown by the GOI and the private sector, technical feasibility, and commercial viability.

USAID/Jakarta should defer the environmental reviews of PURSE demonstration projects until after the PURSE project has been authorized. The PURSE team and USAID/Jakarta should prepare an environmental review during the PURSE project for each demonstration project that is actually selected and developed. Environmental reviews should be conducted at the earliest time during the planning for each demonstration project at which the review can be meaningful.[17]

The PURSE team will proceed according to the following general steps in each demonstration project:[18]

- Step 1: Project Identification -- the initial identification and description of a potential project that the GOI would like to implement.

- Step 2: Project Analyses -- a set of analyses to evaluate the technical feasibility and commercial viability of a project, plus preparing a detailed description of the project that the GOI will distribute to potential investors/contractors.

- Step 3: Project Implementation -- an extended set of activities to help the GOI identify qualified investors/contractors, secure their interest in the proposed project, conclude necessary agreements with the selected investor/contractor, and oversee project construction and/or operations.

USAID/Jakarta does not anticipate using any of the PURSE project funds to finance construction or operational activities undertaken by private sector investors and contractors.

Information that is available at the Project Identification step should generally be sufficient to support an IEE. The more extensive information required for an EA should be available during the Project Analysis step, either during or after the technical feasibility analysis has been completed. Thus, to satisfy USAID environmental regulations, the PURSE team and USAID/Jakarta should prepare an IEE as part of Project Identification and should prepare an EA, when required, as part of the Project Analyses.

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[17] Id. Part 216.3(a)(7)(ii).

[18] See Annex 2.D for a more complete discussion of this process.

IV. Relationship to GOI Requirements for Environmental Review

A. Summary of GOI Requirements

The GOI has established regulations requiring an environmental review of all development projects that will have an "impact on the environment."[19] USAID regulations require that missions cooperate with host countries "to the maximum extent possible" in the preparation of EAs.[20] To satisfy both requirements, PURSE project staff and USAID/Jakarta should ensure that the environmental reviews of PURSE demonstration projects comply as much as possible with GOI requirements regarding the content and timing of environmental assessments.

The following is a brief summary of GOI requirements for assessing the potential environmental impacts of new projects.

1) The proponent of a project[21] must prepare a Penyajian Informasi Lingkungan (PIL) if the project will have an "impact" on the environment.[22] The PIL "is a brief assessment of the proposed activity, its environmental setting, the possible environmental impacts due to such activity and a plan of action to manage these environmental impacts."[23]

2) If the PIL indicates the project will have a "significant impact" on the environment, the proponent must prepare an Analisis Dampak Lingkungan (ANDAL).[24] A significant impact is defined as "a considerable change to

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[19] See Gov. Reg. RI No. 29, 1986, Part 1, Art. 2(1). All references in this document to GOI regulations are based on unofficial translations included in "Documents Relating to the Environmental Impact Analysis Process in Indonesia," 2d ed., 1991, hereinafter RI/EIA Documents, published by Environmental Management Development in Indonesia (EMDI), Ministry of Population and Environment, Jl. Jederal Sudirman Kav. 2, Jakarta, Indonesia. EMDI is a joint project of the State Ministry of Population and Environment, Republic of Indonesia and the Canadian International Development Agency.

[20] 22 CFR Part 216.6(b) (1990).

[21] Id. at Art. 7(1); see also Art. 1(7) (defining proponent as "a person or institution who proposes an activity and is held responsible for its implementation").

[22] Gov. Reg. RI No. 29, Part 1, Art. 2(1) (1986); RI/EIA Documents at 5.

[23] Id. Art. 1(4); RI/EIA Documents at 4.

[24] Id. at Art. 3(1); RI/EIA Documents at 5.

the environment";[25] the ANDAL is "a detailed and in-depth study of the significant impacts of a proposed activity."[26] The ANDAL must be prepared according to an agreed-upon scope of work, referred to as the Kerangka Acuan (KA).[27]

3) The authorized agency of the GOI[28] must reject the proposed project if the ANDAL concludes that "the negative environmental impacts that cannot be mitigated . . . outweigh the positive impacts . . . ."[29] If the project is approved, the proponent must submit an environmental management plan (Rencana Pengelolaan Lingkungan, or RKL) and an environmental monitoring plan (Rencana Pemantauan Lingkungan, or RPL) to the authorized agency.[30] The RKL includes technical, economic, and institutional measures required to prevent or mitigate negative environmental impacts of the project.[31] The RPL describes the environmental variables that will be monitored, benchmark values, and institutional responsibilities for collecting and using monitoring data.[32]

The GOI and USAID regulations have extensive similarities, since both are based on U.S. regulations established to implement the National Environmental Policy Act; these similarities are summarized in Table 3. The purpose of the PIL required by GOI regulations is analogous to that of the IEE required by USAID: both documents are initial evaluations to determine whether a project will produce "significant" environmental effects that warrant further study and consideration. Similarly, the ANDAL required by GOI and the EA required by USAID have similar purposes: to provide a more in-depth evaluation of the potential environmental effects of a project, to analyze alternatives to the proposed

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[25] Id. at Art. 1(3); RI/EIA Documents at 4.

[26] Id. at Art. 1(2); RI/EIA Documents at 4.

[27] "Guideline for the Preparation of KA for ANDAL," App. II to Ministerial Decree No. 50/MENKLH/6/1987, at A(I); RI/EIA Documents at 55.

[28] See id. at Art. 1(8); RI/EIA Documents at 4 (definition).

[29] Id. at Art. 17(1); RI/EIA Documents at 10.

[30] Id. at Art. 18; RI/EIA Documents at 11.

[31] See generally "Guideline for the Preparation of RKL for Proposed Activities," App. IV. to Ministerial Decree No. 50/MENKLH/6/1987; RI/EIA Documents 81-85.

[32] See generally "Guideline for the Preparation of RPL for Proposed Activities," App. V to Ministerial Decree No. 50/MENKLH/1987; RI/EIA Documents at 86-88.

design (including a "no action" alternative), and to identify measures that should be incorporated into the project to mitigate adverse effects.

Several characteristics of the GOI process will affect the ability of the PURSE team and USAID/Jakarta to coordinate its own environmental review with GOI requirements. First, the PIL and ANDAL must address both the positive and negative impacts of the project. Second, all of the documents mentioned above--PIL, KA, ANDAL, RKL, and RPL--must be approved by a Regional Commission and by a Central Commission.[33] Finally, the required contents of PILs[34] and ANDALs[35] may not be entirely consistent with the contents or level of detail that USAID requires in its IEEs and EAs. In particular, the required contents of PILs may exceed the information generally developed to support an IEE.

B. Recommendations on Coordinating USAID and GOI Environmental Procedures

Staff of the PURSE project and USAID/Jakarta should become familiar with GOI regulations, consult with staff from the EMDI project, and work with designated GOI officials to ensure that the IEEs and EAs prepared for PURSE demonstration projects satisfy as many of the GOI requirements as possible. It should generally be possible to complete a PIL using information generated for the IEE, to negotiate a KA so that it is consistent with the result of scoping for the EA, and to complete an ANDAL using information generated for the EA. When possible, it would clearly save time and effort to use the same reports as annexes to satisfy both USAID and GOI requirements.

When requirements imposed by GOI regulations or officials are more stringent than those imposed by USAID procedures, it is important that PURSE and USAID/Jakarta staff fully understand and satisfy the additional GOI requirements. To be successful in implementing the demonstration projects, the PURSE project must comply fully with GOI environmental requirements.

Although the GOI regulations do not provide for categorical exclusions from environmental review, it appears from the description of activities for which a PIL is

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[33] Ministerial Decree No. 53/MENKLH/6/1987; RI/EIA Documents at 134-137 (describing, inter alia, the composition and responsibilities of the two levels of commissions).

[34] See "Guideline for the Preparation of PIL," App. I to Ministerial Decree No. 50/MENKLH/6/1987; RI/EIA Documents at 50-54.

[35] See "Guideline for the Preparation of KA for ANDAL," App. II to Ministerial Decree No. 50/MENKLH/6/1987, RI/EIA Documents at 55-62, and "General Guideline for the Preparation of ANDAL," App. III to Ministerial Decree No. 50/MENKLH/6/1987, RI/EIA Documents at 63-80.

required[36] that PILs will not be required for any PURSE project activities other than the demonstration projects. PILs will be required for all demonstration projects, however, including those for which an IEE is not required under USAID regulations; GOI regulations do not provide for bypassing the PIL based on a presumption that the project will cause significant adverse effects. Thus, PURSE project staff may not realize the time savings available from avoiding the IEE and moving directly to the EA under USAID regulations.

Responsibility for satisfying the GOI environmental review requirements may be shared with the private partner involved in a particular demonstration project. In most cases, the PURSE project should bear the expense of preparing the IEE and the EA, and the corresponding PIL and ANDAL required by the GOI. Preparing these documents is part of identifying, analyzing and planning a project; the PURSE design anticipates that the project will bear these types of initial costs to reduce barriers to private sector participation in urban services. On a case-by-case basis, the PURSE team may consider sharing responsibility for the EA and corresponding ANDAL, if the likely private partner has been identified prior to the time at which such studies must be prepared. The private partner should generally be made responsible for preparing the RKL (management plan) and RPL (monitoring plan), because the private partner will be responsible for negotiating their terms with the GOI and complying with their terms during project implementation.

Actions that the PURSE team and USAID/Jakarta should take to comply with USAID and GOI environmental review requirements are summarized in Table 1.

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[36] See Gov. Reg. RI No. 29, 1986, Art. 2(1); RI/EIA Documents at 3.

