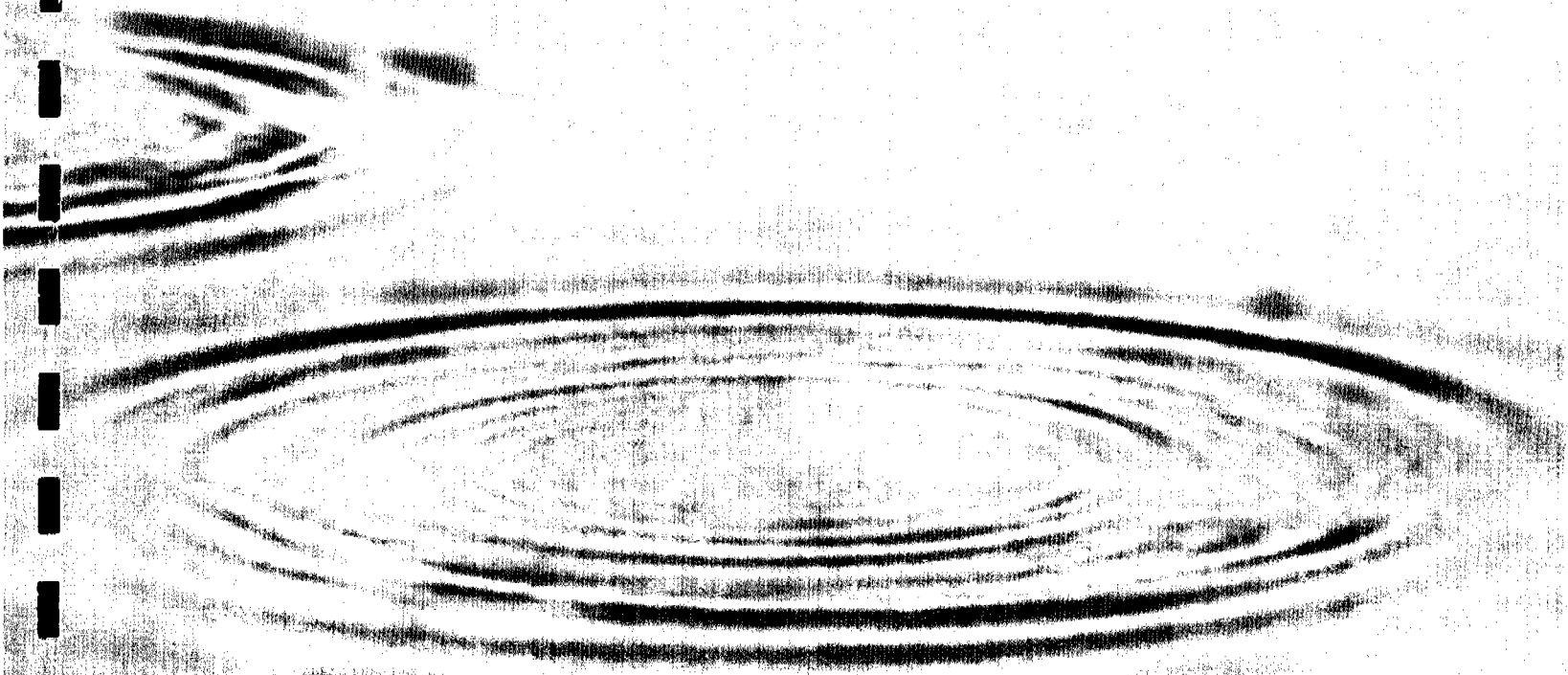
Weathering External Shocks: A Case Study of Indonesia



1999

WATER SUPPLY AND SANITATION

Financing Sustain

Weathering Shocks: A Case Study of Indonesia

Moderator: *Raja Iyer, Principal Management Specialist, Urban Development Sector Management Unit, East Asia And Pacific Region, The World Bank*

Speakers: *Christian Michelon, President Director, Pt PAM Lyonnaise Jaya (Indonesia)*

Benny Chatib, Executive Director, PERPAMSI (Indonesia)

Abimanyu, President Director, PDAM Kotamadya Surakarta (Indonesia)

1999 Water Supply & Sanitation Forum
April 8 – 9, 1999
Water & Sanitation Division
The World Bank

Table of Contents

Background Reference Documents

Available from Internal Documents Unit:
http://www-wds.worldbank.org

ICR – Second JABOTABEK Urban Development Project
(Ln. 3219-IND)

ICR – East Java Bali Urban Development Project
(Ln. 3304-IND)

Introductory Notes

Sector Background. Till the mid-seventies, piped water supply in urban areas was a departmental responsibility (with the Ministry of Public Works) in Indonesia. In the late seventies the government decided to transfer responsibility for all aspects of water supply – planning, design, construction, operations and maintenance, billing and collection – to autonomous bodies. The government established local government companies for water supply (Perusahaan Daerah Air Minum – PDAM) in each of the 300 plus local government jurisdictions in the country. The majority of these PDAMs are quite small - with less than 10,000 connections – and do not recover full costs. Initially the central government provided grant funds for capital expenditure, implemented the investment program, and transferred the assets to the PDAMs. Over time, capital expenditure has been increasingly financed through a blend of grants and soft loans, with responsibility for implementing capital works also being transferred – especially for the loan funded part – to the PDAMs. Water supply remains largely in the public sector. Although a number of MOUs were signed by international operators with individual PDAMs, only a very few have progressed to deals. The negotiated Jakarta Cooperation contracts, signed in 1998 represent major private involvement in the sector.

Bank Involvement in the Sector. The Bank has been active in the urban and water supply sector in Indonesia since the mid-seventies. During the initial period, the Bank was involved in free standing water supply projects, and supported the government's policy of conversion of departmental water supply management to PDAMs, and espoused the principles of cost recovery. However, since the mid-eighties, in keeping with government's policy of integrated urban infrastructure development programs (IUIDP), the Bank's involvement in water supply has been through such integrated projects. This resulted in a reduced focus on the policy agenda for urban water supply, and it appeared that the sector was beginning to lag behind international trends in water supply, especially in the areas of institutional and legal reform, and private sector participation. At the government's request, the Bank addressed these issues in a 1997 Urban Water Supply Policy Framework Paper. This paper was widely discussed in draft within the country, and there is a consensus that it outlines the future direction of the sector in Indonesia.

The Crisis. In June 1997, Indonesia was enjoying its thirtieth year of virtually uninterrupted rapid growth, with low inflation and declining poverty (which reached below 15%). However, in 1998 Indonesia witnessed a dramatic reversal in fortune, partly as a result of the Asian contagion and partly as a result of a crisis in the political arena. At one point, the value of the currency, the Rupiah, fell from Rp. 2,400 to the dollar (in June 1997) to Rp. 17,000 to the dollar, before closing the year at about Rp. 8,000 to the dollar. Inflation in 1998 reached 80%, and the economy contracted by about 15%. Foreign creditors have withdrawn, and investors have retreated.

Impact of the Crisis on the Water Sector. The water sector suffered catastrophic consequences as a result of these shocks to the economy. A vast majority of the three hundred water enterprises in Indonesia were very badly hit: operating costs increased sharply, while tariffs could not be increased in the turbulent political and economic environment; debts could not be serviced; funding for capital

expenditure – both from internal generation, and from government grants and soft loans – dried up. Nevertheless, local governments (as the sole owners of PDAMs) continued to collect dividend payments quarterly on the basis of budgeted profits, even though the water enterprises were suffering losses. An incipient private sector in the water sector was badly affected.

Bank assistance to the Water Sector in the Context of the Crisis. The Bank is already supporting the implementation of a substantial investment program in urban water supply through a number of on-going IUIDP projects. In specific response to the crisis, the Bank is currently working with the government agencies in Indonesia to provide both immediate assistance to the sector, and to use the crisis as an opportunity to implement the reforms identified in the policy paper. The Bank's crisis response in the urban water supply sector include the following:

Immediate Assistance

A. Support to the Province of Jakarta for addressing issues relating to the two Cooperation Agreements with International Operators, including (a) funding technical assistance to discuss and reach agreement on issues relating to tariff increases due in 1999; (b) assistance to establish a Regulatory Body for the cooperation agreements; and (c) assistance with an Independent Assessment of the Cooperation Agreements.

B. Support for a PDAM Rescue Program, to assist on a demand driven basis, those PDAMs which seek financial assistance to overcome the impacts of the crisis. The Bank assisted in the development of the program concept, provided bridging technical assistance, and is seeking ASEM funds on behalf of the government for on-going technical assistance to support program implementation. The Bank has agreed to amend the loan agreements of on-going urban projects (if requested by government) to finance the costs of the program.

C. Support Water Supply Innovations on a pilot basis in PDAM Surakarta. These include (a) financing an Operational and Management Audit; (b) assisting with the development of, and part financing the implementation of, a Pilot Communication Program; and (c) assisting in the development of an extended overseas internship program.

Sector Reform and Support for Investment Program

The Bank is working with government in developing an Urban Water Supply Sector Investment Loan, as an Adaptable Program Loan (APL), to support implementation of the reform agenda in a phased manner, complemented by support for an investment program for the sector. The proposed APL is one of the loans in the FY00 lending program.

The Session. This session will feature three speakers who will provide different perspectives on how the water supply sector in Indonesia is coping with the impacts of the unprecedented crisis in Indonesia:

(a) *Impact on the Private Sector* – Christian Michelon, President Director, PT PAM Lyonnaise Jaya, will discuss the problems faced by the private sector operators under the Jakarta cooperation agreements;

(b) *PDAM Rescue Program and the Role of PERPAMSI* – Prof. Benny Chatib, Executive Director of PERPAMSI (an association of water companies) will discuss the impact of the crisis on water companies, the PDAM Rescue Program, and the role of PERPAMSI in its implementation; and,

(c) *Initiatives of an individual PDAM* – Ir. Abimanyu, President Director, PDAM Kotamadya Surakarta, will discuss steps being taken by PDAM to cope with the crisis.

Raja Iyer
Session Leader

Biographies

RAJA IYER

Mr. Iyer joined the World Bank in 1987, and is currently Principal Management Specialist in the Urban Development Sector Unit of the East Asia and Pacific Region.

Prior to joining The World Bank, Mr. Iyer worked as a short-term consultant for the World Bank on water supply projects in Indonesia, Thailand, and Malaysia. Since 1993, he has been working primarily in the urban and water sectors in Indonesia and currently is leading the effort in implementation of major sectoral reforms presented in the World Bank's 1997 paper on "Urban Water Supply Policy Framework for Indonesia". He is actively involved in private sector participation issues in Indonesia, particularly in Jakarta, Bali, Semarang, Surakarta and Serang. He is also familiar with water sector issues in the Philippines and Vietnam.

Mr. Iyer worked as A. F. Ferguson's institutional specialist on a WHO-UNDP study on water supply and sanitation in the Madras Metropolitan Area, which led to the establishment of the Metrowater Board in Madras. During the second part of his three and a half year engagement, he became team leader of an international team, implementing major institutional, management, financial and tariff reforms in Metrowater. He then worked in a number of water sector projects in India that were subsequently financed by the World Bank including the states of Tamil Nadu and Kerala.

CHRISTIAN MICHELON

Mr. Michelon was appointed in August 1995 as Project Director for the negotiation of the Water Supply Concession Contract for the Western Part of Jakarta. He is President Director of PALYJA, Suez Lyonnaise des Eaux's subsidiary in charge of the concession contract.

Prior to this assignment, he held numerous positions both in water management and engineering services, most recently as Director of Water Supply & Sewerage Management Contracts for SLDE's activities in Italy, Co-director in charge of operations of SLDE's main subsidiary in Italy and Managing Director of Societe des Eaux de l'Essone in France. Before joining SLDE, he worked for nearly 14 years with the engineering firm BCEOM. He is an engineer from Ecole Nationale des Ingenieurs des Travaux Ruraux, Strasbourg, France.

BENNY CHATIB

Mr. Chatib participated in PERPAMSI activity for the first time in 1983 as a scientific advisor. He became Executive Director in 1997. He also serves as an active member of the Indonesian Association of Sanitary & Environmental Engineers, the Society of Indonesian Engineers, and of Scientific and Technical Council, IWSA.

He graduated from Sanitary Engineering Division Bandung Institute of Technology in March 1960, and has been a faculty member since then. In 1971, he received a Master degree in Sanitary and Hydraulic Department of UC Berkeley and a Doctor degree from USTL, Monpellier, France, in 1980.

ABIMANYU

Mr. Abimanyu is the Chief of Planning Department, Kampung Improvement Program (IBRD assisted project). He serves as President Director of PDAM (Water Utility) in Indonesia. His most recent experience was as Technical Director of PDAM (Water Utility), Surakarta. Prior to that, he was Chief of Drainage Department, Public Works, Surakarta.

He received a Bachelor of Civil Engineering from Diponegoro University in 1972, and a Master of Business Administration, Surakarta in 1992.

Indonesia Background

Document of
The World Bank

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Report No. 18963 IND

INDONESIA

Country Assistance Strategy – Progress Report

February 16, 1999

CURRENCY EQUIVALENTS
(Exchange Rate Effective February 12, 1999)

Currency unit = rupiah (Rp)
Rp 1 = US$0.00011
US$1 = Rp 8,725

FISCAL YEAR

April 1 - March 31

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
AMU	Asset Management Unit
BULOG	State Logistics Agency
CAR	Capital Adequacy Ratio
CAS	Country Assistance Strategy
CEM	Country Economic Memorandum
CGI	Consultative Group for Indonesia
CPAR	Country Procurement Assessment Report
CPPR	Country Portfolio Performance Review
ESW	Economic and Sector Work
FIAS	Foreign Investment Advisory Service
FY	Fiscal Year
GDP	Gross Domestic Product
GOI	Government of Indonesia
IBRA	Indonesia Bank Restructuring Agency
IBRD	International Bank for Reconstruction And Development
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
INDRA	Indonesian Debt Restructuring Agency
JEXIM	Japanese Export-Import Bank
JI	Jakarta Initiative
MIGA	Multilateral Investment Guarantee Agency
MPR	Special Consultative Assembly
NGO	Non-Governmental Organization
OECF	Overseas Economic Cooperation Fund
OED	Operations Evaluation Department
PLN	State Electricity Company
PRSL	Policy Reform Support Loan
SECAL	Sector Adjustment Loan
SME	Small- and Medium-sized Enterprise
SSN	Social Safety Net
SSNAL	Social Safety Net Adjustment Loan
TA	Technical Assistance

	IBRD IFC
Vice President:	Jean-Michel Severino/Jemal-ud-din Kassum
Country Director:	Dennis de Tray/Rashad Kaldany
Task Manager:	Oscar de Bruyn Kops/Peter Wogart

INDONESIA
CAS PROGRESS REPORT

Table Of Contents

Page Number

THE INDONESIA COUNTRY ASSISTANCE STRATEGY AT A GLANCE

- The turmoil that has characterized Indonesia over the past 18 months has led to a complete revision of the strategy set out in our last CAS presented in July 1997. We expect to present a full CAS following general elections scheduled in June 1999 and the appointment of a new government toward end-1999.
- Following the onset of the crisis in July 1997, the Bank played an important role with the IMF in pursuing banking restructuring, corporate debt restructuring, international and domestic trade reform, and increasing transparency in government operations, in an effort to restore market confidence. At the same time, the Bank moved to ease the impact on the poor. We amended ongoing projects to finance emergency needs in education, health, job creation, and maintenance of existing assets, and canceled $1 billion from our portfolio. New lending was introduced for structural reform, poverty alleviation, and technical assistance for banking and corporate restructuring. Non-lending services were strengthened to provide continuous policy advice and enhance monitoring of the social impacts of the crisis. And the Bank stepped up donor coordination.
- Looking ahead to the next 12 to 18 months, we see two stages of program support: (1) the period until the Presidential election around November1999; and (2) the post-election period. The table below summarizes likely conditions and strategies for each of these periods.

January 1999 - November 1999	November 1999 -
COUNTRY SITUATION	
Government continues to show commitment to reform, but may be increasingly focused on short-term measures in the lead-up to the election. Period of growing uncertainty and increasingly limited decision making ability by the government. Run-up to general elections (June), election of President (November), and subsequent appointment of new Cabinet (December).	Presidential elections. Possible substantial change in the Cabinet. New government begins to settle in. Transition begins.
BANK STRATEGY	
Maintain economic stability and pace of reform, address social impacts of crisis, and continue portfolio restructuring. Intensify analytical work on key governance and reform areas in anticipation of new Cabinet, plus portfolio management. If GOI continues to make progress on its reform program, Bank will provide *adjustment lending* for social safety nets and structural reforms to continue. Depending on availability of counterpart funds and capacity to implement a selective *investment program* would support crisis-response projects protecting human and physical assets, with partial IDA financing. Continued *restructuring of the portfolio* to improve performance. *Non-lending (ESW)* will focus on quick response and timely advice on immediate reform measures and on planning longer-term analytical work on institutional reform. Attention to monitoring progress in bank and corporate restructuring; actions to protect public social safety net resources; implementation of poverty targeting measures; and preparation of briefings on key policy issues for newly elected government.	*Engage the new government, intensive policy dialogue and advice.* Focus on structural and governance areas, and capacity building technical assistance as necessary. Bank will begin formulation of a new Country Assistance Strategy. Depending on GOI capacity and commitment to reform and budget needs, adjustment lending may be made available for structural and sector reforms (financial, public sector management, agriculture, forestry, urban, energy). As Indonesia resumes economic growth, the balance in the lending program would shift back to investment lending.

INDONESIA

COUNTRY ASSISTANCE STRATEGY PROGRESS REPORT

I. INTRODUCTION

1. Indonesia's last full CAS was discussed at the Board on July 19, 1997, just eight days after the devaluation of the Thai baht which marked the beginning of the East Asian Crisis. As the CAS was presented, staff argued that a strong rupiah signaled that Indonesia might resist contagion. A mere ten days later Indonesia's Central Bank widened its exchange rate band, the rupiah depreciated significantly, and Indonesia was launched into an economic and social crisis that would soon take on historic proportions.

2. The turmoil in Indonesia over the past 18 months led the Bank to revise quickly the strategy set out in the last CAS. Virtually our entire program and resources have been redirected in support of the government's effort to hold the economy—and the country—together.

3. Continuing economic uncertainty and upcoming general elections in June 1999 have led us to prepare a CAS progress report rather than a full CAS. We plan to prepare a full CAS with the next government when it takes office, probably toward the end of 1999. This CAS progress report provides an update of the government's policy responses and the Bank's program. It then sets out a country assistance strategy for roughly the next 12 to 18 months to protect the poor, stabilize the economy, and lay the foundation for recovery. The period will be dominated by enormous uncertainties associated with the complex political transition to a new government, which will influence greatly the Bank's future role in Indonesia.