Table 1. Recommended Actions to Comply with USAID and GOI Requirements for Environmental Review of the PURSE Project

PURSE Project Input	Action under USAID requirements	Action under GOI requirements	Responsible Party
Technical Assistance	No review required	No review required	
Training	No review required	No review required	
Demonstration Projects	Review required for each project	Review required for each project	
Water Supply			
investment	EA without IEE	PIL then ANDAL RKL and RPL	PURSE & AID/J Private p'tner
svc contract	IEE then EA	PIL then ANDAL RKL and RPL	PURSE & AID/J Private p'tner
Wastewater Tmt			
investment	EA without IEE	PIL then ANDAL RKL and RPL	PURSE & AID/J Private p'tner
svc contract	IEE then EA	PIL then ANDAL RKL and RPL	PURSE & AID/J Private p'tner
Solid Waste			
investment	IEE then EA	PIL then ANDAL RKL and RPL	PURSE & AID/J Private p'tner
svc contract	IEE then EA	PIL then ANDAL RKL and RPL	PURSE & AID/J Private p'tner

IEE - Initial Environmental Examination
EA - Environmental Assessment
PIL - Penyajian Informasi Lingkungan
ANDAL - Analisis Dampak Lingkungan
RKL - Rencana Pengelolaan Lingkungan
RPL - Rencana Pemantauan Lingkungan
"then" - if required, based on results of IEE or PIL
See Table 3 for descriptions of each type of document.

Table 2 : Potential Adverse Environmental Effects of PURSE Demonstration Projects in Urban Services

SOURCE	POTENTIAL ADVERSE ENVIRONMENT
Water Supply	
- Investment	. Poor site selection, source selection or construction may produce contaminated drinking water
	. Site selection may displace residents, conflict with land-use plans, or interfere with historical and cultural assets
	. Oversizing of plant using groundwater will accelerate aquifer depletion and contaminant migration/intrusion
	. Poor construction of distribution systems may cause water loss & consequent unnecessary extraction of groundwater
	. Increased water usage may exceed capacity of surface drainage and sewer systems
- Service Contracts	. Poor operation and maintenance plant may produce contaminated drinking water, water loss, pipes and over-utilization of groundwater
Waste Water Treatment	
- Investment	. Poor site selection may damage wetlands, fisheries and other fragile ecosystems
	. Site selection may displace residents, conflict with land-use plans, or interfere with historical and cultural assets
	. Undersizing or poor plant design may result in inadequate capacity for high flow periods, inadequate treatment of influent, and excessive contamination in effluent
	. Poor construction of collection system may cause loss of influent
	. Inadequate regulatory controls on industrial connections may compromise proper functioning of treatment system
	. Inadequate systems for sludge treatment and use/disposal may compromise plant operation and pollute other areas (land, surface water, coastal zones)

SOURCE	POTENTIAL ADVERSE ENVIRONMENT
	• Increased truck traffic for sludge transport may cause public safety hazards and road degradation
	• Truck fueling facilities and maintenance procedures may pollute groundwater and surface water
- Service Contracts	• Poor operation and maintenance may result in inadequate plant treatment of influent with consequent damage to fragile pipes ecosystems
	• Improper treatment and disposal of sludge may compromise plant operation and pollute other areas (land, surface water, coastal zones)
	• Truck fueling facilities and maintenance procedures may pollute groundwater and surface water
Solid Waste Management	
- Investment	• Poor site selection may damage wetlands or other fragile ecosystems
	• Site selection may displace current residents, conflict with land-use plans, or interfere with historical and cultural assets
	• Poor design, construction and operation of facilities may pollute ground-water or surface water, and may create a public health hazard or nuisance
	• Inadequate operational procedures may threaten worker safety and health or result in the improper disposal of hazardous wastes
	• Increased truck traffic may cause public safety hazards and road degradation
	• Truck fueling facilities and maintenance procedures may pollute ground-water and surface water
- Service Contracts	• Improver operation of facilities may pollute ground-water or surface water, and may create a public health hazard or public nuisance
	• Inadequate operational procedures may threaten worker safety and health or result in the improper disposal of hazardous wastes
	• Increased truck traffic or unsafe truck operation may cause public safety hazards and road degradation

SOURCE	POTENTIAL ADVERSE ENVIRONMENT
	• Truck refueling facilities and maintenance procedures may pollute groundwater and surface water

Table 3. Correspondence Between Documents Required Under USAID and GOI Environmental Review Procedures

Purpose	Document required by USAID	Document required by GOI
Initial review to determine whether environmental effects will be "significant"	Initial Environmental Examination (IEE)	Penyajian Informasi Lingkungan (PIL)
More extensive evaluation required if project will cause significant environmental effects	Environmental Assessment (EA)	Analisis Dampak Lingkungan (ANDAL)
Process for defining the scope of work for the more extensive evaluation	"Scoping" for the EA	Negotiation of the Kerangka Acuan (KA)
Environmental management plan describing actions required to prevent or mitigate significant environmental effects	Not required. The EA must discuss "appropriate mitigation measures not already included in the proposed action or alternatives." 22 CFR 216.6(c)(3)	Rencana Pengelolaan Lingkungan (RKL)
Environmental monitoring plan describing variables to be monitored and baseline values	Not required. "To the extent feasible, projects should be designed to include measurement of any changes in environmental quality, positive or negative, during their implementation." 22 CFR 216.3(a)(8)	Rencana Pemantauan Lingkungan (RPL)

ANNEX C

STATUTORY CHECKLIST

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

ANNEX C

5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than to the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fund resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.	
CROSS REFERENCE: IS COUNTRY CHECKLIST UP TO DATE?	Yes.
A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS	
1. Host Country Development Efforts (FAA Sec. 601(a)): Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.	The further development of Indonesia's private sector to increase the supply of infrastructure required for economic growth will have positive effects on a freer flow of (a) international trade as well as investment. An increased role for the private sector should also have a positive impact on (b), (c), (d) and (e). (f) N/A.
2. U.S. Private Trade and Investment (FAA Sec. 601(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	The project will finance long- and short-term technical assistance from the United States. It should also positively impact on future investment by U.S. firms.
3. Congressional Notification	
a. General requirement (FY 1991 Appropriations Act Secs. 523 and 591; FAA Sec. 634A): If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified (unless the notification requirement has been waived because of substantial risk to human health or welfare)?	A Congressional Notification expired on August 10, 1991. This project was reported in the FY 1992 Congressional Presentation, submitted to Congress in October, 1990.

b. Notice of new account obligation (FY 1991 Appropriations Act Sec. 514): If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures?	N/A.
c. Cash transfers and nonproject sector assistance (FY 1991 Appropriations Act Sec. 575(b) (3): If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic policy reforms to be promoted?	N/A.
4. Engineering and Financial Plans (FAA Sec. 611(a)): Prior to an obligation in excess of $500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firms estimate of the cost to the U.S. of the assistance?	a. Yes. b. Yes.
5. Legislative Action (FAA Sec. 611(a) (2)): If legislative action is required within recipient country with respect to an obligation in excess of $500,000, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?	No further legislative action is required.
6. Water Resources (FAA Sec. 611(b): FY 1991 Appropriations Act Sec. 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures establishment pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines).	While AID will not be financing actual construction costs, assistance provided for determining the feasibility of individual pilot/demonstration projects involving construction will utilize the principles, standards and procedures to the extent practible.

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7. Cash Transfer and Sector Assistance (FY 1991 Appropriations Act Sec. 575(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements nonproject sector assistance)?	N/A.
8. Capital Assistance (FAA Sec. 611(e)): If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?	N/A.
9. Multiple Country Objectives (FAA Sec. 601(a)): Information and conclusions on whether projects will encourage efforts of the country to : (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperative, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.	The further development of Indonesia's private sector in expanding the country's supply of infrastructure will have positive effects on a freer flow of (a) international trade as well as investment. An increased private sector role should also have a positive impact on (b), (c), (d) and (e). (f) N/A.
10. U.S. Private Trade (FAA Sec. 601(b)): Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	The project will finance long- and short-term technical assistance from the United States. It should also positively impact on future investment by U.S. firms.
11. Local Currencies	
a. Recipient Contributions (FAA Secs. 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	The GOI and the Indonesian private sector will provide the equivalent of over $5.4 million for the Project, primarily for the local costs.
b. U.S.-Owned Currency (FAA Sec. 612 (d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No.

c. Separate Account (FY 1991 Appropriations Act Sec. 575). If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:	N/A.
(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?	N/A.
(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the proposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government?	N/A.
(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes?	N/A.
(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government?	N/A.
12. Trade Restriction	
a. Surplus Commodities (FY 1991 Appropriations Act Sec. 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?	N/A.

b. Textiles (Lautenberg Amendment) (FY 1991 Appropriations Act Sec. 521(c): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807", which allows reduced tariffs on articles assembled aborad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing appeared?	No.
13. Tropical Forests (FY 1991 Appropriations Act Sec. 533(c)(3)): Will funds be used for any program project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas?	a. No. b. No.
14. Sahel Accounting (FAA Sec. 121(d)): If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)?	N/A.
15. PVO Assistance.	
a. Auditing and registration (FY 1991 Appropriations Act Sec. 537): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?	N/A..

b. Funding source (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (Other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from source other than the United States Government?	N/A.
16. Project Agreement Documentation (State Authorization Sec. 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).	The Project Grant Agreement in this case is for less than $25.0 million and accordingly is not required to follow Case-Zablocki Act procedures.
17. Metric System (Omnibus Trade and Competitiveness Act of 1988 Sec. 5164, as interpreted by conference report, amendment Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance activity use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?	The bulk of the procurement under the Project will be for technical services. To the extent commodities are purchased, efforts will be made to use metric measurements to the maximum extent possible.

18. Women in Development (FY 1991 Appropriations Act, title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?	Yes.
19. Regional and Multilateral Assistance (FAA Sec. 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.	No. The proposed project is concerned exclusively with urban infrastructure and services in Indonesia.
20. Abortions (FY 1991 Appropriations Act. Title II, under heading "Population, DA", and Sec. 525):	
a. Will assistance be made available to any organization or program which, as determined by the President,supports or participates in the management of a program of coercive abortion or involuntary sterilization?	No.
b. Will any funds be used to lobby for abortion?	No.
21. Cooperatives (FAA Sec. 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life?	No.
22. U.S.-Owned Foreign Currencies.	
a. Use of currencies (FAA Secs. 612(b), 636(h); FY 1991 Appropriations Act Secs. 507, 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.	The GOI and Indonesian private sector entities will contribute 26% of total project costs.
b. Release of currencies (FAA Sec. 612(d): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No.
23. Procurement.	