II. INDONESIA IN CRISIS: ECONOMIC, POLITICAL AND SOCIAL DEVELOPMENTS

4. **Economic Collapse in a Period of Political Uncertainty.** Just 18 months ago, Indonesia was enjoying its 30th year of virtually uninterrupted rapid growth, low inflation and declining poverty. Trade and capital flows were booming, foreign exchange reserves were plentiful. Prior to the crisis, Indonesia appeared better positioned than other Asian crisis countries on such bellwether indicators of economic performance as GDP growth, foreign exchange reserves, inflation, the external current account balance, trends in the real effective exchange rate, and the fiscal balance.[1] In the last year, however, Indonesia witnessed a dramatic reversal of fortune. The nominal value of the rupiah fell at one point by 80 percent, annual inflation reached almost 80 percent, the economy swung from rapid growth to even more rapid contraction, unemployment and underemployment climbed, and the US dollar equivalent value of the stock exchange fell by more than 90 percent at its low point.

5. Although the Thai crisis may have been the trigger, internal and external conditions combined to move Indonesia's problems from foreign contagion to macro collapse.[2] The proximate causes of the crisis were the *rapid build-up of short-term, unhedged private external debt* in recent years combined with long-standing—and long recognized—*shortcomings in Indonesia's banking system.* As if the financial crisis was not trouble enough, Indonesia was hit by arguably the *worst drought this century*, and, as the crisis continued, by a *collapse in regional demand*, and the *lowest international oil prices in decades.* The country's *critically weak institutions and endemic corruption,* amplified the financial crisis because there were no credible institutional arrangements to offer investors confidence that the crisis would be dealt with decisively, fairly, and effectively, or that the presidential succession issue would be managed smoothly.

6. Indonesia's weak institutional infrastructure has now become one of the main impediments to recovery. Well before July 1997, investors showed concerns about the bureaucracy, red tape, corruption, insider trading, the soundness of the financial system, the weak legal system, arbitrariness of decisions, and the political strength of established commercial

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[1] World Bank. *Indonesia in Crisis – A Macroeconomic Update*, July 16, 1998 (Washington D.C.: World Bank).

[2] World Bank. Ibid.

interests. Many of these weaknesses in public sector institutions stemmed from the highly centralized nature of decision making and lack of autonomy at local government levels; an underpaid civil service; a lack of transparency in budget preparation; and weak audit arrangements. There are widespread perceptions of highly systematic and deeply embedded corruption in many government agencies.

7. **Political transition.** By early January 1998, if not before, it was clear that Indonesians no longer believed a Soeharto-led government had the understanding or authority to do what was needed to release Indonesia from its economic woes. The looming transition caused a collapse in domestic confidence and deepened the country's economic problems. Indonesia's efforts to make the transition from 32 years of Soeharto's highly centralized and personal rule were impeded by the absence of a credible and organized opposition.

8. The end game for the Soeharto regime played out in a complex series of events between January and May 1998, culminating in Soeharto's resignation on May 21st. The May 14 riots are now seen as at least partially orchestrated, but by whom and to what end continues to be debated. Whatever the background, the riots scarred the Chinese Indonesian community deeply.

9. Today, Indonesians are understandably impatient for change. Calls for a "people's economy" and a redistribution of assets from the rich to "pribumis" have acquired considerable popular support and need to be channeled in constructive ways, or else they could do considerable damage. So great are the challenges of change that it is likely to be years before the new Indonesia is firmly established. It is doubtful that the rapidly shifting political landscape (over 100 political parties have been created in the past year) will stabilize or acquire clarity any time soon, certainly not until well after the parliamentary elections in June. Following the June elections, the new parliament is expected to select a president in November, who in turn would appoint a new Cabinet toward the end of 1999.

10. **State of the economy in light of the crisis.** Figure 1 provides a brief graphic history of Indonesia's crisis. High interest rates, a moribund banking system, crushing corporate external debt, and a pernicious external environment are together exerting continued downward pressure on domestic economic activity. GDP is expected to decline by over 13 percent in 1998/99 (i.e. from April to March), with only agriculture (notably tree crops) and mining avoiding contraction. By end-1998, total private sector debt exceeded 60 percent of GDP, and it is estimated that nearly half of Indonesia's private corporations are technically insolvent. Recent months have seen encouraging stabilization in the exchange rate, a significant reduction in inflation and a decline in previously high interest rates. These gains are fragile and set in the context of economic output levels that are expected to stagnate or decline further. Largely because of a collapse in imports, the current account of the balance of payments is expected to be in surplus (about 4-5 percent of GDP in 1998/99) as is the overall balance of payments.

11. **Social impacts.** The great tragedy of the Indonesian crisis is that social gains over the past thirty years—significant poverty reduction, rapid increases in life expectancy and school enrollment, and declines in infant mortality—are now at risk of being reversed. According to preliminary and partial data, poverty has increased from about 10 percent in 1997 to about 14 percent (almost 30 million people) in 1999.[3] Urban areas have been hit harder than rural areas and the people on Java appear to have been affected more than those on outer islands. The new data also show that while some of the poor have been affected badly, others appear to be better off, and many of the newly emergent urban middle classes have been hit the worst of all.

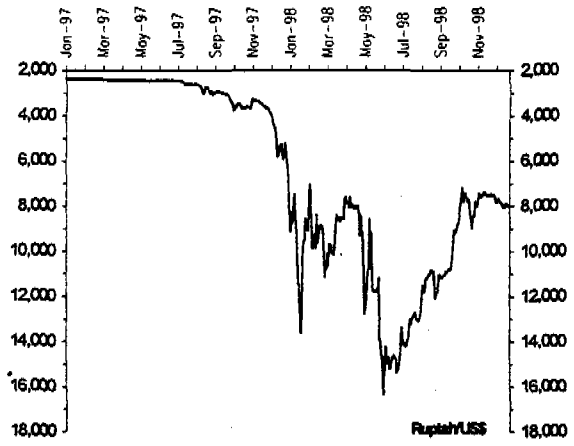
12. As the economy contracted, the demand for labor fell, resulting in layoffs in construction and manufacturing, and in falling real wages. With limited savings and few public sector safety nets, however, few Indonesians can afford to be unemployed for long. Thanks to flexible labor markets, most of them are being absorbed in informal and service occupations, but with significantly lower earnings.

13. The crisis could also affect future earning capacity, as progress in education and health is slowed by lack of resources, especially among the poor. In the past, poor families tended to withdraw

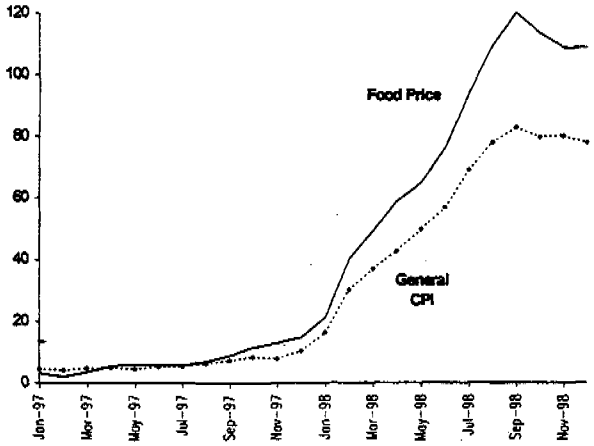
[3] We consider the government's earlier projection that poverty rates will reach 40 percent as analytically flawed and much too high.

Figure 1. Recent Economic Development

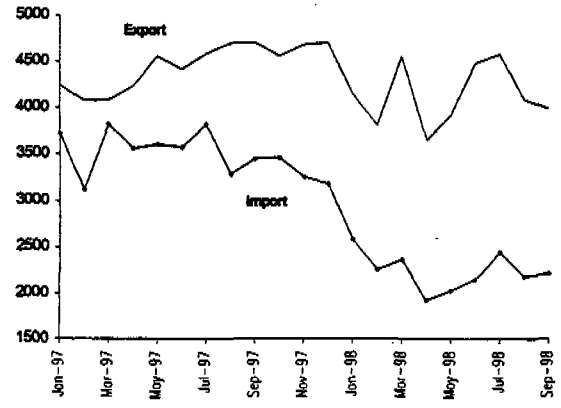
Rupiah appreciates since June 1998
(Daily Rupiah per US$ spot rate)



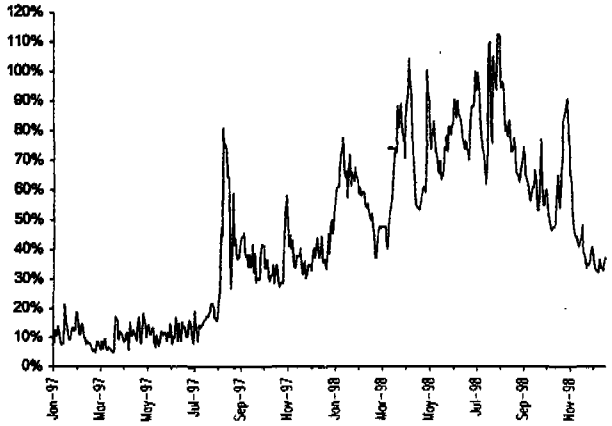
Inflation picks up rapidly, especially food
(12 month Percentage change in Consumer & Food Price index)



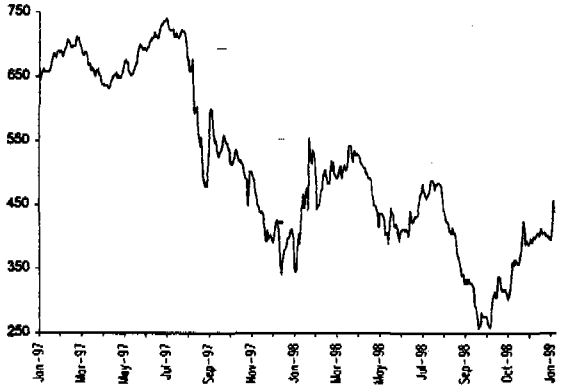
Trade surplus increases
(Nominal monthly export and import in USD Million)



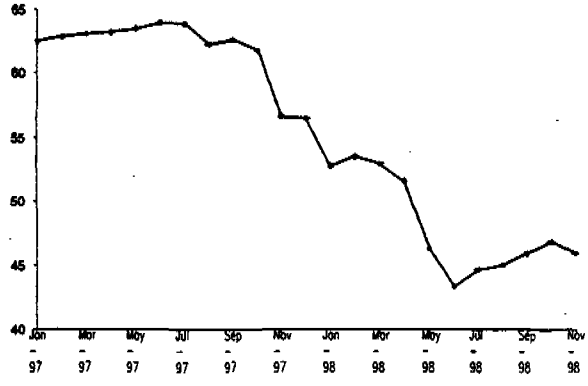
Interest rates rise and then begin to fall
(Overnight interbank call rate)



Stock market crashes
(Jakarta Stock Exchange Index)



Depositors lose confidence in private national banks
(Ratio of deposits in private national banks to deposits in total commercial banks)



their children from school as a way of coping with crisis; to some extent this may be happening again, especially at the junior secondary level. Preliminary survey results indicate that urban junior secondary enrollment is down about 6 percent relative to the previous year. Similarly, health is also vulnerable, as the depreciation of the rupiah has raised the prices of drugs, vaccines, contraceptives, and other necessary medical supplies. The poor and near-poor, including expectant mothers, are now less likely to seek formal medical treatment, immunization coverage appears to have fallen, and these factors, combined with the reduced ability of the poor to purchase staple foods, have raised the risks of malnutrition and micronutrient deficiencies, particularly for infants and children.

III. Policy Response, Outlook, and Challenges

A. The Government's Policy Response

14. The government's response to the crisis in its early days followed conventional wisdom. Immediately after the rupiah was floated in August 1997, the government aggressively tightened monetary policy, doubling interest rates and dramatically reducing liquidity to stabilize the rupiah. But contagion effects, worries about foreign debt service, and political uncertainties pushed the rupiah to lower levels, leading in early October, 1997, to a request for IMF assistance. The government's initial reform program earned little credibility with Indonesians or international investors. But beginning with the presidential transition in May, a more comprehensive and credible agenda was developed. The program had three objectives at its core:

- *stabilizing the economy,* by resuscitating demand to restore production as quickly as possible while stabilizing inflation, the exchange rate, and interest rates; reforming and strengthening the banking system; and restructuring corporations and corporate debt;

- *protecting the poor,* by ensuring the availability of food (especially rice) at affordable prices, supplementing purchasing power of the poor, and preserving critical social services; and

- introducing *structural reforms* to increase healthy competition, reduce corruption, and improve governance.

15. Although progress in implementing this agenda has not been smooth and key elements have been subject to delay, the overall impression has been one of gradual forward movement (Table 1). On the positive side, some progress has been made in stabilizing macroeconomic conditions, establishing frameworks to facilitate bank and corporate restructuring, and implementing significant reforms of trade, competition, and investment policies. The government has also expanded social safety net programs to protect the poor, and launched actions to combat corruption and improve governance and transparency.

16. But progress has been slow and halting, hampered by weak implementation capacity, lack of coordination, insufficient political commitment, and continued political interference. Slow progress on bank and corporate restructuring is of particular concern. In *banking*, the resolution of troubled banks is just beginning while none of the "better" banks has been recapitalized so far. Corporate and corporate debt negotiations between creditors and debtors are proceeding slowly, hindered by recalcitrant creditors unwilling to write off part of their loans, intransigent debtors unwilling to acknowledge their obligations, and early failure of the bankruptcy law to provide an effective exit mechanism.

17. While many government *programs to protect the poor* have been put in place, they have not been implemented speedily and require significant reshaping. Disbursements on the major labor-intensive public works employment programs (*padat karya*) has been slow as many of these programs are new, vulnerable to implementation constraints, and prey to corruption. In addition, they need to be better targeted geographically to meet the urgent needs of the urban poor. After initial difficulties in mid-1998, the state logistics agency, BULOG, has been reasonably successful in ensuring the availability of food and distributing rice to the poor at subsidized prices. But the recent announcement to increase the paddy procurement price will severely weaken BULOG's capacity to maintain rice prices at their current level without large budgetary infusions (or import protection).

Table 1: Assessment of progress in policy reforms

Recent policy measures	Assessment of progress
Macroeconomic stabilization	
• Expansionary fiscal policy to stimulate demand.	Budgetary development expenditures are lower than planned due to late finalization of the budget, appreciation of the rupiah, and cautious implementation of social safety net programs.
• Tight monetary policy to reduce inflation and stabilize the rupiah.	Inflation has slowed, rupiah appreciated gradually through last quarter of 1998, partially reversed in January 1999; nominal interest rates have halved.
Bank restructuring	
• Established IBRA and AMU to resolve troubled banks and collect bad loans.	Complexity, weak political commitment, and inadequate capacity and coordination have slowed progress; troubled banks representing 55 percent of total bank assets transferred to IBRA; three ailing banks closed and four nationalized. Resolution of troubled banks just beginning.
• Tightened procedures for granting liquidity credits; introduced new loan classification and provisioning rules and regulations on bank disclosure; adopted program of regulatory forebearance to give banks until end-2000 to reach 10 percent CAR	Done, but BI's capacity to oversee safe and sound banking system remains weak.
• Developed bank recapitalization program to support core banks; owners would shoulder 20 percent and GOI the rest using bond financing.	No bank recapitalized yet; the cost of bank restructuring may be 30 to 40 percent of GDP.
Corporate debt	
• Establishment of framework for voluntary corporate debt work-outs through Frankfurt Agreement, INDRA, and Jakarta Initiative.	Bilateral restructuring negotiations between creditors and debtors are underway accounting for less than 20 percent of corporate foreign debt, but few concluded so far.
• Amendment of bankruptcy law, and creation of special commercial court.	Limited effectiveness thus far; tendency to favor debtor in the few cases adjudicated so far.
• Removal of tax, legal, regulatory impediments to corporate restructuring.	Underway.
Social safety net	
• Ensuring availability of food through increase and deregulation of food imports, and expanded delivery of subsidized rice to the poor.	Rice prices have stabilized and 20 kgs. per family of subsidized rice is reaching 7.5 m poor families, but may require higher subsidies or import protection to sustain.
• Supplementing purchasing power among the urban and rural poor through large labor-intensive public works programs (*padat karya*).	Implementation problems have slowed progress, and geographic targeting is weak. Some padat karya programs may be prone to corruption.
• Preservation of critical social services by protecting budget allocations for health and education.	Implemented major "back-to-school" program for poor children, and preserved health allocations.
Structural reforms	
• Significant import and export policy reforms, domestic market deregulation, and investment policy changes, and improved forest management regulations.	Important achievements; competition policy needs strengthening and legal enforcement to be enhanced through impartial competent judicial system.
• Initiated anti-corruption actions by canceling tainted govt. contracts, bringing off-budget funds on-budget, developing regulations for competitive project bidding, initiating criminal prosecutions on bribery charges, and initiating national anti-corruption strategy.	Initial progress, although a comprehensive plan is still being formulated, together with a stronger anti-corruption law.
• Proposed draft laws on fiscal and functional decentralization to create autonomous local government at district level.	Draft laws to be submitted for Parliamentary debate during February, 1999, would enable major devolution of functional responsibility to local government.

Box 1: Summary of Anti-Corruption Actvities Undertaken by Government

Since May 1998, Government has made a modest start in designing and implementing anti-corruption measures.

Actions Completed by end-1998

- In June 1998, all GOI ministries were instructed to prepare anti-corruption strategies and to review existing contracts, joint operations agreements, concessions, studies and other work in progress. So far, more than 100 contracts (worth about Rp. 10 trillion) based on improper procurement procedures have been cancelled.
- The Attorney General has brought charges in 102 cases where losses to government are estimated at Rp. 2.4 trillion.
- A public information campaign encouraging citizens to report corruption brought forth 4,500 letters (as of October 31, 1998) in which allegations ranged from embezzlement to land fraud, involving nearly Rp. 1.5 trillion.

On-going Actions

- A new anti-corruption law is being prepared by the Ministry of Justice for parliament's consideration in March 1999.
- The Special Consultative Assembly (MPR) passed a resolution to investigate the wealth of the former President's family.
- An inter-ministerial team is preparing a new Construction Industry Law that will strengthen requirements for registration, qualification and operation of contractors, suppliers and consultants in both public and private sector construction activities nationwide; the law is to be presented to parliament by March 1999.
- An inter-ministerial team is redrafting procurement regulations to further tighten procedures for public sector contracting and improve the transparency of procurement procedures.

18. Finally, reforms to *improve public sector governance and transparency and to combat corruption* are just starting (Box 1). There appears to be broad consensus developing among the government, Indonesian civil society, and the donor community that a generational opportunity is at hand to undertake serious governance reform. Indications are that several initiatives could be started during the period leading up to the election, including anti-corruption actions, civil service reforms, fiscal decentralization, and judicial reforms. There is a danger, of course, that these initiatives may be motivated by short-term political considerations to the detriment of longer-term development objectives, and they will require close monitoring and intensive, constructive involvement by the Bank and others.

B. Economic Outlook

19. **External environment.** The global outlook continues to look grim for Indonesia. Quite apart from depressed international commodity markets (especially for oil), which affects both export and budgetary revenues, the prognosis for Indonesia's East Asian markets looks none too promising. China appears to be decelerating, Japan remains in the doldrums, and neighboring South-East Asian economies are grappling with problems of their own. On the other hand, a buoyant US and Europe has helped Indonesian export revenues, and much will depend on whether the growth momentum in these two large markets can be maintained. Low international interest rates are another bright spot, but they bring little cheer to Indonesia as private foreign capital – whether FDI, portfolio investments, or private debt flows – is unlikely to return in significant amounts any time soon.