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a. Small business (FAA Sec. 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?	Yes.
b. U.S. procurement (FAA Sec. 604(a)): Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him?	Yes.
c. Marine insurance (FAA Sec. 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?	Indonesia does not so discriminate.
d. Non-U.S. agricultural procurement (FAA Sec. 604(e)): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.).	N/A.
e. Construction or engineering services (FAA Sec. 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries).	No.

f. Cargo preference shipping (FAA Sec. 603)): Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonably rates?	No. Section 90 (b) applies.
g. Technical assistance (FAA Sec. 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?	Yes. Yes, as appropriate.
h. U.S. air carriers (International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is finance on grant basis, will U.S. carriers be used to the extent such service is available?	Yes.
i. Termination for convenience of U.S. Government (FY 1991 Appropriations Act Sec. 504): If the U.S. Government is a party to a contract for procurement, will the contract contain a provision authorizing termination of such contract for the convenience of the United States?	Yes.

j. Consulting services (FY 1991 Appropriations Act Sec. 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?	Yes.
k. Metric conversion (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and a implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to united States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, through the implementation stage?	The bulk of the procurement under the Project will be for technical services. To the extent the commodities are purchased, efforts will be made to use metric measurement to be maximum extent possible.
l. Competitive Selection Procedures (FAA Sec. 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes.
24. Construction	
a. Capital project (FAA Sec. 601(d)): If capital (e.g., construction), will U.S. engineering and professional services be used?	N/A. While this is not a capital project, U.S. engineering and professional services will be used to do feasibility and other analyses.
b. Construction contract (FAA Sec. 611(c)): If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?	N/A.

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c. Large projects, Congressional approval (FAA Sec. 620(k): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress?	N/A.
25. U.S. Audit Rights (FAA Sec. 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights?	N/A.
26. Communist Assistance (FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries?	Yes.
27. Narcotics	
a. Cash reimbursements (FAA Sec. 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated?	Yes.
b. Assistance to narcotics traffickers (FAA Sec. 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any law or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been involved in the illicit trafficking of, any such controlled substance?	Yes.

28. Expropriation and Land Reform (FAA Sec. 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President?	Yes.
29. Police and Prisons (FAA Sec. 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?	Yes.
30. CIA Activities (FAA Sec. 662): Will assistance preclude use of financing for CIA activities?	Yes.
31. Motor Vehicles (FAA Sec. 636(i)): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?	Yes.
32. Military Personnel (FY 1991 Appropriations Act Sec. 503): Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel?	Yes.
33. Payment of U.N. Assessments (FY 1991 Appropriations Act Sec. 505): Will assistance preclude use of financing to pay U.N. assessments, arrearages or dues?	Yes.
34. Multilateral Organization Lending 9FY 1991 Appropriations Act Sec. 506): Will assistance preclude use of financing to carry out provisions of FAA Section 209(d) (transfer of FAA funds to multilateral organizations for lending)?	Yes.
35. Export of Nuclear Resources (FY 1991 Appropriations Act Sec. 510): Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology?	Yes.

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36. Repression of Population (FY 1991 Appropriations Act Sec. 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?	Yes.
37. Publicity or Propaganda (FY 1991 Appropriations Act Sec. 516): Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress?	No.
38. Marine Insurance (FY 1991 Appropriations Act Sec. 563): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate?	Yes.
39. Exchange for Prohibited Act (FY 1991 Appropriations Act Sec. 569): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law?	No.

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B. CRITERIA APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY	
1. Agricultural Exports (Bumpers Amendment) (FY 1991 Appropriations Act Sec. 521(b), as interpreted by conference report for original enactment): If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities: (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (2) in support of research that is intended primarily to benefit U.S. producers?	N/A.
2. Tied Aid Credits (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund"): Will DA funds be used for tied aid credits?	No.
3. Appropriate Technology (FAA Sec. 107): Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?	Appropriate technologies will be emphasized.
4. Indigenous Needs and Resources (FAA Sec. 281(b)): Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in of skills required for effective participation in governmental and political processes essential to self-government.	The project is based on more than five years of analytical work in the urban services and infrastructure sector which has explored options in assisting the GOI and the Indonesian private sector to achieve greater economic growth and increased efficiencies through improved policy, institutional,and regulatory frameworks and rationalizing the GOI's role in the delivery of infrastructure and services. Local capabilities will be used to the maximum extent possible.

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5. Economic Development (FAA Sec. 101(a)): Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?	Yes.
6. Special Development Emphases (FAA Secs. 102(b), 113, 281(a)): Describe extent to which activity will: (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.	a. The poor will benefit from an increase in employment opportunities generated by more efficiently delivered urban services and infrastructure, directing investment to the productive sector, an expanded productive sector resulting from a relaxation of government interventions, and from an increase in their health and welfare through better urban services, ie. water, sewerage and sanitation. b. N/A. c. Yes. d. N/A. e. N/A.
7. Recipient Country Contribution (FAA Secs. 110, 124(d)): Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?	Yes.

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8. Benefit to Poor Majority (FAA Sec. 128(b)): If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?	Yes.
9. Abortions (FAA Sec. 104(f); FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 535):	
a. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?	No.
b. Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?	No.
c. Are any of the funds to be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?	No.
d. Will funds be made available only to voluntary family planning projects which offer, either directly or through referral to, or information about access to, a broad range of family planning methods and services?	No.
e. In awarding grants for natural family planning, will any applicant be discriminated against because of such applicant's religious or conscientious commitment to offer only natural family planning?	No.
f. Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?	No.

g. Are any of the funds to be made available to any organization of the President certifies that the use of these funds by such organization would violate any of the above provisions related to abortions and involuntary sterilization?	N/A.
10. Contract Awards (FAA Sec. 601(e)): Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes.
11. Disadvantaged Enterprises (FY 1991 Appropriations Act Sec. 567): What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?	Given the broad nature of the technical assistance contract to be awarded under this project supplement, it is unlikely that any one firm or organization could fill all of the required positions. There are, however, a number of such entities which could qualify as a partner for recruiting short-term experts for the project's needs, as well as providing sub-contracting activities under the prime contract.
12. Biological Diversity (FAA Sec. 119(g): Will the assistance: (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?	(a) No. (b) No. (c) No. (d) No.
13. Tropical Forests (FAA Sec. 118; FY 1991 Appropriations Act Sec. 533(c)-(e) &(g)):	

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a. A.I.D. Regulation 16: Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16?	Yes.
b. Conservation: Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (1) stress the importance of conserving and sustainably managing forest resources; (2) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (3) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (4) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (5) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (6) conserve forested watersheds and rehabilitate those which have been deforested; (7) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (8) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (9) conserve biological diversity in forest	N/A.

areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (10) seen to increase the awareness of U.S. Government agencies and other donors of the immediate and long-term value of tropical forests; (11) utilize the resources and abilities of all relevant U.S. government agencies; (2) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land; and (13) take full account of the environmental impacts of the proposed activities on biological diversity?	

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c. Forest degradation: Will assistance be used for: (1) the procurement or use of logging equipment, unless an environmental assessment indicates that all timer harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; (2) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas; (3) activities which would result in the conversion of forest lands to the rearing of livestock; (4) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undergraded forest lands; (5) the colonization of forest lands; or (6) the construction of dams or other water control structures which flood relatively undergraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?	N/A.
d. Sustainable forestry: If assistance relates to tropical forests, will project assist countries in developing a systematic analysis of the appropriate use of their total tropical forest resources, with the goal of developing a national program for sustainable forestry?	N/A.
e. Environmental impact statements: Will funds be made available in accordance with provisions of FAA Section 117(c) and applicable A.I.D. regulations requiring an environmental impact statement for activities significantly affecting the environment.	Yes.

14. Energy (FA 1991 Appropriations Act Sec. 533(c)): If assistance relates to energy, will such assistance focus on: (a) end-use energy efficiency, least-cost energy planning, and renewable energy resources, and (b) the key greatest impact on reducing emissions from greenhouse gases?	N/A
15. Sub-Saharan Africa Assistance (FY 1991 Appropriations Act Sec. 562, adding a new FAA chapter 10 (FAA Sec. 496)): If assistance will come from the Sub-Saharan Africa DA account, is it: (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) to be used to promote sustained economic growth, encourage private sector development, promote individual initiatives, and help to reduce the role of central governments in areas more appropriate for the private sector; (c) being provided in accordance with the policies constrained in FAA section 102; (d) being provided in close consultation with African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (e) being used to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish	N/A.

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a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy reforms, the need to protect vulnerable groups; (f) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the renewable natural resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas?	
16. Debt-for-Nature Exchange (FAA Sec. 463): If project will finance a debt-for-nature exchange, describe how the exchange will support protection of: (a) the world's oceans and atmosphere; (b) animal and plant species; and (c) parks and reserves; or describe how the exchange will promote: (d) natural resource management, (e) local conservation programs, (f) conservation training programs, (g) public commitment to conservation, (h) land and ecosystem management, and (i) regenerative approaches in farming, forestry, fishing, and watershed management.	N/A.
17. Deobligation/ Reobligation (FY 1991 Appropriations Act Sec. 515): If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for countries within the same region as originally obligated, and have the House and Senate Appropriations Committees been properly notified?	N/A.

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18. Loans	
a. Repayment capacity (FAA Sec. 122(b): Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest.	N/A.
b. Long-range plans (FAA Sec. 122(b): Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?	Yes.
c. Interest rate (FAA Sec. 122(b): If development loan is repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter?	N/A.
d. Exports to United States (FAA Sec. 620(d): If assistance is for any productive enterprises which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest?	N/A.