20. **Prospects for recovery.** Indonesia's prospects are subject to a wider-than-usual band of uncertainty. The point at which the economy will bottom out and start growing again is hard to predict. Part of the uncertainty lies in Indonesia's main markets in East Asia, and part in continued political uncertainty at home. The Bank's base case projections currently show that GDP is likely to fall by 13 percent in FY98/99, decline slightly (one percent) in FY99/00, before modest growth of 3 percent in FY00/01. This assumes that reforms are implemented speedily and consistently, that the fiscal stance remains expansionary, and that monetary policy eases gradually as prices and the exchange rate continue to stabilize. The turnaround in growth is expected to come from agriculture (partly a rebound from last

year's drought), mining, and from exports of labor intensive manufactures.

21. Were global conditions and/or political developments to take a turn for the worse, clearly Indonesia's recession would be prolonged and its recovery postponed. A reversal in world equity markets and a deepening recession in Japan would seriously impact the economy, as would deteriorating social and political conditions. If global conditions worsen,[4] we project GDP to decline by three percent in FY1999/2000 and remain stagnant in FY2000/01. But it is virtually impossible to project alternative trajectories of social and political developments within Indonesia and the effects they will have on the economy. These will have to be monitored carefully as they occur and their economic consequences assessed on an ongoing basis.

22. **External financing needs.** Indonesia's ability to meet its immediate objectives—stabilize the economy while restructuring banks and corporates and protecting the poor—rests squarely on its ability to obtain adequate foreign financing. So far, the government has wisely avoided financing its fiscal deficit through money creation or bank borrowing, relying instead on foreign borrowing. The budget deficit is expected to remain stable at about 4.8 percent of GDP in FY98/99 and FY99/00. Assuming it can raise significant revenues from privatization and sale of bank assets,[5] Indonesia requires just over US$9 billion in gross disbursements of external finance in FY99/00. Of this, about $4 billion is expected to come from disbursements of project aid and the remainder—about $5 billion—from World Bank and ADB adjustment loans together with special Japanese funding under the Miyazawa Initiative. Estimates of the budget deficit and the external financing needs are sensitive to the exchange rate and the ultimate budgetary cost of bank restructuring.[6]

23. **Creditworthiness.** Indonesia's ability to raise funds has declined even as external financing needs have grown. Domestic demand contraction and the rupiah's real depreciation have helped swing the current account into surplus, but Indonesia faces medium term amortization payments (public and private) of about US$15 billion in FY98/99 and in each of the next four years. Reserves are currently around $23 billion—equal to about 6 months of imports at their current depressed level. Donors have rescheduled most of Indonesia's official bilateral debt, but export credit agencies are reluctant to advance large new credits. Since outstanding private debt obligations will take time to restructure, Indonesian private borrowers will continue to find it difficult to access international capital markets for new loans. Even the government is constrained as sovereign commercial borrowing can only be at significantly higher cost than in the past. Spreads on Indonesia's traded eurobonds were around 1,750 basis points in mid-October, compared to 120 in mid-1997 before the crisis. Rating agencies have downgraded the country's sovereign issues—Moody's to B3, a downgrade of 6 notches, and Standard and Poor's to CCC+, a downgrade of 8 notches.

IV. Bank Group Strategy

A. What went wrong?

24. The speed, scale, and severity of Indonesia's economic crisis defied prediction.[7] Indonesia's collapse flew in the face of decades of strong economic growth and poverty reduction—gains which were real, and which were hailed as models of successful development. Yet, within the space of less than 12 months, it was all beginning to look like a mirage. Where did Indonesia go wrong? Where did the Bank go wrong? What are the lessons? These are

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[4] In line with the downside scenario in GEP 1999.

[5] Cash recoveries from sale of bank assets are (rather aggressively) projected to be about US$2 billion in the FY99/00 budget.

[6] If any of these assumptions were to prove to be too optimistic, or adequate external financing fail to materialize, the government is committed to cutting expenditures accordingly in close consultation with the World Bank.

[7] A recent study of the predictability of economic crises ("Economic Crisis: Evidence and Insights from East Asia", Furman and Stiglitz, November 1998) shows Indonesia as having the largest gap of any East Asian country between the predicted likelihood of economic crisis as defined by what we knew in the first half of 1997 and the actual outcome of the crisis. Indeed, all East Asian countries except the Philippines scored low in terms of prospects for crisis, but Indonesia was in a class by itself.

questions that the Bank as an institution could profitably study with diligence and deliberation, but two messages seem clear at this point. First, Indonesia's crisis was not *principally* a crisis of bad macroeconomic management. For three decades Indonesia's policymakers followed conventional wisdom—ensure a stable economy, invest in human resources, especially basic education, develop according to comparative advantage, stay competitive by keeping borders reasonably open—and it paid high dividends. The great failure of the New Order Government was a failure of *microeconomic*, principally institutional policy. Second, the many successes of Soeharto's New Order Government, coupled with a lack of public debate, fueled an internal complacency that led to its demise. Good news pre-empted bad news. The authorities were deaf to proposals for serious institutional and political reform. Critics were rebuffed. Nobody seemed able to argue with sustained 7% growth, including the Bank which had difficulty making some of its tougher policy advice heard.

25. In successive country reports, meetings of the Consultative Group on Indonesia, and policy discussions the Bank was at once congratulatory on Indonesia's macroeconomic progress and increasingly cautionary over the gathering risks from microeconomic sources -- a weak banking system, growing inefficiencies in the economy created by high-level government interference, and increased borrowing abroad by corporates. Where we failed was in not pushing harder the message that sustainable development requires not only good economic policies, but good institutions as well. When the regional crisis combined with political transition, Indonesia's weak institutions were simply not capable of responding quickly and assuring investors of its ability to weather the crisis.

26. In hindsight, the Bank should have been more assertive in its policy dialogue with Government in some areas. Our failure was best highlighted in the financial sector. The Bank conducted a continuous policy dialogue with Government on financial sector issues alongside a series of lending operations that began in the mid-1980s. By the mid-1990s, however, the final loan in that series, the financial sector development project (approved in FY93), had run into serious difficulties. It was poorly implemented, lacked government commitment, and was cancelled only after long delay. Earlier cancellation might have sent a stronger signal.

27. On governance and corruption, the Bank often raised concerns at the highest levels about the need for greater transparency as an essential step toward improving the effectiveness of public services and creating a more efficient business environment. But in public statements it often diluted the message by euphemisms such as "high-cost economy," "leakage," and "inadequate accounting". Government and Indonesian civil society understood our meaning clearly, but it was not until the 1997 CEM and CGI meeting that "corruption" entered our explicit public vocabulary. We should have done that sooner.

28. The past 18 months have been the most challenging of the Bank's thirty years in Indonesia. They have required a comprehensive review and adjustment of all aspects of the country program at the very time when the Bank's East Asia Region was itself undertaking a major reorganization as part of the Bank's process of institutional renewal. Fast breaking economic and political developments, uncertain country conditions, and the depth, severity, and complexity of the crisis tested the resolve of the Bank's Indonesian team, often leaving them reeling. During the May 1998 riots leading to the overthrow of Soeharto, the Bank's Jakarta office was closed and staff were evacuated. A mere ten days later, staff were once again intensely involved in assisting the new cabinet with containing the economic fallout and resuscitating the reform program.

29. It will require further careful study to understand fully what has happened and how we could have done better. In the meantime, some tentative lessons are emerging. In particular, we will need to pay special attention to: (i) an effective early warning system that measures and monitors key triggers that are known to cause economic crises, including the financial health of banks and corporates; (ii) a clear focus on good governance and transparency in the private sector and government, including the strengthening of oversight and voice mechanisms; (iii) absorbing political, institutional, and social dimensions more fully into our country assessments and supporting poverty alleviation programs more directly than before; and (iv) ensuring clarity, coherence, and integrity in the messages we give government and markets. These initial lessons are in line with the conclusions of a recent OED

evaluation of the Bank's country assistance program in Indonesia.

B. The Bank Group Strategy

30. Fashioning a strategy in Indonesia's confused and complex situation has not been easy. There are economic, social, and political problems wherever we look, and it is difficult to set priorities and ensure appropriate sequencing of our proposed program elements. What may seem sensible today could easily be invalidated tomorrow. We acknowledge the need therefore to keep our strategy under constant review and will almost certainly need to alter it as new information becomes available and circumstances change. Indonesia is entering uncharted waters, and in some sense the Bank Group has no comforting landmarks according to which it can set its course.

31. It is with this cautionary introduction that we put forward our proposed strategy for the next year and a half. Broadly, we expect to focus on three areas:

- Consistent with the Bank's overarching mission, we set as our highest priority the *reinforcement of social safety nets* to help protect the poor and preserve human assets during these most difficult times.
- We will work with other development partners in support of government efforts to *stabilize the economy* by helping restore banks and businesses to financial health, maintain physical assets, and resume growth.
- In recognition of the institutional basis of this crisis, we will build a foundation for launching an aggressive program for *strengthening institutions to support sustainable growth* in the future, including public sector reforms and anti-corruption measures.

32. On the surface, this strategy bears similarities with the one described in the 1997 CAS.[8] But in its details, the differences are striking. For example, we have temporarily abandoned our emphasis on infrastructural development (although we still stress the importance of maintenance), our focus on macroeconomic stability emphasizes the restructuring of the financial and corporate sectors, our stress on protecting the poor involves direct measures in support of the government's social safety net programs, and we are giving considerably added significance to better governance and anti-corruption.

33. The competing challenges we face have created real and difficult tensions within the program. On the one hand, macroeconomic considerations argue for substantial levels of external financing to help stimulate domestic demand and avoid inflationary domestic financing. On the other, weak institutions, the specter of corruption and a government with questionable legitimacy in the eyes of some suggest a more cautionary approach until the next government is in place. Faced with these competing viewpoints, we have consulted extensively with Indonesians from across the political and ideological spectrum—opposition leaders, religious leaders, women's groups, students, NGOs, the business community—to determine our course of action. All sent the same message: Indonesia's future will depend on whether the current government is able to institute the reforms necessary to get the economy working again, and to implement social safety nets that maintain domestic confidence and social stability. Time and again we were told that if this government fails in either of these areas, the prospects for success of the next government will be dim indeed.

34. Government officials and most opposition leaders agree that as Indonesia waits for a new government to emerge, economic and social stability must be nurtured if the country is to have any chance of success. The Bank Group, through its program, can play an important supporting role in this regard. We recognize however that we operate in a highly uncertain and complex environment, and the Bank's role in helping to solve the enormous challenges is limited. The following sections describe the main elements of our strategy to achieve these ends. Details, including specific instruments and operations, are given in the accompanying country assistance strategy matrix.

1. Reinforce Social Safety Nets

35. Fortunately, recent data on the extent and impact of the crisis reveal a picture that does not

[8] The strategic objectives in the previous CAS were: maintaining macroeconomic stability, strengthening the private sector, improving infrastructure services, enhancing human development, and promoting legal, institutional, and administrative reforms.

support the need for country-wide subsidy programs. This new information provides critical input into the design of *targeted* programs to reach the poor. We will ensure that we maintain the momentum of our data collection efforts (including regular updates of poverty estimates and the regional and gender dimensions of poverty) so that program designs can be periodically adjusted for maximum effectiveness.

36. Our social safety net efforts are focused on ensuring the availability of rice to the poor, providing jobs through public works and other community-based labor-intensive programs, and delivering basic education and health services. In addition to improving poverty targeting, the Bank aims to help the government consolidate and strengthen its social safety net programs in three ways: (i) by safeguarding funds from fraud and misuse, (ii) by ensuring adequate government budgets for key social expenditures, and (iii) by building on the positive lessons from decentralized programs that have empowered poor communities and emphasized transparency and independent verification of performance. Starting in late 1997, the Bank made amendments to *ongoing projects* to add or expand components creating low-paying jobs, supporting poor students and schools through a successful "back-to-school" campaign, and financing critical health services. More recently, a social safety net adjustment loan is being prepared to safeguard government and donor efforts to help the poor, and to ensure that funds allocated to these operations are protected. We cannot emphasize enough the difficulties we are facing in designing this loan in a way that it ensures good governance in public expenditure management while at the same time meeting the immediate resources needs of the economy.

2. Achieve Short-term Stability and Restart the Economy

37. ***Restore macroeconomic stability.*** Stabilizing the exchange rate and lowering inflation are central to recovery. The IMF is leading the effort on these fronts by combining an expansionary fiscal stance to stimulate domestic demand with flexible monetary policy to keep inflationary pressures in check. This stabilization program has struggled to balance inflation and exchange rate goals against the need for credit to allow the economy to recover. The Bank is providing assistance through adjustment lending for budgetary support, development of a program to reduce subsidies, and analytical work on public expenditure priorities and processes to ensure consistency with social safety net and other policy objectives.

38. ***Restart the banking and corporate sectors.*** This is perhaps the most complex element of the reform program, where the appropriate sequencing of actions is not immediately obvious and the resource, administrative, institutional, and political constraints are many. Considerable time has elapsed in setting the legal and policy foundations for restructuring actions by government and the private sector.

39. Indonesia's immediate priority is to re-establish banking services and get corporations hiring and producing again. To help re-establish banking services, the Bank is working closely with the IMF and ADB in supporting actions to: (a) strengthen the Indonesian Bank Restructuring Agency (IBRA) and resolve problem banks (through merger, sale, or closure), (b) strengthen a core of potentially viable private banks through recapitalization, (c) merge four state banks and beginning in earnest the restructuring of the other two, and (d) recover debts and restructuring assets transferred to IBRA's asset management unit (AMU).

40. The Bank is also supporting efforts to encourage and facilitate creditors and debtors in corporate restructuring, as well as to improve standards of corporate governance. The Bank has been active in supporting the Jakarta Initiative (JI), which provided a framework for debtors and creditors to negotiate restructuring plans for potentially viable debtors with the help of expert mediators. Jointly with the IMF, the Bank has helped the government to sharpen the Bankruptcy Law and train judges in its interpretation. By engaging in active workouts with companies in its portfolio, IFC is demonstrating how orderly restructuring can be arranged for viable companies. Enforcement of lenders' rights is a key element in this process.

41. In addition to being engaged in active workouts with companies in its portfolio, IFC concluded, in one case, that the only possible way to recover its loans was to engage in bankruptcy proceedings. Based on the experience of bankruptcy litigation to date, IFC continues to have concerns and is reconsidering some of its programs originally planned for FY99. In the meantime, the Bank will continue to assist the

government and the judiciary to improve the implementation of these reforms. The proposed corporate restructuring TA project will include support for training of commercial court and supreme court judges to improve implementation of the new bankruptcy system.

42. ***Trade finance and SME support.*** In both these areas, we will be challenged to provide meaningful support. In trade finance, we will assist government in redesigning their export finance guarantee scheme and provide better linkage between preshipment and postshipment export financing mechanisms. In this context, IFC is preparing an operation that helps to renew and guarantee trade finance for a group of Indonesian exporting industries which, if successful, could be duplicated in other industries. As far as SME development is concerned, we will work together with ADB in helping government develop international best-practice credit schemes for SMEs, promote appropriate lending technologies, introduce measures to reduce transactions costs, improve the effectiveness of existing venture capital schemes, and establish management training institutes along lines already proven to be successful in Indonesia.

43. ***Preserve existing physical assets.*** With funds increasingly short for new infrastructure, maintaining existing facilities takes on added meaning. The public utilities (particularly the state electricity company PLN) have been hit badly as they face political constraints to raising tariffs. Here, the Bank's strategy is first to restructure our portfolio to support maintenance activities and second to help the government set public expenditure priorities for maintaining current service capacity in the electric power system, the transportation network, urban and rural infrastructure, and in restructuring the public utilities.

3. Strengthen Institutions to Support Sustainable Growth

44. To this point we have concentrated on the Bank's program to help Indonesia meet the immediate challenges created by the crisis. But, as we have learnt painfully from the Indonesian crisis, the institutional foundations of the economy must lie at the very center of .policy reform package, otherwise the recovery could prove short-lived.

45. ***Strengthening public sector institutions.*** We have made improving the efficiency and transparency of public sector institutions and reducing corruption an integral part of *every* Bank operation in Indonesia. We will also pursue this agenda through analytical work, policy dialogue and lending operations. While our strategy addresses important components of institutional reform, the agenda is evolving and there is a need for further consensus building with government and civil society.

46. To provide the next government with a foundation from which to implement broader public sector reforms, the Bank will undertake extensive *analytical work* over the next six months on civil service reforms, legal reforms, budgetary processes, institutional effectiveness reviews, and surveys of public service delivery standards. We intend to launch a National Institutional Review which will provide the Bank an objective assessment of current institutional issues and suggest priorities for reform and capacity building. We will also provide advice on governance-related laws currently being drafted for consideration in the legislature, including laws on anti-corruption as part of the national anti-corruption plan (Box 2), central-local financial relations, local government autonomy, and procurement arrangements, especially in construction. The crisis-driven slowdown in Indonesia's urbanization process also provides an opportunity to rethink city management. The Bank will pursue opportunities for policy reforms in water supply and sanitation, urban management, and city development strategies. Our *lending operations* will fully integrate these governance reforms, including the forthcoming structural adjustment loans, and a proposed special

Box 2: National Anti-Corruption Plan

The Bank is working with government, other stakeholders and Indonesian civil society to develop a strategy to combat corruption in public sector operations. Preliminary recommendations focus on actions to safeguard the government's social safety net programs from misuse of funds, making immediate progress on transparency and information actions such as freedom of information measures, whistleblower protection, conflict of interest rules in public decision making, establishing institutional mechanisms for developing and implementing a national anti-corruption strategy, and initiating action on the longer-term governance reforms.

Table 2: Governance Program: Links Between Reform Areas and Proposed Operations

	Proposed Reform Areas for ESW/Diagnostics					
Lending Program	National Institutions Review (NIR)	Anti-Corruption Strategy	Fiscal Decentralization	Civil Service Reforms	Budget Processes	Legal & Judicial Systems
Adjustment operations						
PRSL II (99)	○	●	○	○	●	○
SSNAL (99)	○	●	○	○	●	○
PRSL III (00)	●	●	○	○	●	●
Governance PSAL (00)	●	●	●	●	●	●
SECAL I (00)	●	●	●	●	●	○
Investment/TA projects						
Governance TA (00)	●	●	●	●	●	●
Basic Education IV (00)	●	●	●	●	●	○
Provincial Health II (00)	●	●	●	●	●	○
District Health (00)	●	●	●	●	●	○
Irrigation Sector (00)	●	●	●	●	●	○
Decentralized Agriculture (00)	●	●	●	●	●	○
W. Java/DKI Env. Mgmt (00)	●	●	●	●	●	●
Lombok Urban (00)	●	●	●	●	●	○
Water Sect. or Urb. Sector (00)	●	●	●	●	●	●

Note: Diagnostics in the two other major reform areas are being supported by parallel efforts: Taxation Policy Reform by IMF, and Land Policy Reform by on-going project and AusAID assistance.

public sector reform loan (Table 2). This program will create a framework within which nearly every major segment of Indonesian society—government, civil society, NGOs, academics, media, private sector, and the international donors—can work together to tackle issues of governance and public sector reform.