19. Development Objective [FAA Secs. 102(a), 111, 113, 281(a)]: Extent to which activity will: (1) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to mall towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (2) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?	N/A. (1) The poor will benefit from an increase in employment opportunities generated by more efficiently delivered urban infrastructure, utilities and services, directing investment to the productive sector, and an expanded productive sector resulting from a relaxation of government regulations. (2) N/A. (3) N/A. (4) N/A. (5) N/A.

20. Agriculture, Rural Development and Nutrition, and Agricultural Research (FAA Secs. 103 and 103A):	
a. Rural poor and small farmers: If assistance is being made available for agriculture, rural development or nutrition, describe extent to which activity is specifically designed to increase productivity and income of rural poor; or if assistance is being made available for agricultural research, has account been taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made.	N/A.
b. Nutrition: Describe extent to which assistance is used in coordination with efforts carried out under FAA Section 104 (Population and Health) to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicit addressing the problem of malnutrition of poor and vulnerable people.	N/A.

c. Food security: Describe by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.	N/A
21. Population and Health [FAA Secs. 104(b) and (c)]: If assistance is being made available for population or health activities, describe extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach.	The project will improve the urban environment through expanding the delivery of piped water supply, wastewater treatment and solid waste management. Access to these services will have a significant positive impact on the quality of life, particularly health standards, of the urban poor.
22. Education and Human Resources Development (FAA Sec. 105): If assistance is being made available for education, public administration, or human resources development, describe (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.	N/A

23. Energy, Private Voluntary Organizations, and Selected Development Activities (FAA Sec. 106): If assistance is being made available for energy, private voluntary organizations, and selected development problems, describe extent to which activity is:	
a. concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy resources which are environmentally acceptable and require minimum capital investment;	(a) N/A
b. concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;	(b) This Project will extensively involve the U.S. Private Sector for the demonstration and technical assistance components.
c. research into, and evaluation of, economic development processes and techniques; d. reconstruction after natural or manmade disaster and programs of disaster preparedness; e. for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;	(c) Research and analysis will be conducted to assess the policy, regulatory and institutional constraints and requirements for greater private sector participation, both Indonesian and U.S.,in the provision of urban services and infrastructure. (d) N/A. (e) N/A.
f. for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help the urban poor participate in economic and social development.	(f) Through the training and communications component, the urban poor will be active participants in the Public/Private Forums and the In-country training program, enabling them to both shape the Project's overall direction, as well as assist in the planning of the demonstration projects.

	24. Sahel Development (FAA Secs. 120-21). If assistance is being available for the Sahelian region, describe: (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multidonor development plan, which calls for equitable burden-sharing with other donors; (b) whether a determination has been made that the host government has an adequate system for accounting for an controlling receipt and expenditure of project funds (dollars or local currency generated therefrom).	N/A.
C.	CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY	Not ESF funded.
	1. Economic and Political Stability (FAA Sec. 531(a): Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?	N/A.
	2. Military Purposes [FAA Sec. 531(e)]: Will this assistance be used for military or paramilitary purposes?	N/A.
	3. Commodity Grants/Separate Accounts (FAA Sec. 609): If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	N/A.
	4. Generation and Use of Local Currencies [FAA Sec. 531(d)]: Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at lease 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?	N/A.

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5. Cash Transfer Requirements [FY 1991 Appropriations Act, Title II, under heading "Economic Support Funds," and Sec. 575(b)]. If assistance is in the form of a cash transfer:	N/A.
a. Separate account: Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds?	N/A.
b. Local currencies: Will local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements?	N/A.
c. U.S. Government use of local currencies: Will all such local currencies also be used in accordance with FAA Section 609, which requires such local currencies to be made available to the U.S. Government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves	N/A.

used for programs agreed to be available?	
d. Congressional notice: Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?	N/A.

ANNEX D

AID/W PID Approval Cable
(State 106159 dated April 3, 1991)

AID/W Delegation of Authority for PP Approval Cable
(State 165843 dated May 21, 1991)

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

UNCLASSIFIED

TELEGRAM

AGENCY FOR INT'L DEV. TELECOMMUNICATIONS CENTER

PAGE 01 STATE 165843 210121Z 1679 040239 AID1091
ORIGIN AID-00

ORIGIN OFFICE APPD-03
INFO APMS-01 APRE-01 PPPB-02 GC-01 PPEA-01 APHO-07 APSP-02
APFP-02 APA-02 ES-01 SDB-02 APIB-01 APEM-01 AMAD-01
/028 A0 21/0227Z

INFO LOG-00 CIAE-00 DODE-00 EAP-00 EB-00 /003R

DRAFTED BY: AID/APRE/DR/PD: WELLIOTT: LSL: WD 0258R
APPROVED BY: AID/APRE/DR/PD: GMORRIS
AID/APRE/FPM: PDAVIS
AID/APRE/H: PKIMM
AID/APRE/A: LMORSE

R 210122Z MAY 91 ----------6869E5 210122Z /3
FM SECSTATE WASHDC
TO AMEMBASSY JAKARTA

UNCLAS STATE 165843

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: PRIVATIZING URBAN SERVICES (PURSE) PROJECT, 4970373: APPROVAL TO PROCEED WITH PROJECT PAPER

REF: (A) JAKARTA 05801; (B) STATE 106159

1. IN RESPONSE TO REF A, THE BUREAU FOR ASIA AND PRIVATE ENTERPRISE (APRE) APPROVES USAID/INDONESIA'S REQUEST TO PROCEED WITH THE DEVELOPMENT OF A PROJECT PAPER FOR THE PRIVATIZING URBAN SERVICES (PURSE) PROJECT, 497-0373. AUTHORITY FOR THE MISSION DIRECTOR TO AUTHORIZE THE PROJECT IS CONTAINED IN DELEGATION OF AUTHORITY, DATED NOVEMBER 19, 1990.

2. THE AVAILABILITY OF WILL ELLIOTT, APRE/DR/PD, AND FUNDING FOR TDY PROPOSED IN REF A WILL BE DISCUSSED IN SEPTEL. BAKER

ACTION AID 0 INFO DCM ECON CHRON

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UNCLAS SECTION 01 OF 02 STATE 106159

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AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: PID APPROVAL AUTHORITY: INDONESIA - PRIVATIZING SERVICES IN THE URBAN SECTOR, 497-0373

REF: (A) ELLIOTT TO LEWIS/FREJ FAX, 3/19/91, (B) JAKARTA 02188

1. THE ASSISTANT ADMINISTRATOR FOR THE ASIA AND PRIVATE ENTERPRISE BUREAU HEREBY DELEGATES PID APPROVAL AUTHORITY FOR THE PRIVATIZING SERVICES IN THE URBAN SECTOR PROJECT, 497-0373, TO THE USAID/INDONESIA MISSION DIRECTOR.

2. A MEETING TO REVIEW THE NEW PROJECT DESCRIPTION (NPD) FOR THE SUBJECT PROJECT WAS HELD ON MARCH 8, 1991. IT WAS WELL ATTENDED WITH REPRESENTATIVES FROM APRE/IR/TR, APRE/A, APRE/H, APRE/FPM, APRE/I, PPC/WID, PPC/PE AND APRE/DR/PD. THE FOLLOWING ISSUES, COMMENTS, QUESTIONS, AND SUGGESTIONS AROSE AT THE MEETING AND SHOULD BE CONSIDERED BY THE MISSION DURING PROJECT DESIGN. (NOTE: NONE OF THE ITEMS BELOW, INCLUDING THE QUESTIONS, REQUIRE A MISSION RESPONSE TO AID/W. TO REPEAT, THESE ITEMS ARE SOLELY FOR MISSION CONSIDERATION.)

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A. WHILE IT WAS ACKNOWLEDGED THAT THE U.S. DOES NOT HAVE AS BROAD AN EXPERIENCE BASE IN THIS FIELD AS IN OTHERS, A LIVELY DEBATE ON PRIVATIZATION ISSUES HAS EMERGED IN THE U.S. IN THE LAST FIVE YEARS AND AID PROBABLY DOES HAVE A COMPARATIVE ADVANTAGE IN PRIVATIZATION WITHIN THE DONOR COMMUNITY.

B. SOCIAL EQUITY ISSUES SHOULD BE CONTINUOUSLY ADDRESSED DURING THE DESIGN PROCESS, PARTICULARLY WITH REGARD TO ACCESS TO AND RATE STRUCTURES FOR ESSENTIAL URBAN SERVICES.

C. LESSONS LEARNED FROM OTHER PROJECTS: ALTHOUGH THE PROJECT IS PIONEERING NEW GROUND, THERE MAY BE LESSONS LEARNED FROM OTHER DEVELOPMENT PROJECTS WHICH COULD BE USEFUL DURING PROJECT DESIGN. APRE/H AND APRE/DR/PD

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WILL WORK TOGETHER TO GATHER PROJECT EXPERIENCE FOR YOUR USE.

I. PRIVATIZATION: A COPY OF THE REVISED POLICY DETERMINATION ON PRIVATIZATION, PD 14, WILL BE SENT TO THE MISSION. ANY QUESTIONS ON THIS POLICY SHOULD BE SENT TO WILL ELLIOTT, APRE/DR/PD, AND FRED KIRSCHSTEIN, PPC/PIPR.

E. PILOT PROJECTS: WHAT TYPE(S) OF INTERVENTIONS ARE ENVISIONED FOR THIS IDR 6.5 MILLION COMPONENT? TECHNICAL ASSISTANCE? A LOAN FUND? WILL THEY BE SUSTAINABLE THROUGH LOCAL RESOURCES (HUMAN, TECHNICAL AND FINANCIAL)?