47. ***Strengthen the institutional foundations for an efficient financial system.*** Beyond the immediate needs of restoring core banking services and resolving the problems of insolvent banks is the longer-term goal of strengthening the institutional foundations for an efficient financial system. Achieving this goal involves strengthening banking laws and regulations, creating the institutional capacity for effective banking supervision and enforcement, requiring greater financial transparency through better reporting and auditing of banks, developing more effective legal infrastructure and institutions for capital market development, and providing extensive training to overcome capacity weaknesses.

48. ***Strengthen the institutional foundations for healthy competition.*** The Bank will work with government and non-government institutions to improve the legal and institutional foundations for healthy competition in trade, production, and labor markets. It will continue its support for reforms in trade and investment policy; assist in the preparation of the new competition law and the establishment of the institutional structure for its enforcement; strengthen corporate governance by building institutional capacity for crafting, disseminating, and enforcing codes of best practice based on OECD guidelines; by helping institutions (government and non-government) supporting small scale industry and agriculture[9]; by assisting the government in carrying

[9] In agriculture, the focus will be on alleviating distortions and inefficiencies in commodity marketing and input supply, and addressing natural resource management constraints (forestry, water).

Box 3: Anti-Corruption Action Plan for Bank-Financed Activities in Indonesia

In September 1998, we prepared an internal action plan for protecting the integrity of Bank-financed activities in Indonesia as part of our global and regional initiative in combating corruption and in the context of Indonesia's National Anti-Corruption Plan (Box 2). It is a rolling plan, updated three times already. The goal is to create within the staff an environment of *zero tolerance for corruption* in which we do everything in our power to ensure that corruption is minimized in activities the Bank finances -- every opportunity to improve procedures is taken, managers are accountable for sound implementation arrangements, indications of malfeasance are pursued immediately, staff are rewarded for measures taken well, and sanctions are applied to staff and managers who do not adhere to this policy. The plan has two broad components to create this environment: *processes* and *people.*

Processes are being put in place that address the proper use of Bank financial resources through:

- Toughening procedures on procurement. Examples include increased emphasis on transparency in tendering and ex-post technical audits. RSI has recruited new procurement staff and is working to certify others. A Country Procurement Assessment Report will be completed before the end of FY99. The Bank assisted GOI in preparing its current procurement guidelines, which meet WTO and other international standards, and we are working with the ADB and GOI to further strengthen these guidelines in early 1999.
- Strengthening financial management. Upgrading the quality, transparency and impact of audits is a priority. RSI has employed a full-time audit specialist since the early 1990's; we have recruited a new financial management specialist; and we expect to add another soon. Strengthening of GOI's audit capacity and performance is featured in our governance work program. There are indications that the State Audit Agency's performance has improved in recent months as the reform movement gains momentum, and we are providing lending and non-lending support to the Parliamentary Audit Agency.
- Mainstreaming anti-corruption efforts. Focus has been on improving project designs, increasing transparency and involvement of civil society in oversight of project implementation, and establishing a mechanism for investigation and resolution of complaints. RSI has appointed an Acting Coordinator for Corruption Allegations in August, 1998, and has maintained a Corruption Allegation Database since then. Civil society consultation and participation is a regular feature of most Indonesia projects. We now encourage involvement of NGOs and the press in monitoring of portfolio projects, and we are coming to rely on them in checking results on the ground for new decentralized projects.

People are supported to implement these procedures through:

- *Improving knowledge and skills.* Increased priority has been given to training in procurement, financial management, project preparation and supervision, and corruption detection and minimization. A staff handbook on dealing with corruption is under preparation.
- *Providing adequate resources.* We have increased average supervision budgets by 8 percent and increased effort to coordinate anti-corruption measures so as to make efficient use of available resources, for example by encouraging inter-sectoral cooperation in dealing with allegations. The Acting Coordinator for Corruption Allegations is responsible for helping task leaders to find approaches and resources so they can address corruption allegations most effectively.
- *Offering incentives to follow through in tackling corruption.* Key measures include managerial participation in follow-up, shielding staff from possible adverse pressures, and attention to personal security. Managers and Headquarters-appointed staff intervene whenever local staff find themselves in compromising positions, and staff most active in pursuing corruption have been assigned increasing responsibilities.

out its plan for the reform of state owned enterprises; by establishing transparent frameworks for private provision of infrastructure; and by helping government formulate a framework for industrial relations and social insurance in an era of growing labor freedoms.

49. ***Emphasize institutional strengthening in support of human resource development.*** Beyond the immediate crisis response to preserve gains in education and health, the Bank remains strongly committed to supporting Indonesia's human resource development institutions. In education, the aim is to help create accountable and financially sustainable service delivery arrangements through greater decentralization of education management and increased autonomy of schools. We will, of course, continue to assist government in improving basic

education quality and increasing access to junior secondary education. And we plan to develop programs that target youth who cannot be reached by conventional schooling systems, especially young people forced out of school by the economic downturn. Similarly in the health sector, our medium-term strategy is to help government decentralize services to local governments and communities who are better able to plan and target the appropriate groups. Government's role would shift to safeguarding basic health services for the poor and under-served, and providing supportive and high-quality accountability, regulatory, and accreditation frameworks.

50. ***Strengthen environmental and social institutions.*** The Bank has placed environmental management and social development issues high on its near and medium-term agenda. The program emphasizes improved management of Indonesia's water, forest, and coastal resources, and cleaner urban air. Our non-lending services in FY99-00 will include an update of the 1994 environment sector report which will focus on sectors most vulnerable to unsustainable patterns of development during the crisis and recovery – forestry, mining, plantation crops and fisheries. In each of these sectors, the report will assess the short-term impacts of increased poverty, urban unemployment, and possible urban-rural migration on sustainable resource management. In the medium-term, the program will emphasize strengthening environmental institutions as well as addressing needs of Indonesia's women and vulnerable minorities, strengthening its civil society institutions, and developing its cultural assets. We will also emphasize support of community-based natural resource management, mainly through lending in partnership with the Global Environment Facility and non-lending services. Consistent with findings of our review of integrated conservation and development projects in Indonesia completed in FY98, we will seek to ensure sustainable management of a large network of protected areas. Keys will be decentralization of management authority, promotion of livelihood systems based on sustainable use of biodiversity, and building of local constituencies for environmental protection through awareness campaigns that promote local cultural and natural heritage.

C. The Bank Group program

51. All components of the Bank Group program—portfolio management, lending, and non-lending services—have been reshaped in response to the crisis. This has involved exploring new lending and non-lending instruments, accelerating lending for projects that address poverty alleviation or structural reform, shaping a series of reform packages with the government and in consultation with the IMF, redirecting our economic and sector work, stepping up donor coordination efforts, monitoring crisis impacts, laying the groundwork for anti-corruption measures and reform of public sector management, and restructuring our portfolio of investment projects. Much of this has involved new areas of expertise for Indonesia and the Bank, and continued pressure on the Bank's Indonesia team to deliver a broad range of crisis assistance.

52. ***Portfolio management.*** The crisis has severely affected the Bank's portfolio of ongoing projects in Indonesia. It led to a significant quality deterioration with only 74 percent of projects rated satisfactory in end-FY98 as compared to 90 percent in end-FY97. A total of 53 percent projects were at risk in FY98. Disbursements slowed from 19 percent in FY97, to 14 percent in FY98. The proximate causes have been: (i) cutbacks in counterpart funds as fiscal resources were squeezed and spending priorities altered; (ii) severe financial problems in some of our corporate sub-borrowers, especially the state power utility PLN; (iii) private contractors involved in project implementation which faced similar difficulties; and (iv) an estimated savings of more than $1 billion across the portfolio due to rupiah depreciation. At the same time, there has been increasing attention to possible misuse of funds in Bank-financed projects in Indonesia, and the new openness of debate and free press has led to an increased number of corruption allegations in our projects. In response, we have undertaken a thorough review of the application of Bank controls and procedures in the portfolio and developed actions to further strengthen internal processes and incentives to address such allegations. (See below.)

53. Our response to deterioration in the portfolio began with a CPPR done jointly with ADB in December 1997. This started a project-by-project assessment of the relevance of projects and their components, adjustment of implementation schedules, assessment of savings, and identification of opportunities for reallocation and/or cancellation of

Table 3: Portfolio Improvement Plan: Investment Portfolio Benchmarks, FY97-01

Indicators	FY97(A)	FY98(A)	FY99	FY00	FY01
% Project at Risk (No.)	15.5	53.5	35.0	20.0	12.5
% Actual Problem Projects (No.)	9.0	25.0	20.0	15.0	10.0
% Realism Index	63.6	47.4	58.0	75.0	80.0
% Pro-activity Index	50.0	71.4	100.0	85.0	85.0
% Disbursement Ratio	18.8	14.0	15.0 a/	20.0	20.0

a/ The disbursement ratio would increase to 20 percent if US$1 billion cancellation is taken into account.

loan commitments. This provided the raw material to launch a full portfolio restructuring involving (i) increases in disbursement percentages to offset shortfalls in counterpart funds; (ii) reallocation of loan funds to activities in support of crisis emergency needs;[10] and (iii) cancellation of about $1 billion of low priority project components and savings.

54. At the same time, we completed and issued a Portfolio Improvement Plan to return portfolio performance to pre-crisis levels. Cross-sectoral initiatives focus on: (i) implementation of an anti-corruption action plan (see Box 3); (ii) an enhanced CPPR process engaging government and other partners (ADB, selected other donors and civil society); (iii) further decentralization of project supervision responsibility to the resident mission, and (iv) further strengthening RSI capacity for support of portfolio management Benchmarks for portfolio improvement are shown in Table 3.

55. Three sectors with problem projects will be central to portfolio improvement: *energy*, which may not improve rapidly because of protracted problems with PLN; *rural* development; and *urban* development, which will require enhanced implementation support. Follow-up will focus on implementing the government's power sector restructuring policy plan as the basis for financial recovery of PLN and reassessing the rural development portfolio for further restructuring.

56. ***Lending program and scenarios.*** The 1997 CAS proposed a lending volume of $4.5 billion over three years (FY98-00) based on annual investment lending in the order of $1.2-1.5 billion. Lending in FY98 amounted to $703 million as a number of large energy projects were deferred due to the crisis. In addition, the Bank initiated new adjustment lending in early FY99.

57. ***Base case scenario.*** Our current base case scenario proposes to lend about $4.9 billion during FY98-00 , including $3.2 billion (about two-thirds) of adjustment lending and $1.7 billion in investment lending (Table 4). *Adjustment lending* to help finance government's budget needs would consist of: (i) a series of structural adjustment loans focusing on consolidating recent gains in stabilization, implementing structural reforms that would contribute toward an early recovery, and protecting human and physical assets; (ii) a social safety net loan designed to ensure budget support for critical social services, improved design of targeting mechanisms for the poor, and adoption of anti-corruption measures to protect SSN programs; and (iii) two to three sector adjustment loans that might focus on covering public sector management, agriculture, forestry, water resources and/or energy.

58. The adjustment package would include $2.0 billion disbursement in FY99 as part of the financing package pledged during the July 1998 CGI donor meeting (of which US$1.0 billion was already approved in July 1998). Since the stock of outstanding loans to Indonesia is already close to the Bank's concentration limit for a single large borrower, each dollar loaned this fiscal year would be one less dollar loaned next fiscal year. Despite this, and despite the obvious risks, we have taken a conscious decision to front load the lending program because we believe that the Bank's continued involvement in Indonesia is the best service we can provide the next government. The amount of adjustment lending proposed for 1998/99 nevertheless represents a reduction of $1 billion from the Bank's July 1997 pledged support in response to declines in government financing needs (para. 21). In view of

[10] For example, labor-intensive publics works activities in urban and rural projects, scholarships to allow children of poor families to return to school, and emergency health needs.

Table 4: Lending Commitment Scenarios and Volumes, FY98-00

	FY98	FY99	FY00		
	Actual	Estimate	Proposed	Proposed	Total
Base case:					
- Adjustment	-	1,000.0	1,400.0	800.0	3,200.0
- Investment	703.2	66.2	305.4	620.0	1,694.8
- o/w proposed IDA	-	-	*135.0*	*175.0*	*310.0*
Total	**703.2**	**1,066.2**	**1,705.4**	**1,420.0**	**4,894.8**
Low case:					
- Adjustment	-	1,000.0	-	-	1,000.0
- Investment	703.2	66.2	245.4	390.0	1,399.8
- o/w proposed IDA	-	-	*100.0*	*100.0*	*200.0*
Total	**703.2**	**1,066.2**	**245.4**	**390.0**	**2,399.8**
Memo item:					
Net flows in base case b/	(753.3)	110.5	1,048.3	376.0	781.5

a/ Actual to date plus proposed equals total expected for FY99.

b/ Net flows is defined as gross disbursements less amortization, interest, fees, and charges.

the restructuring of the lending program, the *investment lending* is reduced to about US$400-700 million per year. Emphasis is on education, health, poverty alleviation, rural development, and technical assistance in bank and corporate restructuring and governance reforms. As lending shifted to social sectors and fiscal resources became scarce, the Bank financed a rising share of local costs in investment projects. The projected average three-year cost sharing ratio now exceeds 70 percent for FY98-00, compared to 48 percent in FY95-97. The base case lending scenario for FY98-00 is shown in Annex B3.

59. Conditions for the base case scenario are closely related to improved policy and governance performance pursued by our proposed adjustment loans, and would include:

- Maintenance of a stable macroeconomic framework and allocation of development expenditures in the 1999/00 budget acceptable to the Bank;
- Continued implementation of financial sector reforms, especially concluding transparent resolution of at least 40 banks and transfer of bad debts from resolved banks to the asset management unit;
- Further improvements in key governance areas, including submission to Parliament of an anti-corruption law (including provision for establishment of a permanent body responsible for investigating corruption involving public officials and judges), fiscal and administrative decentralization laws, and a competition law, acceptable to the Bank;
- Next steps in an ongoing program of forestry policy reforms to further increase efficiency and sustainability; [11]
- Establishment of a mechanism for overseeing and monitoring implementation of social safety net programs that is acceptable to the Bank, and the design and launching of a campaign to monitor effective use of funds for each key safety net program;
- Continued improvement in portfolio performance, in line with PIP portfolio benchmarks (para. 47).

60. ***Low case scenario.*** As we have emphasized, three great uncertainties loom over the planning period of this interim CAS (FY99-00). The first is the evolution of the economy, the path of recovery, and the likelihood of increased volatility. The second is the ability of the social fabric to keep from tearing as the country goes through wrenching economic adjustment and fundamental democratic

[11] In particular, the introduction of a performance bonding system covering concession management, , continued use of the resource rental taxation formula to capture at least 60 percent of economic rent, transparent reporting of independent forest operation inspection teams and the reduction of export taxes on logs and sawn timber to a maximum of 20 percent.

transformation. And the third is the unfolding of political events in the period leading up to the elections and in the character and makeup of the next government. Each of these three dimensions is dependent on the other, and their interactive dynamics could produce a wide range of outcomes, from a stable, responsible government at one extreme to social, political and economic collapse at the other. Quite clearly, in the worst case scenario, if the country conditions were to deteriorate very sharply in any of these three dimensions, then we would return to the Board with recommendations for emergency action. More likely, however, would be a less extreme range of low case scenarios, involving an increase in economic volatility, and/or faltering reform commitment by the current or future government. In those scenarios, we would defer additional adjustment lending and re-evaluate the level and mix of our investment lending .

61. ***IDA credits.*** Indonesia last received an IDA credit in FY80. With greatly diminished access to capital on commercial terms during the past year, and with declining per capita income, Bank management has determined that Indonesia is again IDA eligible, but that this will be for a limited time to assist the country to cope with social sector issues during the current difficulties. Assuming continued progress on structural and governance reforms as well as demonstrated capacity to utilize IDA resources well (in line with IDA's performance criteria), we propose an IDA lending program of SDR 300 million (about $400 million at the current exchange rate) during the three-year period FY00-02, for projects focusing on poverty alleviation and the social sectors. Within this resource envelope, we will continue to monitor Indonesia's access to IDA resources based on improved policy performance in the structural and governance areas. In the above low case lending scenario, IDA lending is envisaged at a level about one-third lower than the base case if we can identify operations with a positive impact on poverty reduction even in the absence of satisfactory progress in policy performance.

62. ***Non-lending services.*** The momentum and priorities of our ongoing program of non-lending services will last through the rest of this fiscal year as well as the next. Our program is being driven by two considerations: first, the importance of monitoring closely the evolving social consequences of the crisis and providing relevant advice on appropriate policy and budgetary interventions; and second, the critical need for continued effort in the two core reform processes that will drive Indonesia's economic recovery—bank and corporate restructuring, and institutional development for better private and public sector governance, including better environmental management and more effective participation of civil society. Specifically, we will focus our efforts on monitoring trends in poverty and social indicators, improving budgetary allocations and processes, updating our financial sector strategy, developing a better legal and institutional framework for corporate restructuring and governance, and reviewing national institutions including the civil service, the judicial system, and fiscal decentralization. We will also provide advice on policies for industrial relations and social insurance in this difficult period of continued disruption in labor markets and a new era of heightened activity among labor unions.

63. With this year's elections, the Bank faces for the first time in three decades the prospect of working with an entirely new cast of government counterparts. If a change-over occurs, there will be a critical need to brief a new generation of policymakers on macroeconomic and sector issues, and to provide assistance on institutional development, including issues related to the civil service, local government development, judicial systems, and center-local fiscal responsibilities. Our non-lending services program is designed to give the Bank a basis on which it can build a productive working relationship with the new government.

64. ***Bank Group partner activities.*** IFC's $900 million portfolio of 42 existing corporate clients in Indonesia has been hard hit by the crisis. As with the corporate sector more generally, major problems involve external debt service and a virtual closure of trade and working capital finance. IFC now has 14 clients in arrears or with needs for rescheduling, and has responded by increasing its presence in Jakarta. It is at an advanced stage in a number of loan reschedulings and in one case, is engaged actively with other lenders in working with a client in winding down it's the client's operations. These actions are serving as models of voluntary debt workouts encouraged under the Bank-assisted Jakarta Initiative. At the same time, IFC is assisting export-oriented clients to acquire medium-term working capital financing while it is in the process of establishing a trade finance facility with a number of international

banks. IFC is also working on a corporate restructuring initiative to assist non-IFC client companies stabilize their operations and repair their balance sheets. While FIAS is providing advice for simplifying foreign investment procedures in the Eastern Islands, IFC is weighing a possible project preparation facility there.

65. MIGA's current exposure in Indonesia is US$80 million, including a first transaction under its new Cooperative Underwriting Program designed to provide additional coverage from private insurers under a single policy. The crisis has led to renewed interest in MIGA coverage for financial, fisheries, power, transportation and manufacturing sectors, with applications and inquiries involving potential investments in excess of US$4 billion. MIGA's Investment Marketing Services Department continues to offer practical support for attracting foreign investment in promising sectors.

D. Consultations and Partnerships

66. The Bank's Indonesia program made significant progress over the past five years in developing strong working relationships with our major development partners, including NGOs—both national and international—active in Indonesia. Many of these partnerships have strengthened during the crisis, and have helped us respond better to Indonesia's changing needs.

67. Since the crisis began we have held regular consultations with civil society and the NGO community to present our views and seek their comments and feedback. In view of the rapidly changing political and social landscape, we are in contact with various emerging political and civil society groups to communicate the position of the Bank as development institution for *all* Indonesians. In preparing the CAS progress report itself, there have been private meetings with prominent civil society representatives and public meetings with NGOs to discuss the overall Bank program and agenda. In our anti-corruption actions we have held a series of meetings with concerned NGOs to discuss the widely publicized reporting of corruption in Bank activities and how the Bank can work with NGOs to avoid such problems in the future. In addition, in preparing our adjustment loans there have been several public meetings, both with NGOs as well as private sector and the media on various dimensions of the programs. Enhancing the involvement of civil society and NGOs in monitoring activities is a key element of the proposed social safety net loan and this has involved extensive discussions and consultations with NGO groups. In preparation for the proposed water sector adjustment loan, there was an extensive program of regional meetings to discuss the social and environmental implications of the suggested reforms. We will continue to broaden our communications with civil society representatives as we further develop our program.

68. We have stepped up our donor coordination efforts, particularly in support of initiatives to address the social aspects of the crisis. Since early 1998, the Bank has held regular donor coordination meetings in Jakarta to report on the impact of the crisis and review donor response. In April, the Bank organized a special one-day donor conference in Washington. The Bank-chaired CGI meeting held in Paris in July engendered a frank and constructive dialogue between donors and the authorities on sensitive issues such as governance, corruption, poverty, and complex financial sector reforms, and led to a $7.9 billion support package.

69. In addition, we have built a productive working relationship with the IMF since its return to Indonesia. As the crisis deepened and dragged on, a sense of trust and common purpose developed between the two teams, especially at the working level. The location of Bank country management in the field greatly facilitated liaison and collaboration with the virtually continuous Fund missions since January, 1998.

70. We also work closely with the ADB. The ADB's portfolio and lending program in Indonesia is similar in size and composition to the World Bank's. The ADB's operations are guided by an interim strategy that focuses on: (i) support for policy and institutional reforms in key economic sectors; (ii) strengthening social safety nets for vulnerable groups; and (iii) reprioritizing its loan portfolio in Indonesia. It's lending now also involves important adjustment and program lending, including for financial sector and public resource management reforms, and social protection measures in education and health. We have worked closely with ADB on banking reforms, measures to address social impacts of the crisis, and on the extensive restructuring of our respective portfolios through joint CPPR meetings with the

government. Similarly, we have been in close touch with other major donors, including OECF and JEXIM, on possibilities for co-financing.

E. Bank Exposure and Risks

71. **Bank exposure**. Based on the above base case lending scenario of about US$4.9 billion in FY98-00, including US$3.2 billion in adjustment lending, Indonesia is projected to approach close to the Bank's concentration limit of US$13.5 billion for a single large borrower in FY00-02 This scenario therefore limits the scope for additional lending in future years to about US$1.2-1.3 billion a year. At the same time, Indonesia's exposure would stay below ten percent of the total IBRD portfolio. IBRD's share in Indonesian public debt service is now about 20 percent, up from about 17.5 percent in FY97/98. The share of preferred creditor debt service is below the 35 percent guideline in FY98/99, but is expected to exceed the guideline in following years. Debt service to IBRD relative to exports of goods and services is projected to be slightly above 3 percent during 1998-2000.

72. **Risks**. It should be clear from the preceding discussion that the Bank's Indonesia country assistance strategy is subject to considerable risk and uncertainty. While indications of economic stabilization are starting to emerge, much will depend on on-going implementation of the economic reform program and on the political transition about to take place. Six major risks could undermine effectiveness:

- *Uncertainty over the political transition.* With relatively open elections for the first time in more than 30 years next year, it is unclear which political coalition will emerge in the country's new leadership and whether or not it will be durable. The next government could range from highly interventionist to highly market oriented in its development philosophy. And, of course, the credibility of the next government will depend on the public's perception of fairness in the election process.

- *The possibility of increasing social unrest and violence, particularly in urban areas,* resulting from a combination of slow recovery, growing unemployment, and ongoing political uncertainty.

- *The continued fragility of the banking system and pressure for rising government expenditures* could undermine the commitment to prudent fiscal management.

- *Political interference in bank restructuring and debt collection* and lack of transparency in decision-making could slow or even derail financial sector reform efforts.

- *Limitations in administrative capacity, coupled with possible opposition from vested interests,* may result in delays in the reform process. The broad array of reforms and social programs has stretched the government's management capacity to the limit.

- The uncertain political outlook and social tensions, mentioned above, add to the *risks that economic stability may not return to Indonesia for some years and normal access to international capital markets may accordingly be delayed.* Slow growth in Indonesia's overseas markets, further real appreciation of the rupiah, and continued weakness in global energy and other commodity prices could limit any export recovery. This, coupled with continued sluggish domestic demand and difficulties in the corporate sector, could in turn keep fiscal revenues low. At the same time, pressures to protect the poor and meet the costs of restructuring companies and banks could raise public spending, undermining the authorities' efforts to curb the fiscal deficit. Even with a strong response, Indonesia is likely to have difficulty regaining substantial early access to spontaneous commercial flows at least until urgent bank and corporate restructuring efforts proceed further. With a vulnerable external financing situation, Indonesia's ability to retain the support of the international community could be jeopardized and its ability to service its external obligations, including to the Bank, would be in doubt. In light of IBRD's large exposure, this would have serious consequences for the Bank's own finances.

73. The Bank's assistance strategy is designed to help mitigate these risks. We give highest priority to addressing the social dimensions of the crisis to reduce the risk of social unrest and we are providing a lot of technical assistance together with ongoing policy dialogue. We have strengthened our ties to civil society to enhance understanding of our

programs and to position the Bank as a development partner for all Indonesians. We support the IMF's recommendation that the authorities maintain high reserve levels (equivalent to 6-7 months of imports) to mitigate payments risks. And, we will maintain a high degree of flexibility to allow rapid adjustment as the future unfolds. Of course, uncertainty remains. Indonesia's future is where it should be, in the hands of Indonesians. We must not forget that in Indonesia the Bank is playing only a small role in a much larger drama.

James D. Wolfensohn
President

By:

Sven Sandström

Peter Woicke

Washington, D.C.
February 16, 1999

Annex 1

Indonesia: Country Assistance Strategy Matrix, 1998-00

Goal: To help Indonesia stabilize its economy and build for the future

Strategic Objectives	*Diagnosis/Issues*	*Strategy/Actions*	*Progress Indicators*	*Bank Group Instruments*	*Other Donors*
A. Reinforce social safety nets					
Protect the poor	• Increased poverty due to job loss, reduced incomes • Sharp increase in inflation especially food prices • Reduced effectiveness public SSN programs due to slow disbursements, misuse of funds • Poor targeting of SSN activities	• Safeguarding of SSN funds from fraud and misuse through improved delivery, implementation, and monitoring • Protecting social sector budgets by keeping/expanding effective projects and cutting ineffective ones • Improving SSN program design by emphasizing decentralization, transparency and independent verification of performance. • Ensuring the availability of food through: ➢ close monitoring of the supply, prices and distribution of rice and other basic foods, ➢ an effective program of targeting rice subsidies, deregulating food commodity trade and enhancing private channels, and ➢ restructuring the role of BULOG to focus it on selected target groups • Maintaining purchasing power in poorest areas through: ➢ decentralized, transparent community recovery programs (VIP, KDP models) and ➢ targeted, monitored labor intensive works schemes	• Increased effectiveness of SSN programs • Availability of rice to targeted poor families • Numbers of poor/women employed in labor intensive public works at min. wages • Rapid response to reports of leakage • Better targeting	*Portfolio* Labor intensive works expanded in urban, rural & transport loans *Lending* KDP (98) Urban Poverty (99) PRSL I (99) PRSL II (99) SSNSAL (99) *Non-Lending Services* Poverty & Inequality (99) Poverty Monitoring (99-00) Social Mon. Unit (99-00) Food Production and Price Monitoring (99-00)	• ASEM • AusAID • Japan • ILO • USAID • FAO • WFP • CARE • CRS • DFID • Norway • UNDP • Germany • Denmark • SFD

Strategic Objectives	Diagnostics/Issues	Strategic Actions	Progress Indicators	Bank Group Instruments	Other Donors
Preserve human assets	• Risk of drops in primary, jr. secondary school enrollment • Short supply/high price of drugs • Decrease in use of basic health services especially by the poor • Risk of malnutrition for infants & children • Misuse of funds	• Ensure access to critical health and education services by: ➢ preserving public spending on basic health and education programs for the poor, ➢ ensuring continued high enrollment rates for children through the first nine years of school ➢ supporting community-based education programs for those who cannot be reached with conventional schooling, and ➢ maintaining access to essential drugs, community health services and nutrition improvement among other the priorities.	• Numbers of students receiving scholarships • Enrollment levels preserved • Maintained access to basic and critical health services • Reduced fall in primary and junior secondary school enrollments • Sustained immunization rates • Reduced decline in nutritional standards	*Portfolio* • School grants & scholarships added in ongoing educ. projects *Lending* • Safe Motherhood (98) • W.Java Basic Ed (98) • Health V (99) • Distr. Health (99) • Child Dvt (99) • Sumatra Basic Ed (99) • Sulawesi Basic Ed (99) • Basic Education IV (00) *Non-Lending Services* • Health Monitoring (Crisis Impacts) (99) • Educ. Monitoring (Crisis Impacts) (99) • Health Strategy (99)	• ASEM • DFID • AusAID • UNICEF • ADB • WHO • OECF • USAID • CIDA • UNFPA • Austria • Spain
B. Achieve Short-term Stability and Restart the Economy					
Restore macroeconomic stability	• Unstable exchange rate • High nominal interest rates • High inflation	• Strengthen monetary policy • Improve revenue mobilization • Realign public expenditures including targeting of food and energy subsidies	• Lowering inflation • Falling nominal interest rates • Increased fiscal revenue in FY99/00	*Lending* PRSL (99) PRSL II (99) PRSL III (00) *Non-Lending Services* PER I (98) PER II (99) IMF Support (98-99)	• IMF • ADB • AusAID • USAID
Restart bank and corporate sectors	• Breakdown of credit flows & financial services due to bank system collapse • Inability of most corporations to service debt due to large-scale unhedged foreign borrowing after Rp. devaluation	• Reestablish effective banking services by removing the worst non-performing loans & rebuilding a core of sound banks w/ priority on: ➢ strengthening IBRA and resolving problem ➢ merging of four state banks and begin restructuring of other two ➢ strengthening a small core of potentially viable banks through recapitalization	• Higher share of bank deposits returning to domestic private banks • Reduction in total liquidity support • Adequate funding and authority for IBRA • Continued implementation of resolution programs for troubled banks	*Lending* BRAP (98) PRSL I (99) BRAP II (99) Corp Restr TA (99) PRSL II (99) PRSL III (00)	• IMF • ADB • Japan • US • Australia • ASEM

Strategic Objectives	Diagnosis/Issues	Strategy/Actions	Progress Indicators	Bank Group Instruments	Other Donors
Restart bank and corporate sectors (cont'd)		➢ recovering debts & restrcturing assets trnsfrd to IBRA's AMU; • Support voluntary corp restructrng by helping the govt. create an enabling framework including: ➢ the effective operation of the amended bankruptcy law & the new commercial courts; and ➢ removal of tax, legal & regulatory impediments	• Increase in trade finance • Set up Jakarta Initiative task force & one-stop shop for corporate rest. • Increase of voluntary corp. debt workouts	*Non-Lending Services* Support MOF/BI (98-99) - TA to Financial Sector Action Comm. Fin. Sector Strategy (99) Corp. Restr. Strategy (99) *IFC* Client debt restructuring and rescheduling	
Trade finance and SME support	• Difficult to restart exports due to lack of trade finance • Limited reach of formal credit system in rural areas • Underdeveloped SMEs	• Redesign export trade finance guarantee scheme and provide better linkage between pre-shipment and postshipment export financing • Develop international best-practice support schemes for SMEs	• Increased lending for trade finance • Increased export volumes • Increased job creation by SMEs • SMEs accounting for increased portion of trade volumes	*Non-Lending Services* Trade Finance TA (99) SME Study (98-99) *IFC/MIGA* IFC - Provision of trade finance for clients MIGA - guarantees for investments in promising sectors	• ADB • Japan • US • ASEM
Preserving existing physical assets	• Disrepair of physical infrastructure - transport, urban • Critical financial position of PLN leading to cut in electricity serv. • Contracting industry bankruptcy	• Maintain sufficient O&M expenditures in budget for core physical infrastructure • Provide analytical and technical assistance to restructure PLN so that it regains solvency • Resolve price escalation issue in contracting	• Continued effective infrastructure services - electricity, transport, urban services • Stable condition of road network	*Portfolio* • New/expanded maintenance support in energy, transport and urban loans *Non-Lending Services* Power Sec. Restr. (98/99)	• AusAID • CIDA • DFID • ADB • OECF • Kfw • Spain
C. Strengthen Institutions To Support Sustainable Growth					
Strengthening public sector institutions	• Lack of public and investor confidence in government operations and legal system • Non-transparent, highly centralized decision making • Weak urban governance & city management • Inefficient SOE operations	• Combat corruption in public sector operations • Increase transparency and efficiency public sector activities • Establish transparent framework for prvt provision of infrastructure • Initiate reform of the civil service • Decentralize responsibility & resources • Reform legal and administration of judicial systems	• Established civil society monitoring groups • Increased budget transparency • Accurate newspaper reports on devt. projects • Expanded decentralization and community participation in Bank projects	*Lending* Bengkulu Reg Dev (98) Maluku Reg Dev (98) KDP (98) N. Sumatra Rds (98) Urban Poverty (99) PRSL (99) PRSL II (99) SSNSAL (99) Municipal Innov. LIL (99) Governance TA (00) Irrigation Sector (00)	• ADB • USAID • Ford Fndation • DFID • New Zealand • Norway • UNDP • UNESCO • OECF • Germany • EIB • IDB • Kuwait Fund

Strategic Objectives	Diagnosis/Issues	Strategy/Actions	Progress Indicators	Bank Group Instruments	Other Donors
Strengthening public sector institutions (contd.)	• Certain groups, e.g. poor women have no voice in planning • Uncertainty due to Y2K problem	• Strengthen land management and planning • Improve capacity of NGOs and other groups to participate in the public sector • Improve urban governance and pilot city development strategies • Policy reform in water supply and sanitation • Increase transparency of SOE administration	• Enhanced, efficient delivery urban services - transport, water, sanitation • Wide and effective dissemination of Bank documents	*Lending (contd.)* Governance I (PSAL/SECAL) (00) West Java & Jakarta Env. Management (00) Lombok Urban (00) Urb Sector (or Water) (00) Ports Environment (00) Local Env. Mgt (LIL) (00) Governance PSAL (00) All FY00 loans *Non-Lending Services* PER I (98) Mayors Conference (98) Power Sec Reform (98/99) PER II (99) Local Inst. & Part. (99) Hydrocarbon Review (99) Media training (99) Y2K grants (99) Development Recovery Program (99) Civil Ser.Reform (99-00) National Institutional Review (99-00) Civil society consultations	
Strengthen the institutional foundations for an efficient financial system	• Weak bank supervision & enforcement • Underdeveloped capital markets	• Improve governance and supervision of banks by creating the institutional capacity for effective banking supervision and enforcement of prudential regulations, improving financial reporting and auditing of banks • Strengthen policy and institutional infrastructure for banking including laws and regulations • Strengthen policy and institutional/legal infrastructure for capital markets, • Overall, by providing extensive training to overcome the capacity weaknesses in the sector.	• Emergence of core of healthy domestic banks • Reduction of connected lending • Increasing bond issues	*Lending* BRAP (98) PRSL (99) BRAP II $30m (99) PRSL II (99) PRSL III (00) *Non-Lending Services* Support MOF/BI (98-99 Fin. Sec. Strategy (99)	• IMF • ADB

Strategic Objectives	Diagnosis/Issues	Strategy/Actions	Progress Indicators	Bank Group Instruments	Other Donors
Strengthen the institutional foundations for healthy competition	• Continued trade & investment impediments to private sector efficiency • Inefficient BULOG presence in food commodity markets • Inefficient SOEs • Non-transparent bidding procedures private infr. projects • High cost in outlying islands	• Increase import competition and remove export impediments • Deregulate domestic markets and transport further • Phase out remaining investment barriers • Develop a framework for competition policy, including implementation of a competition law to establish guidelines for fair business practices and to avoid anti-competitive behavior as part of developing a system of modern business law • Assist in SOE privatization and reform including easing of downstream effects including labor and land divestiture issues • Establish transparent framework for private provision of infrastructure • Improve the business climate for sm & med sized enterprises • Improve food security through market-oriented reforms supported by policy reforms & followed by investment.	• Adherence to agreed program of import and export tax reductions • Freedom to compete in import & domestic mkts for all food commodities other than rice • Competition law in place • Increased foreign investment • Successful privatization of some SOEs • Availability of food	*Lending* IIDP (98) BRAP (98) PRSL (99) PRSL II (99) PRSL III (00) Agriculture SECAL (00) Decentralized Agric and Forestry Extension (00) *Non-Lending Services* Regional Distortions (98) SME Study (98-99) Labor Mkt Review (99) *IFC/MIGA* FIAS – advice for simplifying foreign invest. procedures in E. Islands MIGA – guarantees for investments in promising sectors	• IMF • ADB • USAOD • UNIDO • Germany • Switzerland
Emphasize institutional strengthening in support of human resource development	• Education quality problems reflected in low achievements, primary dropouts, and drop in jr. sec. school enrollments • Weak skills development • Quality deficiencies health services and personnel skills • Centralized planning, management, provision of health services	• Basic educ: improve quality & access jr. sec educ, through decentralization & greater autonomy of schools • Enhance autonomy of higher education institutions • Improve skills development • Focus on teacher workforce related issues, such as trng, distrb & promotion, remuneration, & civil service status • Decentralize health servcs to local governments & communities • Shift from quantity to quality of health services and personnel • Develop health financing alternatives (cost recovery, insurance, resource mobilization)	• Maintain enrollment rates: basic and junior secondary education • Implement health sector reform including decentralization and alternative training schemes	*Lending* Safe Motherhood (98) W.Java Basic Ed (98) Health V (99) Distr. Health (99S) Child Dvt (99) Sumatra Basic Ed (99) Sulawesi Basic Ed (99) Basic Education IV (00) District Health (00) Provincial Health II (00) *Non-Lending Services* Educ Strategy Wkshp (99) Health Sect. Strategy (99)	• ADB • OECF • IDB