F. WITH REGARD TO SUSTAINABILITY FOR THE ENTIRE PROJECT, THE REVIEW COMMITTEE NOTED THAT USAID/INDONESIA'S OFFICE OF PROGRAM AND PROJECT SUPPORT HAS REQUESTED TDY ASSISTANCE FROM MARCUS INGLE OF THE UNIVERSITY OF MARYLAND'S INTERNATIONAL DEVELOPMENT MANAGEMENT CENTER (IDMC). THE MISSION IS ENCOURAGED TO INCLUDE THIS PROJECT IN INGLE'S TDY SCOPE OF WORK.

G. WHAT IS THE STATUS OF THE TWO IMPORTANT RECOMMENDATIONS FROM THE WATER STUDY? HAS THE GOI ACCEPTED THEM? WILL USAID PROVIDE TA TO HELP IMPLEMENT THEM?

H. IS THIS EFFORT TO IMPROVE URBAN SERVICES

COMPLEMENTED BY ADEQUATE POLICIES AND RESOURCES (GOI, AID, OTHER DONORS) FOR RURAL, VILLAGE AND TOWN DEVELOPMENT?

I. IS THE THIRD POLICY ISSUE, THE REDUCTION OF PRESSURE ON FAST-GROWING URBAN CENTERS, ABLE TO BE ADDRESSED BY THIS PROJECT OR IS IT BEYOND THE REACH OF AND UNABLE TO BE LINKED TO THE PROJECT'S INPUTS? WHILE THE PROJECT MAY BE ABLE TO ADDRESS THE FIRST TWO POLICY ISSUES (INCREASED EFFICIENCY OF CITIES AND SHIFTING RESPONSIBILITY TO MUNICIPALITIES AND THE PRIVATE SECTOR), THE PROJECT'S IMPACT ON THE THIRD ISSUE MAY BE FAR MORE INDIRECT AND OVERSHADOWED BY OTHER FACTORS.

J. WHAT CRITERIA WILL BE USED TO DECIDE WHICH URBAN AREAS (AND THEIR RESPECTIVE SERVICES) WILL BE ASSISTED BY THE PROJECT? THE MISSION IS ENCOURAGED TO GIVE ATTENTION TO URBAN AREAS OTHER THAN THE LARGEST CITIES.

K. AS AN IMPLEMENTING VEHICLE IS THERE A RATIONALE FOR
PT
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AN AUTONOMOUS UNIT TO LEAD THESE PRIVATIZATION EFFORTS AS OPPOSED TO HAVING PRIVATIZATION ADVISORS IN DIFFERENT OFFICES?

I. WHAT LINKAGES WITH THE PRIVATE SECTOR WILL BE DEVELOPED FOR DESIGN, IMPLEMENTATION AND POST-PROJECT ACTIVITIES?

M. AS THE PROJECT EVOLVES, DOES THE REAL DEFINITION OF THE PROBLEM MOVE FROM PRIVATIZATION TO DEREGULATION? IF SO, WHAT IMPACT WILL THERE BE ON OUTCOMES?

3. FUNDING: IF THE PLANNED LOP FUNDING LEVEL OF DOLS 15 MILLION OR THE FY 92 OBLIGATION OF DOLS 4 MILLION CHANGE DURING THE COURSE OF THE DESIGN, APRE/W CONCURRENCE WILL BE REQUIRED. CABLES SHOULD BE SENT TO THE ATTENTION OF PPM AND DR/PD. (NOTE: THIS PART OF THE GUIDANCE WILL CHANGE IF IPRP FUNDING IS AVAILABLE FOR THIS ACTIVITY IN FY 91. THE BUREAU HAS REQUESTED DOLS 10.0 MILLION IN FY 91 FUNDING FOR THIS PROJECT. WE WILL ADVISE ONCE PPC HAS RESPONDED TO OUR REQUEST.)

4. A SERIES OF PAPERS FROM A RECENT QUOTE ROUNDTABLE ON URBAN INFRASTRUCTURE FINANCING UNQUOTE ORGANIZED BY APRE/E WILL BE SENT TO THE MISSION.

5. PRIOR TO AUTHORIZING THE PROJECT, THE IEE SHOULD BE

APPROVED BY THE BUREAU'S ENVIRONMENTAL OFFICER, MOLLY KUX, APRE/DR/TR. IN ORDER TO REVIEW THE IEE AND MAKE A DECISION REGARDING THE RECOMMENDED ENVIRONMENTAL THRESHOLD DECISION, PLEASE SUBMIT A COPY OF THE PID ALONG WITH THE IEE.

6. PLEASE SEND A COPY OF THE APPROVED PID TO APRE/DR/PD FOR FILING AND DISTRIBUTION. PD WILL ORGANIZE A STAFFLEVEL REVIEW WITH THE AIM OF PROVIDING INSIGHTS AND LESSONS LEARNED FROM OTHER PROJECTS/PROGRAMS WHICH CAN BE USED IN THE PP DESIGN EFFORT. IF THE MISSION HAS SPECIFIC CONCERNS WHICH REQUIRE RESEARCHING IN AID/W, PLEASE LET US KNOW HOW WE CAN HELP. FOR EXAMPLE, IF YOU WOULD LIKE TO PURSUE ANY OF THE COMMENTS/QUESTIONS CONTAINED IN PARAGRAPH 2, WE COULD COMPILE FURTHER INFORMATION FOR YOU. WE ALSO ARE WILLING TO PROVIDE ANY HELP NEEDED IN RECRUITING THE PID AND PP DESIGN TEAMS. WE LOOK FORWARD TO WORKING CLOSELY WITH YOU ON THIS PIONEERING DEVELOPMENT PROJECT AND COMMEND THE MISSION FOR THIS APPROACH. BAKER

FT

#6159

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GOI REQUEST FOR ASSISTANCE

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

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SEP 25 1991
USAID/C&R
Jakarta

DEPARTEMEN DALAM NEGERI
REPUBLIK INDONESIA

Letter No. 050/2319/Bangda
September 25, 1991

Mr. Lewis P. Reade
Director
United States Agency for International Development
American Embassy
JAKARTA

Subject : Republic of Indonesia approved project Proposal for 1991/92 (Code No.L-16): Private Participation in Utilities and Urban Services.

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Dear Mr. Reade

Over the past year, the Government of Indonesia and USAID have been involved in an on-going dialogue regarding USAID support to the GOI's initiatives in addressing infrastructure and utilities deficiencies. This dialogue has evolved from support being provided through short and long-term tehnical assistance to BAPPENAS and the Ministries of Mines and Energy, Public Works and Finance addressing these deficiencies.

Through our mutual discussions, a new project concept has emerged-Private Participation in Utilities and Urban Services. This proposed project is expected to provide strtegic assistance to the GOI in designing, testing and implementing a nation wide program for the expanded role of the private sector and the development of public/private sector partnerships in urban services and utilities delivery and finance. This effort is essential to permit continued economic growth in Indonesia. It is our hope that this project's outputs will be the required institutional, policy and regulatory frameworks necessary to further the role of public/private partneships in the development of national utilities, power generation and selected urban services.

Therefore, the GOI hereby requests USAID to proceed with its authorization of a grant of up to U.S. DOLLARS TWENTY MILLION ($20,000,000.) in project assistance to provide technical assistance and training in support of this new project approved by BAPPENAS for implementation in 1991/92.

We look forward to USAID's support of GOI initiatives in adressing Indonesia's infrastructure deficiencies and your favorable consideration of our request.

Thank you for your kind consideration.

MINISTER OF HOME AFFAIRS
DIRECTOR GENERAL FOR REGIONAL DEVELOPMENT

Ir. H. M. Pawawansa
Pembina Utama
Nip. 010022992

cc. Minister of Home Affairs

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OFFICIAL FILE

DEPARTEMEN DALAM NEGERI
DIREKTORAT JENDERAL PEMBANGUNAN DAERAH
JALAN KRAMAT RAYA NO. 132 JAKARTA PUSAT
TELP. 349773 – 349774

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USAID/C&R
Jakarta

Jakarta, September 12, 1991

Mr. William M. Frej
Chief, Urban Policy Division
Private Enterprise Development Office
USAID, US Embassy
Jalan Merdeka Selatan
Jakarta, Pusat

Dear Mr. William Frej:

Re: Private Participation in Utilities and Urban Services Project (PURSE)

With reference to your letter No. II/1674 of 6 September 1991, BANGDA/BANGKOTA would like to reconfirm our intention to actively participate in this important project. Therefore, we request that USAID proceed with its authorization of a grant of up to U.S $20,000,000 in project assistance to provide technical assistance, training and pilot project funding to support the PURSE Project.

Regarding your request for comments on the Amplified Project Description (Annex 1), please see the following suggestions which we would like considered either in revision of the Amplified Project Description or during subsequent stages of the PURSE Project detailed definition process:

Page 3 - Urban Services Output 1: in addition to the "improved institutional policy and regulatory framework", this output should specifically include the development of practical, service-specific administrative guidelines for use by both central and local government officials in executing privatization projects.

Page 3 - Urban Services Output 4: this output should specifically include preparation of "road maps" for private sector investors/participants to more clearly understand the project formulation, approval and implementation processes.

Page 5/6 - The duration of the Urban Services Technical Assistance experts is not clearly stated in the document. Therefore, it is not possible to understand the allocation of TA resources between the long term TA positions and the direct support to demonstration projects.

It also appears from the document that the resources to be provided to demonstration projects will be almost exclusively TA for feasibility study, detailed design, etc. If possible, some funds should also be budgeted for other types of critical support to pilot projects.

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Page 7 -Rather than concentrating the demonstration projects so heavily on the B.O.T. model of private participation (5 BOT projects proposed), we hope to participate with you in identifying other models of public/private participation in urban service provision. This may include land consolidation projects, public/private partnership in integrated urban infrastructure projects like the highly successful Samarinda model project or other types of projects with substantial investments in urban infrastructures.

Regarding service contracts, a considerable body of experience already exists in some local governments in contracting street sweeping, solid waste transport, PDAM bill collections and other areas. As a first step, this experience should be studied and the lessons learned should be documented and disseminated.

We trust that the above comments will be useful to you in fine-tuning the project documents but that they will not, in any way, delay the USAID authorization of the grant to support this important project.

Thank you for your cooperation.

for DIRECTOR GENERAL FOR REGIONAL DEVELOPMENT
DIRECTOR FOR URBAN DEVELOPMENT

(Ir. SOEDARSONO SOEKARDI)

cc. Director General for Regional Development
Ministry of Home Affairs

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REPUBLIK INDONESIA
DEPARTEMEN PEKERJAAN UMUM
JALAN PATTIMURA NO. 20 KEBAYORAN BARU - JAKARTA

No. : KU.03.01 - SJ/722 Jakarta, 23 September 1991

Kepada Yth.
Bapak Deputi V Regional dan Daerah
BAPPENAS

Perihal : USAID Grant untuk Bantuan Teknis dalam "Private Participation in Utilization and Urban Services"

Dengan ini kami menyampaikan dengan hormat bahwa sesuai dengan kebijaksanaan Pemerintah untuk mendorong peran serta yang lebih besar dari sektor swasta dalam pembiayaan dan pembangunan prasarana dan sarana kota, maka Departemen Pekerjaan Umum telah merintis upaya kerjasama dengan sektor swasta dalam pembangunan jalan tol, penyediaan air bersih dan prasarana kota lainnya. Mengingat masalah kerjasama pemerintah - swasta dalam pembangunan prasarana dan sarana perkotaan merupakan hal yang baru, dan oleh karena itu diperlukan rintisan untuk merumuskan kebijaksanaan, strategi, mekanisme, sistim, prosedur, tatacara, dan pendekatan yang tepat, maka Departemen Pekerjaan Umum memanfaatkan pula peluang bantuan teknis dari badan internasional dan donor bilateral. Dalam rangka memanfaatkan bantuan teknis luar negeri, antara lain telah diperoleh bantuan teknis USAID dalam Water and Sanitation for Health Project (WASH) yang telah diselesaikan dengan baik.

Departemen Pekerjaan Umum dan USAID sementara ini telah mengembangkan kerangka bantuan teknis baru dengan USAID yang diberi judul : "Private Participation in Utilities and Urban Services" seperti tertuang dalam dokumen terlampir. Bantuan teknis USAID yang baru ini mempunyai tujuan pokok membantu Pemerintah dan Departemen Pekerjaan Umum dalam menindak lanjuti dan melaksanakan proyek-proyek uji - coba kerjasama pemerintah dan swasta dalam prasarana dan sarana perkotaan, dengan sasaran khusus :

1. Merumuskan strategi spatial dan pemaketan program-program dan proyek-proyek pembangunan prasarana perkotaan untuk kerjasama pemerintah dan swasta.

2. Melaksanakan beberapa proyek-proyek uji - coba yang dipilih berdasarkan strategi tersebut pada butir 1.

3. Menyelenggarakan program pelatihan bagi aparat pemerintah di pusat dan daerah, termasuk aparat proyek, untuk meningkatkan kepekaan serta ketrampilan dalam memanfaatkan peluang kerjasama pemerintah - swasta dalam pembangunan prasarana perkotaan.

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Pada prinsipnya kami dapat menyetujui kerjasama teknis dengan USAID terlampir, dan kami mohon dapat kiranya memperoleh persetujuan Bappenas dan Pemerintah atas kerjasama teknis tersebut untuk dapat disampaikan kepada USAID.

Sebagai pejabat yang telah ditunjuk Bapak Menteri PU mewakili Departemen Pekerjaan Umum untuk mengkoordinir proyek kerjasama USAID ini adalah Saudara Staf Ahli Menteri PU Bidang Investasi Sarana dan Prasarana Pekerjaan Umum, sedang pelaksanaan proyek untuk sasaran 1 dan 3 adalah Pusat Pengkajian Strategi Pembangunan Pekerjaan Umum dan untuk sasaran 2 adalah Direktorat Jenderal Cipta Karya.

Atas perhatiannya kami ucapkan terima kasih.

SEKRETARIS JENDERAL

SALMON KODIJAT

NIP. 110007660

Tembusan kepada Yth. :

1. Bapak Menteri Pekerjaan Umum (sebagai laporan)
2. Direktur Jenderal Cipta Karya
3. Staf Ahli Menteri PU I
4. Staf Ahli Menteri PU VI
5. Kepala Biro Kerjasama Luar Negeri
6. Kepala Biro Perencanaan
7. PUSTRA
8. Mr. William Frej, Ucaid.

YA/Bappenas./91

402

Code Number : L - 16

1. Project Title : PRIVATE SERVICES FOR URBAN SECTOR DEVELOPMENT

2. Location : Indonesia

3. Executing Agency : National Development Planning Agency (Bappenas)

4. Objectives :
- To expand private urban services delivery and financing options;
- To explore ways to let market forces determine priority urban services requirements; and
- To support consumer participation in the planning, financing, provision and maintenance of urban services.

5. Project Description : The proposed project is expected to provide strategic assistance to the GOI in designing, testing and implementing a nation wide programme for privatization of urban services and development of public/private partnerships in urban service delivery and finance. Its outputs will be new policies, standards, models for privatization and structures throughout Indonesia, as well as policy reforms and recommendations for policy implementation generated by project-supported research and analysis.

The project will provide numerous kinds of assistance, including:

- Technical assistance in analyzing, reformulating and drafting policies and standards pertaining to the public provision of urban services, including divest of public urban services enterprises and entitlements;
- Training for public and private sector participants;
- Strengthening institutional capacity of the public and private sector to deliver and maintain urban services;
- Funding of pilot/demonstration projects to provide feedback for the policy formulation process and to obtain practical implementation experience.

6. Implementation Time : 3 (three) years

Code Number : L - 16

7. Project Cost	: Total Cost	: US $ 15,000,000
	Local Cost	: US $ -
	Foreign Exchange Cost	: US $ 15,000,000
8. Amount Proposed for Commitment	: US $ 15,000,000	
9. Related to Technical Assistance		
10. Stage of Project Preparation		

ANNEX F

GRAY AMENDMENT CERTIFICATION

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

CERTIFICATION PURSUANT TO GRAY AMENDMENT

As the Director and Principal Officer of the Agency for International Development in Indonesia, I certify that during the design of the Private Participation in Urban Services (PURSE) Project (497-0373) full consideration has been given to the potential involvement of small and/or economically and socially disadvantaged enterprises, and historically black colleges, universities, and minority controlled private and voluntary organizations covered by the Gray Amendment.

The project procurement plan is based on the need to utilize contractors with highly specific substantive knowledge and technical competence across a broad array of disciplines, such as specialized areas of legal and regulatory analysis for public services, urban environmental management, and public finance, including the development of credit mechanisms for local government. The necessary knowledge and expertise are not available, to the best of our knowledge, from minority controlled and women-owned firms, historically black colleges and universities, and minority controlled private voluntary agencies. However, it is anticipated that the prime contractors will use such concerns as sub-contractors for at least 10 percent of the total contract value. If all other aspects of the evaluation of contract bids are equal, the participation of such concerns may become the determining factor for selection.

Further, it is the policy of this Mission to use Gray Amendment firms for all interim and final project evaluations.

Lee Twentyman
Acting Mission Director

September 30, 1991

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ANNEX G

DRAFT SCOPES OF WORK FOR EXPATRIATE RESIDENT ADVISORS

Private Participation in Urban Services (PURSE)

USAID/Jakarta

September, 1991

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SENIOR URBAN SERVICES ADVISOR
SCOPE OF WORK

1. Background

The Senior Urban Services Advisor shall supervise all PURSE project activities undertaken in the name of the Contractor for this project. He/she will work with the Steering Committee Chair in BAPPENAS to coordinate project activities and serve as the principle liaison with the USAID/Jakarta PURSE Project Officer. The Senior Urban Services Advisor will provide guidance on policy, legal, and regulatory issues, with an initial focus on issues affecting demonstration projects. This advisor will have particular responsibility for assuring that appropriate lessons from demonstration projects are learned and applied through in-country training activities and out-reach to U.S. firms. BAPPENAS will also collaborate with the Senior Urban Services Advisor to call upon task-specific short-term technical assistance as needed. A level-of-effort of 72 person-months is planned for this advisor.

2. Specific Duties

2.1 Project Management

1. Design and implement an annual work planning process in consultation with the Steering Committee which formulates workplan objectives and develops a schedule for completion of work activities and specific deliverables for each long-term resident advisor and for all short-term technical assistance and training activity.

2. In conjunction with the annual work planning process, supervise the preparation of quarterly reports which review implemetation progress, identify operational or administrative problems, assess the policy environment within which the project is operarting and make recommendations to USAID and the GOI regarding management, implementation, and policy issues which require special attention during the current fiscal year. Oversee the development of project information systems for establishing baseline data and updating such data on a quarterly and annual basis to report progress toward end-of-project status and related outputs, as well as national-level measures useful for assessing the validity of project logframe assumptions underlying output-purpose-goal linkages.

3. Provide overall financial management, formulate systems and procedures for tracking budget expenditures, and provide quarterly and annual financial reports.

4. Provide direct supervision for all long-term consultants, both expatriate and Indonesian, employed by the contractor.

5. Supervise liaison between USAID and BAPPENAS, MPW (DG Cipta Karya and CSS), Home Affairs (DG PUOD and DG BANGDA), and MOF on all technical, administrative, and financial matters related to the project.

6 Assist USAID and the GOI in the design of mid-term and final project evaluations.

2.2 Policy, Legal, and Regulatory Guidance

1. Supervise the design and implementation of project-related studies, assessments, information dissemination strategies, and policy dialogue with the GOI, including : a) the development of a policy statement, or a compilation and publication of existing policy statements, regulations and statues, clarifying GOI interest in and sanction of private participation in various forms of capital works and operating contracts for water, wastewater and solid waste services; and b) a policy study on and review of capital and operating costs for water.

2. Advise BAPPENAS, the Ministry of Home Affairs, the Ministry of Public Works and the Ministry of Finance on technical and policy matters related to the project, including policy discussions to establish GOI consensus on water tariff policy.