Strategic Objectives	Diagnostic Issues	Strategic Actions	Progress Indicators	Bank Group Instruments	Other Donors
Strengthen environmental and social institutions	• Weak regulatory framework and enforcement--forest clearing, mining, overfishing, pollution • Increasing environmental degradation • Poor water and urban air quality • Rich but threatened biodiversity and cultural heritage • Increasing threats to vulnerable people, including women • Weak NGOs and civil society institutions	• Ensure that the new environment law is operational • Protect forest cover and strengthen forest management • Improve water resources management • Improve air quality • Ensure sustainable fisheries management • Pilot community environment funds and community-based approaches to environmental resource management • Strengthen environmental management institutions • Conserve biodiversity • Pilot community-based natural resource management • Conserve cultural assets • Improve EA and SA quality • Develop NGO and other civil society partnerships • Micro-lending for community based economic activities	• Establish implementing regulations for new environmental law • Agreed strategy for forest management • Fuel price study and resulting strategy • Water resource management strategy • Inclusion of cultural heritage in selected projects • Mainstream EA and SA in the Bank and GOI • Establish durable civil society partnership with the Bank and GOI	*Portfolio* Added fire mgmt support to Bapedal TA loan SSUDP added cultural heritage activity *Lending* Coral Reef Mgmt Rehab APL (98) KDP (98) Urban Poverty (99) Maluku Maconar LIL (99) PRSL I (99) PRSL II (99) Water Secal (99) West Java &Jakarta Env. Mgt. (00) Forestry SECAL (00) Irrigation Sector (00) Local Environmental Mgt. (LIL) (00) Ports Environment (00) Water Sector (00) Cultural Heritage (LIL) (00) *Non-Lending Services* ICDP Study (98) Environment Report (99) GEF medium-sized grants suprting biodiversity (99) Integrated Pest Mgmt (99)	• ADB • USAID • GTZ • CIDA • DFID • AusAID • JICA • EU • Norway • DANIDA • UNDP • CI • CARE • WWF • FFI • UNEP • NDF • NDB

Annex 2

Selected Consultation Meetings Between September and December, 1998

Date	Subject	Participants and objectives
09/16	PRSL	Meeting with representatives of major donors (EU, DFID, USAID, GTZ, ADB/ASEAN RETA Project); Ministry of Forestry and Estate Crops (MoFEC), UNESCO; ICRAF; Ford Foundation regarding Bank's draft Indonesian forestry issues paper and solicit policy reform recommendations for next SAL.
09/17	PRSLII	Meeting with 13 forestry sector NGOs concerned with social forestry and forest management, organized at Ford Foundation, Jakarta.
09/17	PRSLII	Meeting with the MoFEC Reform Committee to discuss its recommendations on forestry policy, MoFEC organization, and relationship to possible Bank policy reforms.
10/05	WatSAL	Meeting co-chaired by General Secretary of MoFEC Reform Committee with NGOs to formulate the consultation process for WatSAL.
10/08	PRSLII	Meeting with local and international representatives of WB-WWF Alliance for Forest Conservation and Sustainable Use to discuss potential for Alliance involvement in preparation of ForSAL. Meeting planned for ID NGOs interested in forest conservation.
10/15	WatSAL	Meeting with BAPPENAS and NGOs (LP3ES and SKEPHI) to make final plans for WatSAL consultations at provincial and district levels, to be carried out in Nov & Dec.
10/22	PRSLII	Meeting with Indonesian executive directors of WWF, The Nature Conservancy (TNC), and Conservation International (CI).
10/30	PRSLII	WWF, CI and TNC convened dinner meeting of more than 30 people representing 25 conservation NGOs, MoFEC, the press, and several donors.
11/06	Social Safety Net	Donors outlined areas for coordination and support on activities related to Bank's proposed social safety net and governance/anti-corruption operations. Broadly supportive, emphasized role of civil society, long-term nature of governance operations.
11/20	PRSLII	Meeting with team from DFID-supported Indonesia-UK Tropical Forest Management Programme to discuss comments on Bank's draft forestry issues paper and suggestions for policy reforms in PRSLII.
11/20-27	All loans	Country Director met with leading thinkers and opposition leaders, including Nurcholis Majid, Gus Dur, Sri Bintang Pamungkas, Marsuki Darusam, and student leaders and faculty. Supportive of our program to keep reform program going & economy stable.
11/23	PRSLII	Meeting with USAID and USAEP to discuss strategy and collaboration on conversion to unleaded gasoline and other clean fuels, including possible US EPA support to MIGAS. USAEP committed to conducting analysis of private sector capacity to supply unleaded gasoline to Indonesia.
11/24	PRSLII	Co-sponsored with Swiss Contact a seminar on "The Role of Unleaded Gasoline in Creating Clean Air" and presented Bank's experience with and recommended strategy for conversion to unleaded gasoline.
11/26-27	SSNAL	BAPPENAS counterpart supportive of increased civil society dialogue. Consultations held with civil society leaders re designating main Civil Society interlocutor on the Leadership committee of the SSNAL monitoring group, and appointing more civil society reps for working group.
12/01-05	CAS	Meetings with government counterparts on CAS, lending program, and individual adjustment operations. Agreement on general framework and program matrix.

12/01-12/11	**All loans**	Individual meetings with local and international NGOs in Jakarta on proposed lending operations, gauging of potential support.
12/03	**All loans**	Half-day workshop to distribute documents, explain 4 adjustment programs, answer questions, brainstorm on monitoring mechanisms, and lay groundwork for following week's full day session. Minutes of meeting sent out to participants.
12/07	**SSNAL**	Met with small group of influential NGOs as part of ongoing strategy to incorporate NGOs into decision-making process, set up Advisory Committee.
12/07	**PRSLII**	Consultation with KADIN-Chamber of Industry & Commerce. Discussed helping small and medium size industries, and future trade and industry policy reform.
12/08	**PRSLII**	Meeting with private fuel additive producer and representative of Association of Indonesian Automotive Industries to discuss private-sector alternatives for phaseout of lead in gasoline.
12/09	**All loans**	Full-day workshop on strategy and operations. Break-out into working groups: Social safety net; Anti-corruption; Banking & corporate restructuring; Structural reform & private/public enterprise reform; Legal, land, civil service reform. Civil society, private sector, trade unions, academics.
12/14-18	**WatSAL**	Water sector NGOs and water user associations at the local and provincial level.
12/15	**PRSLII**	Participated in meeting of Consultative Group on Indonesian Forestry (CGIF); meeting of Working Group on Social Forestry and People' Participation, to discuss proposed MoFEC/CGIF work program for consultations to develop implementation plan for MoFEC's "forests for people" policy.
12/17	**All loans**	Consultation with local journalists on Adjustment Operations and CAS.

Annex 3
An Overview of Proposed Governance Reforms

Topic	Enabling actions	First stage reforms (12/99)	Medium term objectives
Anti-corruption reforms	Develop Action Plan and obtain broad agreement with GOI and civil society. Establish national commission to handle anti-corruption action plan	"Not here, not now" campaign Ring fence safety net expenditures Prepare "truth and reconciliation" commission Passage of Anti-corruption laws, including a law establishing an Independent Permanent Commission to combat corruption, collusion, nepotism in the public sector, and issue implementing regulations	Disclosure and conflict of interest regulations with enforcement Improved procurement practices Reliable audit capacities "Clean" GOI at all levels Elimination of collusion practices by suppliers, contractors and consultants
Decentralization of responsibilities	Passage of proposed new basic law on local and regional government	Issuance of Implementing regulations and procedures for new basic law Analysis of functional staff and resource requirements for local governments and reduced needs of central agencies	Reduction of central GOI Ministries staff by transfer to local governments (or by redundancies/retirement) Creation of efficient, effective local governments to provide full range of services to all GOI residents
Central-local finance and resource management and central GOI revenue enhancement/tax realization	Passage of proposed new legislation revising central-local financial patterns	Issue Implementing regulations for new law and develop revenue sharing formulae/procedures Administrative revision of budget procedures with transparency	Strengthen legislative oversight of budget preparation and application at all GOI levels Transparent effective budget processes
Civil Service Reform	"Depoliticize" the civil service Passage of proposed civil service law	Review Civil Service Commission Develop professional enhancement plan for all levels of civil service	Professional, effective civil service
Land Management and Planning	Confirm plans to decentralize land administration function and BPN staff	Implement transfer of function from BPN to local governments Complete issuance of implementing regulation for 1992 Spatial Mgmt. Law Study potential provisions for new land law and build consensus	Improved spatial planning, development management and land administration by local government Further enhance issuance of land certificates to low-income families New Land Law
Legal System and Judicial Reform	Develop Policy Framework and Action Plan based on IDF study and other inputs	Enact legislation establishing an independent permanent judicial sub-commission, thereby establishing a mechanism for reviewing allegations of corruption in the judiciary, requiring the submission of financial reports by judges on their assets and permitting audits of their financial affairs.	Honest effective judiciary Public confidence in legal system
Key Sectoral Reforms	Confirm Action Plans with each sectoral Ministry focusing on anti-corruption, decentralization and related reforms	Begun implementations of each ministry's anti-corruption program Develop detailed plans for decentralization	Effective, transparent operational organizations for delivery of services in each sector

Annex A1

INDONESIA: Key Economic and Program Indicators - Change from Last CAS

	Forecast in Last CAS					Actual		Current CAS Forecast 1/		
	Estimate	Projected					Prel.	Projected (Base Case)		
Economy (FY)	1996/97	1997/98	1998/99	1999/00	2000/01	1996/97	1997/98	1998/99	1999/00	2000/01
Growth rates (%)										
GDP	7.8	7.8	7.8	7.8	7.8	8.3	1.4	-13.0	-1.0	3.0
Exports (merchandise FOB)	8.2	6.7	9.3	9.5	9.6	6.2	13.2	6.0	4.5	4.9
Imports (merchandise CIF)	10.3	6.9	9.9	8.8	8.7	10.4	-3.7	-22.5	7.4	12.4
CPI inflation (period average)	8.0	8.5	8.3	7.2	6.1	6.7	12.7	80.0	20.0	10.0
Gross Domestic Investment (% of GDP)	29.4	30.2	31.0	31.0	30.9	32.3	29.5	16.8	16.3	17.4
Public Finance (% of GDP)										
Overall public sector balance	0.9	0.6	0.4	0.4	0.4	1.1	0.2	-4.7	-4.8	-3.5
Balance of payments										
Current account balance (% of GDP)	-3.5	-4.0	-4.1	-3.9	-3.7	-3.4	-1.1	4.6	3.2	2.4
Gross international reserves										
in months of merchandise imports	4.7	5.0	4.9	4.8	4.8	6.3	4.3	6.8	7.3	6.7
in months of imports GNFS 2/						5.6	3.9	6.0	6.4	5.9
Program (Bank's FY)	FY97	FY98	FY99	FY00	FY01	FY97	FY98	FY99	FY00	FY01
Lending (US$ million)	978.0	1047.0	1,399.0	1,500.0	n.a.	914.6	703.2	2,772.0	1,420.0	1,230.0
Gross disbursements (US$ million)						915.7	658.6	2,700.0	1,900.0	1,000.0

1/ Includes impact of the recent (August 1998) Paris Club Agreement. Incorporates available Government fiscal data as of December 17, 1998.

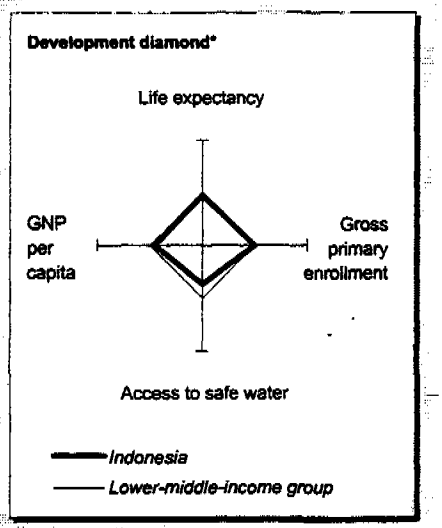
2/ GNFS = goods and non-factor services.

January 20, 1999.

Indonesia at a glance

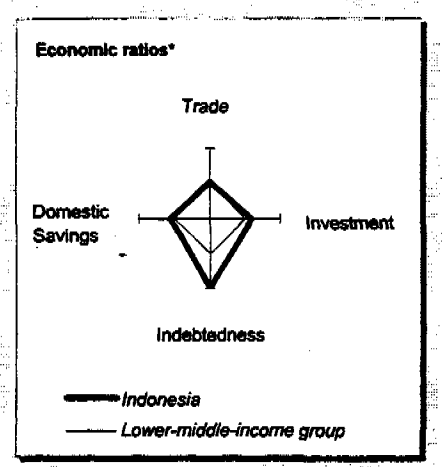
2/10/99

POVERTY and SOCIAL	Indonesia	East Asia & Pacific	Lower-middle-income
1997			
Population, mid-year *(millions)*	200.1	1,753	2,282
GNP per capita *(Atlas method, US$)*	1,110	970	1,230
GNP *(Atlas method, US$ billions)*	222.1	1,707	2,818
Average annual growth, 1991-97			
Population *(%)*	1.6	1.3	1.2
Labor force *(%)*	2.5	1.4	1.3
Most recent estimate (latest year available, 1991-97)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	37	32	42
Life expectancy at birth *(years)*	65	68	69
Infant mortality *(per 1,000 live births)*	47	38	36
Child malnutrition *(% of children under 5)*	40	16	..
Access to safe water *(% of population)*	62	84	84
Illiteracy *(% of population age 15+)*	16	17	19
Gross primary enrollment *(% of school-age population)*	114	118	114
Male	117	120	116
Female	112	119	113

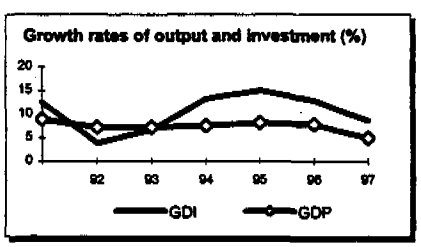


KEY ECONOMIC RATIOS and LONG-TERM TRENDS	1976	1986	1996	1997
GDP *(US$ billions)*	39.3	79.9	227.4	215.0
Gross domestic investment/GDP	24.1	26.7	32.1	30.9
Exports of goods and services/GDP	24.5	20.2	25.8	28.0
Gross domestic savings/GDP	27.1	25.3	31.5	30.6
Gross national savings/GDP	..	..	28.7	26.2
Current account balance/GDP	..	..	-3.5	-0.8
Interest payments/GDP	1.2	3.0	2.2	2.4
Total debt/GDP	35.6	53.7	56.7	63.3
Total debt service/exports	..	..	35.8	30.7
Present value of debt/GDP	..	..	..	59.8
Present value of debt/exports	..	..	..	199.8

	1976-86	1987-97	1996	1997	1998-02
(average annual growth)					
GDP	6.7	7.8	7.8	4.9	..
GNP per capita	4.1	6.2	7.6	2.7	..
Exports of goods and services	-1.7	8.9	8.2	7.8	..



STRUCTURE of the ECONOMY	1976	1986	1996	1997
(% of GDP)				
Agriculture	29.7	24.3	16.7	16.0
Industry	34.1	33.8	43.5	42.9
Manufacturing	10.4	16.8	25.6	25.5
Services	36.3	41.9	39.9	41.1
Private consumption	63.5	62.6	62.4	62.5
General government consumption	9.4	11.1	7.6	6.9
Imports of goods and services	21.5	20.5	26.4	28.2



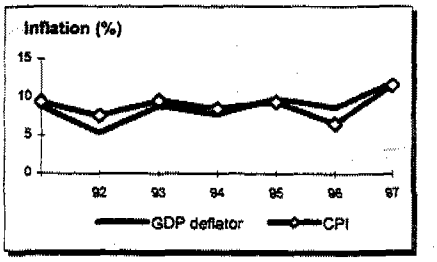
	1976-86	1987-97	1996	1997
(average annual growth)				
Agriculture	4.1	3.2	3.3	0.7
Industry	6.5	10.0	10.7	5.6
Manufacturing	14.5	11.0	11.7	6.4
Services	8.7	7.9	6.6	5.7
Private consumption	10.0	8.1	19.1	6.6
General government consumption	9.2	3.8	0.7	0.1
Gross domestic investment	10.8	11.0	12.9	8.6
Imports of goods and services	7.3	11.7	17.2	14.7
Gross national product	6.2	8.0	9.3	4.3

This table was produced from the Development Economics central database.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

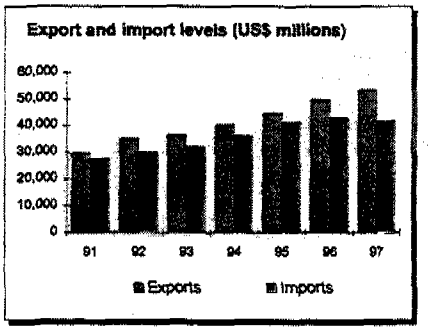
PRICES and GOVERNMENT FINANCE

	1976	1986	1996	1997
Domestic prices				
(% change)				
Consumer prices	..	5.7	6.6	11.6
Implicit GDP deflator	15.4	-0.2	8.7	12.0
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	15.9	16.5	15.9
Current budget balance	..	-4.6	7.0	5.5
Overall surplus/deficit	..	..	1.1	0.9



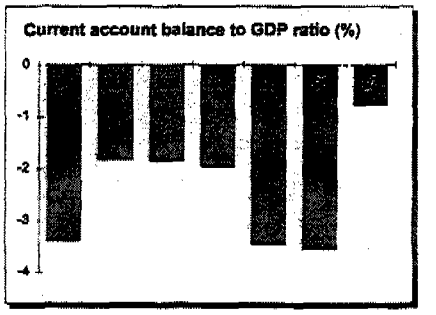
TRADE

	1976	1986	1996	1997
(US$ millions)				
Total exports (fob)	..	13,673	49,815	53,547
Commodity 1	..	6,964	11,722	11,603
Commodity 2	..	752	1,894	1,505
Manufactures	..	2,747	21,210	18,568
Total imports (cif)	..	12,760	42,929	41,680
Food	..	711	4,357	3,796
Fuel and energy	..	2,375	3,607	3,924
Capital goods	..	5,005	19,973	19,558
Export price index *(1995=100)*	..	..	..	..
Import price index *(1995=100)*	..	..	..	..
Terms of trade *(1995=100)*	..	..	..	..