3. Supervise PURSE project assistance to the GOI in the development of policies on water source depletion, environmental management of wastewater, and regulation of alternatives methods of solid waste disposal and pricing strategies.

4. In consultation with the Steering Committee, coordinate the identification of all project short-term technical assistance needs, the development of suitable scopes of work for that assistance, and recruitment of consultants. Provide direct supervision for all short-term consultants, both expatriate and Indonesian, employed by the contractor.

2.3 Demonstration Project Management

1. In coordination with the GOI and the Demonstration Project Manager of the PURSE resident advisory team, identify potential projects at which the private sector may construct, own and operate new facilities or improve the operation and maintence of existing facilities through service contracts; analyze technical feasibility and commercial viability of potential projects identified; identify potential contractors/investors; assist the GOI to develop new policies, regulations, guidance and model contracts; and serve as a catalyst for the GOI to enter into agreements with private firms for the provision of urban services.

2. Supervise and support technical assistance provided by the Demonstration Project Manager to the GOI and private sector firms for demonstration project identification, project planning, investor selection, project financing using credit

enhancement by a U.S. Government or World Bank agency, project negotiation, and implementation monitoring.

3. Evaluate and draw lessons learned from demonstration projects and other private projects underway, using such lessons to a) prepare standard operating procedures that various GOI units can use in initiating private projects, b) develop materials for training and communication activities under PURSE, and c) identify common impediments and needs for oversight that should be addressed by the GOI in new laws and regulations.

2.4 Training and Communications

1. Oversee the public/private forum series, involving approximately forty local meetings and five annual conferences, that address a wide range of topics related to private sector participation in urban services, such as procedures for project identification and development, announcement of specific projects in which the GOI is soliciting private participation, terms and conditions of public/private agreements, and GOI regulation of private activity.

2. Supervise an in-country training program involving approximately forty workshops and twenty skill courses providing guidance for public/private partnerships and strengthening technical and managerial skills.

3. Manage a formal overseas training program, promoting training in urban planning and public administration, for approximately six master degree candidates and eighty participants in short courses.

4. Conduct four quantitative assessments of demonstration project construction and service quality, private sector costs and profitablity, benefits to consumers and the GOI, and the success or failure of contractual terms and GOI oversight mechanisms. Incorporate the results of such research and evaluation into public/private forums and workshops.

4. Qualifications

The consultant must have had ten years of experience in developing countries, including Indonesia, serving as a policy analyst/ advisor. It is expected that this individual will possess strong prior experience as a team leader for project implementation and possess extensive knowledge of A.I.D. practices and procedures. He/she must have a graduate degree in public administration, regional and city planning, public policy or a related field. Indonesia language capability would be an advantage but is not required. Funds for language training will be included in the contract.

MUNICIPAL SERVICES ADVISOR
SCOPE OF WORK

1. Background

The Municipal Services Advisor shall work directly with the Ministry of Home Affairs (Directorate Generals PUOD and BANGDA). This Advisor will be primarily responsible for assisting cities and municipalities structure investment packages and identify service and management contracting opportunities in water, wastewater, and solid waste management. He or she will also be responsible for promoting effective communication between government officials and private entrepreneurs, as well as building their skills in developing public-private partnerships through a variety of training activities. A level of effort of 72 person months is planned for this member of the long term advisory team.

2. Specific Duties

2.1 Policy, Regulatory and Legal Guidance

1. Assist in the development of policy statements and regulations clarifying GOI interest in and sanction of private participation in capital works and performance contracts in water, wastewater and solid waste services.

2. Assist in the formulation of Standard-Operating-Procedures (SOPs), Guidelines, and Models for service contracting in solid waste collection, transport and disposal, and management contracts for water and wastewater operations (accounting, billings, collections maintenance, etc).

2.2 Demonstration Project Management

1. Assist in the identification, design and implementation of at least six service and/or management contracts in water, wastewater, and solid waste management. The Advisor will work with the MOHA to identify potential projects and analyze their technical feasibility and commercial viability; identify potential and pre-qualify firms; market the projects and solicit proposals; and select the firm and negotiate the contract. These projects should demonstrate the efficiency benefits from contracting for maintenance, billing and collection, in the water and wastewater sectors; and for collection, transport and disposal in solid waste management.

2. Assist in the identification, design and implementation of BOO/BOT pilot projects in water and wastewater. The Advisor will work with the MOHA to identify locations and investors for the construction, operation and ownership of

private water and wastewater facilities; and propose a contractual relationship between the investor and the government entity.

2.3 Training and Communications

1. Plan and organize a public/private forum series between government officials and private entrepreneurs which address topics such as GOI policy on private participation in urban services, announcements and description of new projects, GOI tendering procedures, terms and conditions of model contracts, and results of policy studies and lessons learned from demonstration projects.

2. Assist in the preparation of workshops for public and private participants including: the project development process; model contracts and pricing procedures for urban services; and GOI monitoring and oversight procedures for private activity

3. Facilitate participation of private sector personnel in existing workshops and courses to teach specific technical, managerial and adminstrative skills needed to deliver urban services and sustain a viable small or medium sized business.

2.4 Project Management

1. Assist the Chief-of-Party in identifying short-term technical assistance needs of his/her counterpart institution, specifically for implementation of demonstration projects, and in developing suitable scopes of work for that assistance, and recruitment of consultants.

2. Direct and manage the assistance of the Municipal Services Specialist, such that his/her activities are closely coordinated with the Municipal Services Advisor's efforts.

3. Within the purview of his/her responsibilities, provide day-to-day supervision for all short-term consultants, both Indonesian and expatriate, employed by the Contractor.

4. Provide quarterly reports which review implementation progress on the consultant's activities, identifying operational or administrative problems, assessing the policy environment within which the project is operating and making recommendations to the Chief of Party on management, implementation, and policy issues which require special attention during the current fiscal year.

5. Provide annual reports which review implementation progress on the consultant's activities, identifying operational or adminstrative problems, assessing the policy environment within which the project is operating, and making recommendations to the Chief of Party on management, implementation, and policy issues which require special attention in the upcoming fiscal year.

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6. Provide financial management and control of operations within his/her purview.

7. Monitor the progress and pace of implementation of this project component

8. Assist the Chief-of-Party in the design of the mid-term and final project evaluations.

3. Qualifications

In order to carry out these responsibilities, this Consultant should have a minimum of seven years working experience in municipal services management of a major urban area/government. Experience must include hands-on urban infrastructure planning, and substantial interface with the private sector, specifically the contractual aspects of public-private partnerships. The consultant should have at least a masters degree in urban planning, business or management, or an equivalent degree or certification. On-the-job experience may be substituted for graduate-level experience at a ratio of up to three years of hands-on experience for a maximum of two years of graduate school studies.

Relevant on-the-job experience should include hands-on preparation of regulations, model contracts, manuals and implementing instructions related to private provision of urban services. Prior experience working in a developing country, an understanding of USAID administrative procedures, and/or prior experience with project management in the context of regulatory reform are qualities highly sought after for this position. Indonesian language capability would be an advantage but is not required. Funds for language training will be included in the contract.

DEMONSTRATION PROJECT MANAGER
SCOPE OF WORK

1. Background

The Demonstration Project Manager will work with the Senior Urban Services Advisor specificly in support of demonstration projects. He or she will not be assigned to a specific GOI ministry for the provision of long term techncial assistance, but will focus attention on direct assistance to private sector companies in investment or contract opportunities in the provision of urban services in support of GOI initiatives. This advisor will market trade and investment packages, as well as contracting opportunities, to U.S. and small and medium sized Indonesian businesses, and compile information on lessons learned from pilot/demonstration projects undergoing implementation. A level-of-effort of 48 person-months is planned for this member of the long term advisory team.

2. Specific Duties

1. In coordination with the GOI and the Senior Urban Services Advisor, expedite development of five B.O.O. or B.O.T. pilot projects, involving approximately two piped water supply, two wastewater, and one multi-service (private water, wastewater, and solid waste management) project, and six pilot service or performance contracts, involving approximately two piped water and four solid waste management projects.

2. For each demonstration project listed above in item 2.1:

   a) identify alternative demonstration project sites and potential investors and/or contractors;
   b) identify government contracting entities and assess institutional framework and constraints;
   c) communicate and solicit interest among potential U.S. investors and/or arrange workshops and meetings with potential domestic private sector contractors;
   d) present projects to prospective bidders through preparation of contract packages and issuance of Terms of Reference, following either the "outline" or "pre-package" approaches, the later requiring pre-engineering or schematic designs, feasibility analysis, and capital requirements analysis, prepared by short-term technical advisors under the direction of the Demonstration Project Manager;
   e) support GOI investor selection, project negotiation, and contract completion, involving pre-qualification of bidders, project marketing among qualified firms, project solicitation, review of proposals, and contract negotiations;

URBAN ENVIRONMENTAL SPECIALIST
SCOPE OF WORK

1. Background

The Urban Environmental Specialist will work with the Ministry of Public Works to assist the Center for Strategic Studies in the formulation of plans, strategies, and implementation arrangements to support effective public-private partnership in urban services provision. The advisor will play a major role in the development of demonstration projects, including new investments as well as a range of private sector contracting arrangements, working both with the MOPW and in cooperation with the Municipal Services Advisor/Specialist and their counterparts as appropriate. A level of effort of 48 person months is planned for this member of the long term advisory team.

2. Specific Duties

2.1 Policy, Legal and Regulatory Guidance

1. Design and implement policy studies on the capital and operating costs of water supply, wastewater treatment, and solid waste management service provision. Disseminate results to the Ministries of Public Works and Home Affairs.

2. Develop hypothetical tariff structures for water, wastewater and solid waste management which would facilitate cost recovery in local government enterprises, through policy dialogue with the Ministries of Home Affairs, Public Works, Finance and BAPPENAS.

3. Assist the Center for Strategic Studies in formulating policies on water source depletion, environmental management of wastewater, and alternative methods of solid waste disposal.

2.2 Demonstration Projects

1. Assist in the identification, design and implementation of capital works projects in water supply and wastewater treatment which are constructed, financed, owned and operated by the private sector.

2. Evaluate and extract lessons learned from demonstration projects, specifically identifying those policy and institutional shortcomings which must be addressed for effective public-private partnership, and coordinate interministerial dialogue on these issues.

2.3 Training and Communications

1. Assist in the development of in-country workshops for public and private participants, on topics such as cost analysis and pricing adjustments for private provision of infrastructure and services, and project development and evaluation methodology necessary for preparing proposals for projects that are tendered by the GOI.

2. Participate in the public/private forum series between government officials and private entrepreneurs and contribute relevant materials such as results of policy studies and lessons learned from demonstration projects.

2.4 Project Management

1. Assist the Chief-of-Party in identifying the short-term technical assistance needs of his/her counterpart institutions and in developing suitable scopes of work for that assistance, and recruitment of consultants.

2. Direct and manage the assistance of the Project Development/Financial Specialist, such that his/her activities are closely coordinated with the Urban Environmental Specialist's efforts.

3. Within the purview of his/her responsibilities, provide day-to-day supervision for all short-term consultants, both Indonesian and expatriate, employed by the Contractor.

4. Provide quarterly reports which review implementation progress on the consultant's activities, identifying operational or administrative problems, assessing the policy environment within which the project is operating, and making recommendations to the Chief of Party on management, implementation, and policy issues which require special attention during the current fiscal year.

5. Provide annual reports which review implementation progress on the consultant's activities, identifying operational or adminstrative problems, assessing the policy environment within which the project is operating, and making recommendations to the Chief of Party on management, implementation, and policy issues which require special attention in the upcoming fiscal year.

6. Provide financial management and control of operations within his/her purview.

7. Monitor the progress and pace of implementation of this project component.

CONTRACT SPECIALIST
SCOPE OF WORK

1. Background

The Contract Specialist will work with the Senior Urban Services Advisor specifically in support of the substantial sub-contracting aspect of the project. The design of the project includes considerable local subcontracting as direct outreach to the private sector. This subcontracting is expected to involve a high degree of supervisory organization and management from the PURSE office and as liaison with USAID. A level of effort of 24 person-months is planned for this advisor.

2. Specific Duties

1. Serve as the principal advisor to the PURSE team on all aspects of contract management as it relates to sub-contracting short-term technical assistance. In consultation with the Steering Committee and the Senior Urban Services Advisor, supports development of suitable scopes of work for all project short-term technical assistance.

2. Develop a sub-contracting plan under the PURSE project which may require one or several methods of procurement; a variety of procurement contracts, negotiation with several different procurement sources, and implementation of internal sub-contract management procedures

3. Serve as the representative responsible for management of sub-contracting under the PURSE project. Maintain effective liaison with U.S. and Indonesian private firms, education and research institutions and other contractual groups to:

   (a) prepare solicitation documents for short-term techncial assistance sub-contractors;

   (b) coordinate, manage, and negotiate sub-contracts;

   (c) renegotiate proposed contract changes and amendments to redirect or reemphasize contract objectives;

   (d) ascertain contract management capabilities of local private enterprises and assist in developing skills for administration and management of sub-contracts under the PURSE project;

   (e) monitor and evaluate sub-contract implementation and, as delegated, terminate contracts for non-compliance by either party.

4. Interpret data received from sub-contractors and prepare quarterly and annual reports on sub-contractor performance.

5. Develop systems and procedures for tracking the level of short-term technical assistance support allocated to each counterpart GOI ministry and prepare quarterly and annual reports of balances remaining in each agency "account".

3. Qualifications

Eight-years work experience in contract administration, negotiation, termination, price analysis, procurement, and analysis of bids is required. Comprehensive knowledge of A.I.D. contracting procedure is necessary. Academic degree in business administration, law, marketing, industrial management, accounting or other directly related fields is required. Indonesia language capability would be an advantage but is not required. Funds for language training will be included in the contract.

8. Assist the Chief of Party in the design of the mid-term and final project evaluations.

3. Qualifications

In order to carry out these responsibilities, this Consultant should have a minimum of seven years working experience in urban infrastructure development program for a major urban area/government. Experience must have included hands-on urban infrastructure planning and environmental policy formulation. Prior interface with national infrastructure sectors, and environmental research institutes or regulatory bodies, is desired. The consultant should have at least a masters degree in urban planning, business or management, environmental science, or an equivalent degree or certification. On the job experience may be substituted for graduate level experience at a ratio of up to three years of hands-on experience for a maximum of two years of graduate school studies.

Relevant on-the-job experience should include hands on preparation of environmental regulations preferably related to water, wastewater and solid waste management, and the development of manuals and implementing instructions necessary for effective public-private partnership in urban services. Prior experience working in a developing country, an understanding of USAID administrative procedures, and/or prior experience with project management in the context of policy and regulatory reforms are qualities highly sought after for this position. Indonesian language capability would be an advantage but is not required. Funds for language training will be included in the contract.

f) monitor project construction and operations to ensure construction and equipment meets the specification and construction standards, and testing of operating components to ensure product standards have been met; and,

3. Conduct quantitative assessments of demonstration project construction and service quality, private sector costs and profitablity, benefits to consumers and the GOI, and the success or failure of contractual terms and GOI oversight mechanisms. Make the results of such research and evaluation available to PURSE project team to address: a) constraints that affect the privare sectors perception of opportunities and incentives to invest resources, b) constraints that arise from the structure of the prevailing system of financing urban services, and c) procedures for the GOI for joint venture project identification, evaluation, and regulation.

4. Qualifications

This consultant must have extensive experience in contract negotiations and project management, with an emphasis on the delivery of urban services and infrastructure and community-based economic development. This work will have included eight-years experience in a developing country, preferrably Indonesia. Public sector experience in developing public/private partnerships for the delivery of urban services and/or infrstructure, or private sector experience in the execution of urban services projects is required. The specialist should have at least a master's degree in civil engineering, public administration, public finance, investment or commercial banking, urban planning or an equivalent degree or certificate in a related discipline. Indonesia language capability would be an advantage but is not required. Funds for language training will be included in the contract.

ANNEX H

LIST OF CONTACTS

Private Participation in Urban Services (PURSE)

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LIST OF CONTACTS

NAME	POSITION/OFFICE
Aboejoewono A.	Vice Head Jakarta City Sanitation Office
Dr. Russell H. Betts	WWF Representative World Wide Fund for Nature
Budihardjo	Head Jakarta City Sanitation Office
Dr. C. M. Croft	Operations Manager PT. Sarana Organtama Resik (SOR)
Robert T. Dakan	Deputy AID Representative to ASEAN
Rustam Didong	Deputy for Economic Affairs BAPPENAS
R. Djembar Wiradisastra	Director Bandung Municipal Cleansing Enterprise
Robert E. Driscoll	President US ASEAN COUNCIL for Business and Technology, Inc.
Dr. John Herbert	Chief Technical Advisor IUIDP Implementation Support BAPPENAS
William Hollinger	Economic Consultant

NAME	POSITION/OFFICE
Ir. Suhadi Hadiwinoto	National Project Coordinator Metropolitan Environmental Improvement Program UNDP - The World Bank
Dono Iskandar	Head of Board for State Finance, Credit and Balance of Payment Analysis Ministry of Finance
Ir. Yani Indrayanti	Team Leader Jakarta Sewerage & Sanitation Project Directorate General of Human Settlements, Ministry of Public Works
Prof. Dr. Satrio Budihardjo Joedono	Assistant Minister IV, Industry, Mining and Energy Office of the Coordinating Ministry for Economy, Finance, Industry and for Development Supervision (EKUIN)
M. Iman Juwono	Senior Research Advisor Center for Policy and Implementation Studies
Leroy P. Jones	Chief Executive Officer BIDE - Boston Institute for Developing Economies, Ltd.
William Kugler	Municipal Finance Project Ministry of Home Affairs
Siegfried L. Lesiasel	Director Environmental Services PT Environment Nusa Geotechnica Consultant in the Environmental and Applied Earth Sciences
Nabiel Makarim	Deputy for Pollution Control The Environmental Impact Management Agency (BAPPEDAL)

NAME	POSITION/OFFICE
Dr. James McCullough	Municipal Finance Project Ministry of Finance
R.D. Napitupulu	National Investment Coordinating Board (BKPM)
Eka Iskandar Nusantara	PT. Trinaga Terra Energy Recovery Firm
Darmawan Saleh	Director Directorate of Environmental Sanitation Directorate General of Human Settlements Ministry of Public Works
Howard Schumann	Training Specialist Price Waterhouse
Atar Sibero	Director General Directorate General of Public Administration and Regional Autonomy (PUOD) Ministry of Home Affairs
Sugijanto Soegijoko	Deputy for Regional and District Affairs BAPPENAS
Bambang Bintoro Soedijito	Chief, Regional and District Affairs Bureau BAPPENAS
Soedarsono Soekardi	Director for Urban Development Directorate General for Regional Development (BANGDA) Ministry of Home Affairs
Soekrisno	Expert Staff Assistant to the Minister for Investment in Infrastructural Development Ministry of Public Works

NAME	POSITION/OFFICE
Sudarsono	Head Jakarta Municipal Wastewater Management Enterprise (PDAL)
Hendropranoto Suselo	Expert Staff Center for Strategic Studies Ministry of Public Works
Paul Sutmuller	Team Leader IUIDP Implementation Support
John L. Taylor	Municipal Finance Project Ministry of Public Works
S. Thuraisingham	Senior Project Engineer Asian Development Bank Indonesia Resident Office
Dennis Whittle	Economist The World Bank
Claudia M. Winkelman	Research Associate Natural Resources and Environment Program, Thailand Development Research Institute Foundation

ANNEX I

LIST OF REFERENCES

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