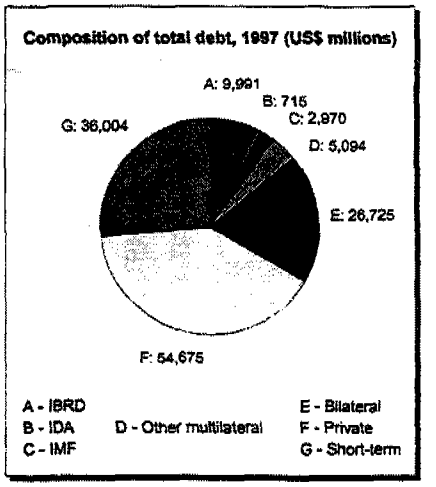
BALANCE of PAYMENTS

	1976	1986	1996	1997
(US$ millions)				
Exports of goods and services	..	..	59,129	62,997
Imports of goods and services	..	..	54,167	50,124
Resource balance	..	..	4,962	12,873
Net income	..	..	-12,781	-11,297
Net current transfers	..	..	-250	-3,275
Current account balance	..	..	-8,069	-1,699
Financing items (net)	..	..	14,169	-11,601
Changes in net reserves	..	..	-6,100	13,300
Memo:				
Reserves including gold *(US$ millions)*	..	..	..	..
Conversion rate *(DEC, local/US$)*	415.0	1,282.6	2,342.3	2,909.4



EXTERNAL DEBT and RESOURCE FLOWS

	1976	1986	1996	1997
(US$ millions)				
Total debt outstanding and disbursed	14,010	42,916	128,941	136,174
IBRD	213	5,058	11,139	9,991
IDA	418	857	736	715
Total debt service	1,340	5,984	21,539	19,736
IBRD	4	636	2,249	1,848
IDA	2	12	26	26
Composition of net resource flows				
Official grants	59	136	190	183
Official creditors	839	1,016	-792	535
Private creditors	1,314	528	6,874	5,888
Foreign direct investment	..	..	..	..
Portfolio equity	0	0	3,099	298
World Bank program				
Commitments	..	..	..	..
Disbursements	257	828	905	899
Principal repayments	1	236	1,429	1,165
Net flows	256	592	-523	-266
Interest payments	6	411	846	709
Net transfers	250	181	-1,370	-975



Note: This table was produced from the Development Economics central database. 2/10/99

Indonesia - Selected Indicators of Bank Portfolio Performance and Management

Indicator	1996	1997	1998	1999
Portfolio Assessment				
Number of Projects under implementation[a]	76	78	80	74
Average implementation period (years)[b]	3.45	3.48	3.68	3.69
Percent of problem projects[a, c]				
by number	13.16	8.97	25.00	27.03
by amount	12.02	8.98	29.72	28.36
Percent of projects at risk[a, d]				
by number	16.42	15.49	53.52	50.00
by amount	14.44	13.75	54.65	48.48
Disbursement ratio (%)[e]	18.95	18.79	14.05	6.36
Portfolio Management				
CPPR during the year (yes/no)				
Supervision resources (total US$)	3,724.73	4,752.10	5,189.81	2,492.15
Average Supervision (US$/project)	49.01	60.92	64.87	33.68

Memorandum item	Since FY80	Last five FYs
Projects evaluated by OED		
by number	193	76
by amount (US$ millions)	17432.85	9768.83
Percent rated U or HU		
by number	17.62	14.47
by amount	13.40	7.62

a. As shown in the Annual Report on Portfolio Performance (except for current FY)
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.

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e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.

FY	Project	US$(M)	Strategic rewards[b] (H/M/L)	Implementation[b] risks (H/M/L)
2001 (PRELIMINARY)				
ADJUSTMENT LENDING PROJECTS				
	GOVERNANCE II	100.0	H	M
	SECAL II (ENERGY OR PSD)	200.0	H	H
INVESTMENT/TA PROJECTS				
	BASIC EDUCATION V	60.0	H	M
	TERTIARY EDUCATION	60.0	M	L
	PROVINCIAL HEALTH III	40.0	H	L
	WSSLIC II	60.0	H	L
	RIVER BASIN DEVELOPMENT	100.0	H	M
	RURAL DEVELOPMENT	40.0	M	M
	COREMAP II	20.0	M	M
	KALIMANTAN URBAN	100.0	M	M
	OTHER URBAN/WATER	100.0	M	M
	SURIP II	150.0	M	M
	KDP II	200.0	H	M
	SUBTOTAL	**1,230.0**		
	TOTAL, FY 1999-2001	**5,423.0**		

a. This table presents the proposed program for the next three fiscal years.
b. For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or low (L).
c. May qualify as IDA blend.
(A) Already approved.

Indonesia - Key Economic Indicators

Indicator	FY94/95	FY95/96	FY96/97	FY97/98	FY98/99	FY99/00	FY00/01
	(Actual)			(Est.)	Projected		
National accounts (as % GDP at current market prices)							
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture[a]	17.3	17.1	16.0	18.6	24.2	26.0	26.6
Industry[a]	40.9	41.5	44.0	47.1	48.7	54.7	55.6
Services[a]	35.6	35.8	35.2	31.0	26.8	16.4	13.7
Total Consumption	68.4	68.8	67.3	64.8	66.3	73.2	73.5
Gross domestic fixed investment	29.5	30.5	32.3	29.5	16.8	16.3	17.4
Government investment	22.9	25.2	26.6	24.9	11.8	10.6	11.6
Private investment (includes increase in stocks)	6.6	5.3	5.7	29.5	5.0	5.8	5.8
Exports (GNFS)[b]	25.6	25.7	25.0	41.4	58.6	37.8	39.2
Imports (GNFS)	23.5	25.0	24.5	35.7	41.7	27.3	30.1
Gross domestic savings	31.6	31.2	32.7	35.2	33.7	26.8	26.5
Gross national savings[c]	27.7	27.3	28.9	28.3	21.4	19.5	19.8
Memorandum items							
Gross domestic product (US$ million at current prices)	183,593	206,360	232,250	149,631	103,168	173,223	183,415
Gross national product per capita (US$, Atlas method)	880.0	990.0	1,080.0	920.0	620.0	620.0	690.0
Real annual growth rates (%, calculated from 1993 prices)							
Gross domestic product at market prices	13.5	7.6	8.3	1.4	-13.0	-1.0	3.0
Gross Domestic Income	8.1	8.9	8.7	0.1	-15.1	-0.6	3.5
Real annual per capita growth rates (%, calculated from 1993 prices)							
Gross domestic product at market prices	12.3	6.5	5.5	-0.1	-14.3	-2.4	1.6
Total consumption	5.2	8.5	5.3	2.4	-7.2	-2.8	2.6
Private consumption	5.4	9.1	4.8	0.9	-3.4	-7.4	2.4

Indonesia - Key Economic Indicators
(Continued)

Indicator	FY94/95	FY95/96	FY96/97	FY97/98	FY98/99	FY99/00	FY00/01
	(Actual)			(Est.)	Projected		
Balance of Payments (US$m)							
Exports (GNFS)[b]	46,999	52,938	58,060	61,944	60,433	65,426	71,837
Merchandise FOB	42,161	47,754	52,071	56,245	56,391	61,509	67,969
Imports (GNFS)[b]	43,232	51,589	56,961	53,391	42,984	47,352	55,151
Merchandise FOB	33,700	46,039	50,762	47,487	37,750	41,721	48,567
Resource balance	3,767	1,349	1,099	8,553	17,449	18,074	16,686
Net current transfers (including official current transfer)	-30	-284	-400	-1,779	-5,209	-5,295	-5,295
Current account balance (after official capital grants)	-3,238	-6,767	-7,849	-1,715	4,706	5,525	4,454
Net private foreign direct Investment	2,566	5,357	6,546	1,800	500	800	1,000
Long-term loans (net)	3,596	3,435	6,170	-1,830	-5,564	-2,939	-4,995
Official	1,835	460	110	1,052	3,256	3,091	-536
Private	1,761	2,975	6,060	-2,882	-8,820	-6,030	-4,458
Other capital (net, including errors and omissions)	-3,426	3,245	3,963	3,029	0	0	0
Change in reserves[d]	1,498	-3,570	-6,198	10,226	2,458	-3,076	-1,509
Memorandum items							
Resource balance (% of GDP at current market prices)	0.2	0.1	0.0	0.6	1.7	1.0	0.9
Real annual growth rates (1993 prices)							
Merchandise exports (FOB)	12.0	5.7	6.2	13.2	6.0	4.5	4.9
Primary							
Manufactures							
Merchandise imports (CIF)	13.6	33.4	10.4	-3.7	-22.5	7.4	12.4
Public finance (as % of GDP at current market prices)[e]							
Current revenues	16.7	15.3	15.9	15.9	13.2	13.3	14.7
Current expenditures	9.1	8.6	9.2	11.1	12.9	12.3	12.4
Current account surplus (+) or deficit (-)	1.1	1.4	1.1	0.2	-4.7	-4.8	-3.5
Capital expenditure	7.2	6.2	6.1	4.1	3.9	4.7	4.7
Foreign financing	1.0	0.2	0.0	0.7	3.2	1.8	-0.3

Indonesia - Key Economic Indicators
(Continued)

Indicator	FY94/95	FY95/96	FY96/97	FY97/98	FY98/99	FY99/00	FY00/01
	---------(Actual)---------			--(Est.)--	--------Projected---------		
Monetary indicators							
M2/GDP (at current market prices)	41.8	45.6	47.4	51.5	47.2	46.2	45.2
Growth of M2 (%)	22.1	28.0	26.7	52.7	24.9	13.6	10.9
Private sector credit growth / total credit growth (%)							
Price indices 1993 =100)							
Merchandise export price index	101	107	117	111	105	110	116
Merchandise import price index	145	147	163	159	163	167	173
Merchandise terms of trade index	70	73	72	70	65	66	67
Real exchange rate index (US$/LCU)f	1.0	0.9	0.9	1.5	1.9	1.1	1.1
Real interest rates							
Consumer price index (% growth rate)	8.5	9.4	8.0	6.6	70.1	33.2	9.4
GDP deflator (% growth rate)	7.8	9.4	8.7	30.2	80.0	20.0	10.0

NOTE: Data in an Indonesia fiscal year basis (i.e. 1994 is April 1994 - March 1995).

a. If GDP components are estimated at factor cost, a footnoote indicating this fact should be added.
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Should indicate the level of the government to which the data refer.
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Indonesia - Key Exposure Indicators

	FY94/95	FY95/96	FY96/97	FY97/98	FY98/99	FY99/00	FY00/01
	(Actual)			(Est.)	(Projected)		
Total debt outstanding and disbursed (TDO) (US$m)[a]	107,824	124,398	129,033	137,896	132,782	129,743	124,351
Net disbursements (US$m)[a]	5066	9941	6085	9463	-5294	-901	-385
Total debt service (US$m)[a]	14,270	16,419	21,463	24,391	21,891	20,010	18,806
Debt and debt service indicators (%)							
TDO/XGS[b]	221.8	226.0	214.1	213.8	213.5	188.5	165.1
TDO/GDP	58.7	60.3	55.6	92.2	128.7	74.9	67.8
TDS/XGS	30.4	31.0	37.0	39.4	36.2	30.6	26.2
Concessional/TDO	..	..	4.0	3.8	2.8	3.9	4.0
IBRD exposure indicators (%)							
IBRD DS/public DS	24.5	19.8	19.3	17.5	20.3	20.4	21.2
Preferred creditor DS/publicDS (%)[c]	37.3	28.4	36.1	26.3	32.5	35.4	40.4
IBRD DS/XGS	4.4	3.4	3.7	2.7	3.1	3.0	2.9
IBRD TDO (US$m)[d]	12,008	12,503	10,538	9,791	12,107	13,189	13,419
Of which present value of guarantees (US$m)							
Share of IBRD portfolio (%)	10.4	11.5	9.9	9.1	9.5	9.4	9.0
IDA TDO (US$m)[d]	776.3	755.9	735.5	715.2	694.2	733.9	852.1
IFC (US$m)							
Loans	80.0	76.0	73.0	82.0	90.0		
Equity and quasi-equity /c	20.0	24.0	27.0	18.0	10.0		
MIGA							
MIGA guarantees (US$m)	51.5	101.5	80.4	80.4			

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Based on Bank's fiscal year. (e.g., GOI FY98/99 is Bank FY99)

e. Includes equity and quasi-equity types of both loan and equity instruments.

Status of Bank Group Operations in Indonesia
Operations Portfolio

Project ID	Fiscal Year	Borrower	Purpose	Original Amount in US$ Millions				Difference Between expected and actual disbursements a/		Last PSR Supervision Rating b/	
				IBRD	IDA	Cancel.	Undisb.	Orig	Frm Rev'd	Dev Obj	Imp Prog
Number of Closed Projects: 211											
Active Projects											
ID-PE-3922	1991	GOI	SULAWESI/IRIAN JAYA	100.00	0.00	0.00	1.78	1.76	0.00	S	S
ID-PE-3997	1992	GOI	TELECOM IV	375.00	0.00	50.08	57.23	107.29	0.00	S	S
ID-PE-3969	1992	GOI	PRIMARY SCHOOL TEACH	36.60	0.00	3.20	2.91	6.11	0.00	S	S
ID-PE-3940	1992	GOI	PRIMARY EDUC QUALITY IMPROVE	37.00	0.00	0.00	10.00	10.00	0.00	S	S
ID-PE-3916	1992		SURALAYA THERMAL POW	423.60	0.00	132.20	24.15	148.73	-.28	U	S
ID-PE-3966	1992	GOI	NON-FORMAL EDUC III	69.50	0.00	3.10	.49	3.57	1.97	S	S
ID-PE-3928	1992	GOI	AGRICULTURAL FINANCI	106.10	0.00	10.79	28.04	38.84	0.00	S	S
ID-PE-3860	1992	GOI	TREECROPS SMALLHOLDE	87.60	0.00	0.00	21.34	19.76	0.00	S	S
ID-PE-4009	1993	GOI	INTEGRATED PEST MGMT	32.00	0.00	5.50	5.05	10.55	0.00	S	S
ID-PE-4006	1993	GOI	E.INDONESIA KABUPATE	155.00	0.00	0.00	15.95	15.92	0.00	S	S
ID-PE-3990	1993	GOI	WTR & SANI FOR LOW I	80.00	0.00	11.00	26.73	37.75	24.95	S	S
ID-PE-3999	1993	GOI	GROUNDWATER DEVT.	54.00	0.00	18.94	8.88	18.22	1.57	U	U
ID-PE-3914	1993	GOI	THIRD COMM HEALTH &	93.50	0.00	16.00	7.82	15.30	0.00	S	S
ID-PE-4007	1993	GOI	POWER (CIRATA II)	104.00	0.00	26.00	29.46	53.50	-.12	U	S
ID-PE-4017	1994	GOI	UNIV.RESEARCH FOR GR	58.90	0.00	0.00	29.34	17.46	0.00	S	S
ID-PE-4020	1994	GOI	KABUPATEN ROADS V	101.50	0.00	0.00	17.06	15.06	0.00	S	S
ID-PE-4010	1994	GOI	DAM SAFETY	55.00	0.00	0.00	34.14	24.39	0.00	S	U
ID-PE-3985	1994	GOI	WTRSHED CONSERVATION	56.50	0.00	0.00	42.06	25.16	0.00	HU	U
ID-PE-3937	1994	GOI	INTEGRATED SWAMPS	65.00	0.00	0.00	32.10	18.78	0.00	U	U
ID-PE-3945	1994	GOI	HIGHWAY SECTOR II	350.00	0.00	0.00	167.29	142.27	-182.73	S	S
ID-PE-3910	1994	GOI	SUMATERA & KALIMAN P	260.50	0.00	20.00	174.19	152.19	-1.00	U	S
ID-PE-3954	1994	GOI	JAVA IRR IMP & W R M	165.70	0.00	0.00	95.10	56.57	0.00	S	S
ID-PE-3998	1994	GOI	SURABAYA URBAN	175.00	0.00	0.00	100.33	67.34	13.76	S	U
ID-PE-3890	1994	GOI	SEMARANG-SURAKARTA U	174.00	0.00	3.67	85.04	52.51	13.09	S	S
ID-PE-4019	1995	GOI	ACCOUNTANCY DEV II	25.00	0.00	0.00	13.83	12.11	0.00	S	S
ID-PE-39754	1995		TA FOR INFRA. II	28.00	0.00	0.00	23.31	20.51	1.85	S	S
ID-PE-4001	1995	GOI	TELECOM SECTOR MODER	325.00	0.00	50.00	205.47	140.47	0.00	HS	S
ID-PE-3984	1995	GOI	LAND ADMINISTRATION	80.00	0.00	0.00	46.52	24.04	0.00	S	S
ID-PE-3972	1995	GOI	AG. RESEARCH II	63.00	0.00	6.00	46.35	32.34	.01	S	S
ID-PE-3965	1995	GOI	HEALTH IV:IMPR HEALT	88.00	0.00	20.00	52.13	24.12	0.00	S	S
ID-PE-3988	1995	GOI	PHRD II	69.00	0.00	0.00	30.95	9.93	0.00	S	S
ID-PE-3968	1995		BOOK & READING DEV	132.50	0.00	31.50	80.08	24.08	0.00	S	S
ID-PE-3979	1995	GOI	RURAL ELECT II	398.00	0.00	39.90	127.00	161.30	0.00	U	S
ID-PE-3951	1995	GOI	KALIMANTAN UDP	136.00	0.00	0.00	62.38	52.37	0.00	S	S
ID-PE-41896	1996	GOI	HR CAPACITY BUILDING	20.00	0.00	3.60	15.04	9.64	0.00	NA	NA
ID-PE-4004	1996	GOI	HIGHER EDUC SUP.(III	65.00	0.00	0.00	46.73	1.20	0.00	S	S
ID-PE-37097	1996	GOI	E.JAVA SEC.EDUC.	99.00	0.00	0.00	81.38	6.88	0.00	S	S
ID-PE-39312	1996	GOI	SECOND E. JAVA UDP	142.70	0.00	0.00	122.77	100.77	0.00	S	S
ID-PE-4021	1996	GOI	POW. TRANS & DIST II	373.00	0.00	80.00	203.49	213.08	-7.31	U	U
ID-PE-4014	1996	GOI	KERINCI SEBLAT ICDP	19.10	0.00	0.00	18.34	6.23	0.00	S	S
ID-PE-4008	1996	GOI	NUSA TENGGARA DEV.	27.00	0.00	0.00	22.32	5.54	0.00	U	U
ID-PE-4003	1996	GOI	SECONDARY SCHOOL TEA	60.40	0.00	0.00	50.24	28.91	0.00	S	S
ID-PE-3978	1996	GOI	IND'L TECHNOLOGY DEV	47.00	0.00	6.00	25.08	22.40	0.00	S	U
ID-PE-4011	1996	GOI	SULAWESI AGRI AREA	26.80	0.00	0.00	21.40	1.89	0.00	U	U
ID-PE-4016	1996	REPUBLIC OF INDONESIA	STRATEGIC URB. RDS I	86.90	0.00	0.00	75.04	31.35	0.00	S	U

FY Approval	Company	Committed IFC Loan	Committed IFC Equity	Committed IFC Quasi	Committed IFC Partic	Disbursed IFC Loan	Disbursed IFC Equity	Disbursed IFC Quasi	Disbursed IFC Partic
		Approvals Pending Commitment							
		Loan	Equity	Quasi	Partic				
1999	P.T. INDORAMA	30.00	0.00	0.00	0.00				
1995	PT BAKRIE PIPE	0.00	0.00	0.00	13.00				
1995	PT VISCOSE II	0.00	5.00	0.00	0.00				
Total Pending Commitment:		30.00	5.00	0.00	13.00				

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October 30, 1997

Indonesia Urban Water Supply Sector Policy Framework

Summary Report

By Alain Locussol
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Indonesia Discussion Paper Series
Number 10
East Asia and Pacific Region

INDONESIA

URBAN WATER SUPPLY SECTOR POLICY FRAMEWORK

TABLE OF CONTENTS

Tables

This report was prepared at the request of BAPPENAS by a team led by Alain Locussol (task manager) with major contributions from Messrs./Mmes.: Raja Iyer, Frida Johansen, Dong Liu, Jae So, Keiichi Tamaki, Risyana Sukarma (Bank staff), Imam Krismanto, Ian Wetherill and Michael Whitbread (consultants). Inputs were also provided by Messrs. Vincent Gouarne, Klas Ringskok and Anjum Altaf who commented on the report's main recommendations.

PRINCIPAL ABBREVIATIONS AND ACRONYMS USED

ADB	Asian Development Bank
BAPPENAS	National Development Planning Agency
BPAM	Non Autonomous Municipal Water Company
Bintek	Technical Directorate
BOOT	Build. Own. Operate and Transfer
BPKP	Government Audit Agency
DG Cipta Karya	Directorate General of Human Settlements
DG Pengairan	Directorate General of Water Resource Development
DG PUOD	Directorate General of Public Affairs and Local Autonomy
FINPRO	Financial Projection Model
GOI	Government of Indonesia
KUDP	Kalimantan Urban Development Project
ICB	International Competitive Bidding
ITB	Institute of Technology of Bandung
IUIDP	Integrated Urban Infrastructure Development Project
JICA	Japanese International Cooperation Agency
JUDP	Jabotabek Urban Development Project
LG	Local Government
MoHA	Ministry of Home Affairs
MOU	Memorandum of Understanding
MPW	Ministry of Public Works
NGO	Non Governmental Organization
NSWA	National Water Supply Authority
PAM JAYA	Jakarta Municipal Water Supply Company
PDAM	Autonomous Municipal Water Company
PERPAMSI	Indonesian Water Distributors Association
PJM	Five Year Development Plan
PJP	Government's Long Term Development Program
PLN	National Power Company
PMDU	Provincial Monitoring and Development Units
PPPAB	DG Cipta Karya's Provincial Water Supply Unit
PVC	Polyvinyle of Chlorure
Telkom	National Telecommunication Company
Tk I; Tk II	Provincial Level; Local Level
TNA	Training Needs Assessment
WTP	Willingness to Pay

URBAN WATER SUPPLY SECTOR POLICY FRAMEWORK

EXECUTIVE SUMMARY

a. At the end of Repelita V in 1994, 36% of Indonesia's urban population of 67 million, or 24 million, had access to piped water. Aiming at serving 62% at the end of Repelita VIII in 2008, or 66 million people out of 106 million, could appear ambitious, would however just reduce the unserved population from the 1994 level of 43 million to 40 million. To meet this objective about Rp7.000 billion and Rp10.800 billion would have to be invested during Repelita VII and Repelita VIII respectively, to be compared with the Rp3.000 billion scheduled for Repelita VI. If the water supply sector is not able to attract commercial financing, because it is perceived as too risky, this level of investment would become an unbearable burden on the Government's budget.

b. Yet financial forecasts show that gradually phasing out of the Government financial support during Repelita VII, and financing development of the water supply sector only from cash generation and the capital market, as of 2004, is affordable. To do this, the average tariff in large PDAMs would have to be gradually increased from Rp650/m3 in 1995 to only about Rp950/m3 in 2008. In smaller PDAMs, the tariff would have to be gradually increased from Rp650/m3 to Rp800/m3. In DKI Jakarta, the average tariff could, in theory be decreased if efficiency gains could be achieved.

c. However, the "graduation" of the water supply sector can be achieved only if an integrated set of policy changes is introduced to transform the current collection of municipal water supply companies into an autonomous and creditworthy customer-oriented service industry. The Urban Water Supply Sector Policy Framework (WSPF) identifies six major policy changes, aiming at increasing the water supply sector's creditworthiness, with the ultimate goal to serve all customers better and at a lower cost. The Government may have no other option if it wants to free some public funds to finance sewerage service and waste water treatment, that are currently provided to less than 5% of the urban population and unlikely to attract commercial financing in the near future.

Establish an Arm Length Relationship between the Owner of Water Supply Assets and their Manager

d. Indonesia's municipal water supply industry currently counts some 300 companies. Their autonomy from their local governments is limited, so they cannot really be held accountable for their operating efficiency. Most PDAMs are far too small to attract good quality managers and staff. Their efficiency is typically low, as evidenced by high staffing ratios or high unaccounted for water. Their revenues are limited because of inadequate commercial policies reflected by low tariff levels and tariff structures

distorting consumption. Strict financial discipline is not enforced and the Government has recently made loans to poor performing and non creditworthy PDAMs. As a result, the financial health of most PDAMs, measured according to a set of criteria related to of efficiency, profitability and debt structure, is questionable. Finally, most local governments expect revenues from their PDAMs and extract dividends even if the level of service justifies that any profits be invested to improve and expand the service.

e. Separating ownership of water supply assets from their management could help limit political influence in the day-to-day management of the water supply operations. This move could be further supported through the participation of professional managers and user representatives in the Board of the operator. This action could also favor the setting and monitoring of performance objectives within the framework of enforceable "performance contracts". While worldwide experience with contracts between governments and companies they owned is not always encouraging, separating ownership and management functions would in fact lay the basis for private sector participation in the provision of water supply. Separation could allow for the consolidation of operations among neighboring local governments to take advantage of economies of scale. The notion of dividends to be paid by a PDAM to its only shareholder could be replaced by the notion of an operating fee to be paid by the operator to the owner of the facilities.

Establish a Regulatory Framework for Private Sector Participation

f. Private sector participation could be the main development in the water supply sector during the years to come. But under the present conditions, participating in the financing of the sector's development is perceived as a risky business by private lenders and equity investors. This perception is further supported by the absence of a transparent regulatory framework, as evidenced by the many memoranda of understanding that have failed to lead to any significant deal.

g. Indonesia could take advantage of worldwide experience in private sector participation in water supply. The experience shows that all options -- from simple service contracts to sophisticated long term concessions -- must be envisaged with the assistance of independent consultants before soliciting proposals from private operators. Standard contracts and selection procedures, serve as the basis for the regulatory framework, must be prepared urgently. Worldwide experience has also shown that transparent competition leads to lower prices and shorter transaction periods than direct negotiations. It also shows that even tightly specified contracts cannot remove the need for direct regulation, to provide a quick response to changing economic, social and technical conditions, and that an independent regulatory body should be operational as soon as contracts with private operators become effective. Since it is difficult to

transform a former public utility into a regulatory body it could be advantageous to consider outsourcing some of the regulatory functions to reputable auditors or certification agents, at least in the short term.

Streamline Water Sector Financial Management

h. · PDAMs have so far financed their development mostly from Government grants and concessional loans, and very little through cash generation. Because of the indiscipline in Government lending and subsidized loan conditions, very few PDAMs may be considered creditworthy.

i. To finance extensions, the Government must emphasize PDAM cash generation, resulting from both efficiency gains and tariff adjustments. Access to Government grants and concessional loans could be clarified and PDAMs should compete for them, with the best performing having access to more favorable terms. In parallel, loans should not be made to PDAMs with weak debt service capacity, and lending conditions could be more strictly enforced. Decentralization of lending functions to domestic banks could be envisaged, albeit cautiously, as a means to move lending conditions closer to commercial ones, increase flexibility in funding PDAM projects and establish the needed discipline. Also, alternative financing means, such as bonds or securitization should be pursued.

j. To reduce the current perception of high risk, it would be necessary to provide investors with reliable sectoral data, certified by independent auditors. A quality data base could also allow the benchmarking of PDAMs performance and help local governments link tariff adjustments to a PDAM performance improvement plan and help the central Government direct its financial support first to PDAMs that improve their performance. Private sponsors of water supply projects would seek guarantees against a variety of risks (revenue, payment, termination and regulation), and the Government should focus mostly on providing guarantees only on termination and regulation risks.

Simplify Pricing Policy

k. PDAM tariffs do not meet any of the economic, financial, social equity and administrative simplicity principles of water tariff-setting. Current tariffs discriminate against lower income households by charging high connection fee and force large consumers to use substitutes such as ground water, thus depriving PDAMs of substantial revenues. They also invite manipulation of meter readings, a suspect in increasing commercial unaccounted for water.

l. An improved tariff structure could consist of a small fixed fee for covering administration and meter maintenance costs and a rate per cubic meter of water

consumed. The latter could include only two consumption blocks. The first could be a "life line" block of up to 10 m^3 per month and a rate such that the first block would not represent more than 4% to 5% of the total expenditure of an average low-income household. The second one could be a "base rate" set such that the overall average tariff represents a balance between economically efficient marginal cost and financially viable average costs. Low-income households could be offered connections free of charge, provided that the tertiary distribution network is reasonably close by, in exchange for a refundable advance payment on their water bill.

m. While tariff negotiations could take place every four to five years only to encourage the operator of the water supply system to implement its performance improvement plan, tariff must be automatically adjusted between two negotiations, using a cost index formula reflecting actual cost composition. The economic cost of providing water could also take into account the cost of collecting and disposing of the waste water. Adding a sanitation surcharge to piped water could, under the current conditions, encourage some users to revert to poorly regulated alternatives. For now, a sanitation fee using the property tax as a basis appears more equitable.

Improve Planning, Design and Implementation of Water Supply Projects

n. As water supply systems are capital intensive, it is essential to develop them within the framework of systematic, long term planning with the objectives of seeking least cost solutions and reaching a broad consensus among all stakeholders on the technical, institutional, financial and cost recovery options chosen. This practice is not yet part of the PDAM culture. An important way of reducing costs and enhancing project quality is to improve procurement practices by grouping works in larger packages to attract better quality contractors, by combining supply and laying of pipes, or by awarding design-and-build contracts for water treatment and pumping plants. Reducing construction costs also means that real competition becomes the rule; since at present too many contracts seem to be awarded on a "rotational" basis for predetermined prices. Finally, since the water supply sector depends very much on consultants for project identification, preparation, implementation and institutional development, it could be beneficial for all parties to take a step back and closely identify those current practices that limit access to the best available expertise.

Emphasize the Identity of the Indonesia Water Supply Industry

o. To help build the Indonesian water supply industry an identity, PERPAMSI could be given a larger role. PERPAMSI could take the lead in setting up the "quality" data base mentioned above. PERPAMSI could also be given enhanced responsibilities in human resource development, and it could assist PDAMs in improving recruitment,

productivity and training plans, and in preparing and implementing medium-term staffing plans. PERPAMSI could update existing selection criteria for various key positions, and help develop a mechanism to advertise vacancies much more widely. PERPAMSI could also take the lead in carrying out independent testing and certification of new technologies, equipment and software available on the market, and support dissemination of best practice among PDAMs. Finally, PERPAMSI should actively "lobby" for the implementation of a water resource policy that addresses the main concerns of the water supply industry with regards to the timely availability of sources and the protection of water quality.

URBAN WATER SUPPLY SECTOR POLICY FRAMEWORK

A. INTRODUCTION

1. The main objective of the "Urban Water Supply Sector Policy Framework (WSPF)" is to identify the changes that have to be introduced to transform Indonesia's collection of municipal water supply companies into an autonomous customer-oriented service industry.

2. The WSPF is based on a main report that includes seven chapters. The first one describes the current situation; the second addresses issues related to the management of the municipal water supply companies; the third discusses private sector participation in the delivery of water supply services; the fourth describes human resources development (HRD); the fifth covers issues of planning and implementation of water supply projects; the sixth discusses pricing of water supply services, and finally the seventh addresses the financing of the water supply sector.

3. This summary will provide a brief description of the current situation and an analysis of the main problems the sector is facing. It suggests a series of integrated policy changes centered around the following themes:

- establishing an arm-length relationship between the owners of water supply assets and their manager and introducing incentives to perform;
- designing and implementing a regulatory framework for the private provision of water supply services;
- streamlining financial management of the water supply companies to make the water supply sector more attractive to private financing sources;
- simplifying the pricing policy;
- improving the planning, design and implementation of water supply projects; and
- emphasizing the identity of the water supply industry through increasing the role of its professional association.

B. THE URBAN WATER SUPPLY SECTOR AT A GLANCE

4. **Distribution of Responsibilities.** The provision of urban water supply services is mostly the responsibility of local governments (LGs). By end 1994, autonomous water supply companies (PDAMs) had been created in 276 LGs; in 20 smaller LGs, piped water is still supplied by interim water supply companies (BPAMs) under the control of the Directorate General of Human Settlements (DG Cipta Karya) of the Ministry of Public Works. Until 1996, DG Cipta Karya assisted PDAMs in the preparation of projects funded by the Central Government; DG Cipta Karya still maintains a supervision role of all technical and construction aspects. The Directorate General of Public Affairs and Local Autonomy (DG PUOD) of the Ministry of Home Affairs (MoHA) supervises and monitors LGs' enterprises, including PDAMs, and trains their staff on financial and administrative matters. PERPAMSI, the professional association of PDAMs, is involved in training activities and disseminates best practices; it has, however, a very limited staff and still acts very much as an arm of the Central Government, with day-to-day activities guided by DG PUOD.

5. **Service Levels.** By end 1994, 35% of Indonesia's population of 192 million, or 67 million, lived in urban areas. According to the available information, piped water supply service was provided through 2.85 million domestic connections and 36,500 standpipes. An additional 350,000 connections served administrations, businesses and industries[1]. Altogether, it was estimated that about 25 million people, or 36% of the urban population, had access to piped water, of which 20 million through direct connections. There is no major difference in service ratio among the various provinces; even in DKI Jakarta, only 32% of the population had access to piped water. However, while the urban population with access to piped water increased 2.7 times from 9 to 25 million between 1980 and 1994, the number of urban settlers without access to piped water also went up 1.8 time from 24 to 42 million during the same period.

6. **Substitutes to Piped Water and Water-Borne Diseases.** Many households, businesses and industries rely on their own source of water such as shallow or deep aquifers, street vendors or even bottled water. A survey carried out in small towns of Eastern Islands revealed that people without access to piped water were not too dissatisfied with their alternative supplies, but were also willing to get piped water and even pay a tariff higher than the current tariff for a better service than the one currently provided by the water company. It is traditional to boil water for drinking purposes whether obtained from the piped network or other sources, and this practice is unlikely to

[1] These numbers were expected to reach 3.22 million domestic connections, 38,000 standpipes and 430,000 non-domestic connections by the end of 1996.

change soon. even if the piped water delivered is potable. The incidence of water-borne diseases has been stable during the 1990-1994 period[2].

7. **The Water Supply Industry**. At the end of 1994, the 276 PDAMs and 20 BPAMs managed about 1,600 piped water supply systems. Total production capacity was estimated at 6.25 million m^3/day, and actual production and distribution at 5.0 and 3.0 million m^3/day respectively[3]. This implies that about 40% of the water produced is unaccounted for and thus generates no revenues. The Indonesian water industry is a collection of small businesses: at the end of 1994, only four PDAMs served more than 100,000 connections and 230 served less than 10,000 connections. The industry employed a total of 33,200 staff – an average of 10.4 per connection. Total assets were estimated at about Rp2,365 million (US$1,000 million). Total revenue of Rp855 billion (US$365 million) was just sufficient to cover current costs (operation, maintenance and debt service) of Rp875 billion (US$370 million). Since 1990, PDAMs had borrowed was about Rp1,750 billion (US$740 million). Compared with the water industry of neighboring countries, Indonesia's scores rather poorly on service ratio. High unaccounted for water (UfW) and low staff efficiency, as measured by the number of staff per 1,000 connections are widespread problems in developing countries of East Asia.

C. Major Problems the Urban Water Sector is Facing

8. Apart from access to water sources of good quality, Indonesia's urban water supply sector is facing problems that are due to: (a) the lack of autonomy of the PDAMs; (b) the financing mechanisms and lack of discipline; (c) the financial performance of the PDAMs; (d) the tariff level and structure; (e) the planning and project implementation practices; (f) the size and geographical limits of the PDAMs, and as a result (g) the lack of attractiveness to the private sector.

9. **Water Resources**. Indonesia is blessed with abundant rainfall and fresh water resources, although unevenly distributed between the various islands and regions. While irrigation remains the biggest user, by far, of surface water, competition between from urban and industrial users is now intense during low flow seasons, in particular in heavily urbanized river basins of Java. In the past, the focus has mostly been on developing new supplies, while the issue of conversation and demand management have attracted less attention. Quality, a key element for urban water supply, has deteriorated rapidly in these river basins and its protection would require a higher commitment, in particular when it comes to urban waste water collection and disposal. The economic good aspect of water is now accepted, but a comprehensive pricing policy to manage demand has yet to be developed and enforced.

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2 *The number of cases of diarrhea has remained at about 25 per thousand people and the number of deaths due to diarrhea has been constant at 25 cases per thousand cases of reported illness. Statistics show that morbidity and mortality due to water-borne diseases are higher in Eastern Indonesia.*

3 The average gross domestic consumption was estimated at 130 lcd.

10. **Autonomy**. Although PDAMs issue financial statements and prepare budgets that are distinct from the ones of the LGs, most PDAMs are in fact no more autonomous than "dinas", i.e., municipal departments relying on the municipal budget. Their Boards of Supervisors, headed by the Bupati or the Walikota and composed of local civil servants, rarely provide the guidance needed to develop the service on a sustainable basis. Boards tend to intervene too much in decisions that should be left with the PDAM management, such as staff selection, technical options or contract award. Most LGs see their PDAMs as a potential source of income and tend to extract dividends from them, even if they are not profitable or if the level of service justifies that earnings be retained to finance system improvement or extension. At the same time, LGs tend to delay tariff adjustments, either for political reasons or because they focus too much on short term cash flows. ***In fairness, PDAMs cannot really be held accountable for their operating efficiency, because they usually do not have the autonomy needed to make relevant decisions.***

11. **Financing Sources and Financial Discipline**. PDAMs are not financially autonomous either. Currently, PDAMs finance their investment programs mostly from Government grants and loans, and little from internal cash generation[4]. To generate more cash, PDAMs routinely request tariff increases, but have seldom been encouraged by their LGs to implement cost reduction programs. Rarely do PDAMs accumulate surpluses for future investment, but LGs sometimes contribute equity to the PDAM. A significant share of the funds have been Government grants either directly to the PDAM or to the LG which in turn makes an equity contribution to the PDAM or under the form of facilities designed and built by DG Cipta Karya.

12. The two main sources of Government loans are: (a) the Subsidiary Loan Agreements (SLAs) that onlend funds borrowed from international financing agencies, and (b) the Regional Development Account (RDA), administered by the Ministry of Finance, that lends funds provided by the budget. Conditions of both the SLAs and the RDA are more favorable than domestic private banks would currently provide[5]. When inadequate tariff increase are granted by the LG, the central Government tends to reschedule loan repayments and to finance further extensions with grants. No RDA loans are reported to have been rescheduled, but SLAs have been transformed into grants for

4 During Repelita V (1989/1994), about Rp1.800 billion were invested in PDAMs. While the Government made substantial contributions in the form of grants, about 50% of this amount was borrowed by the PDAMs and a small proportion was self financing. The investment was only 50% of the originally planned amount of Rp4.000 billion. Repelita VI's (1994/1998) target for urban water supply to serve an additional 22 million people is ambitious, and its allocation of Rp3,000 billion seems low to meet the increased service expectations. It takes into account implementation shortfalls under Repelita V and the expected availability of private sector financing.

5 RDA conditions vary depending upon the PDAM with repayment periods of 3 to 30 years, interest rates of 0 to 11.5%, grace periods of up to ten years, and the possibility of capitalization of interest during the grace period (not construction period, which is a more standard practice), and equal installments of principal (thus declining principal and interest). SLAs typically have repayment periods of 15 years of which 5 years of grace and interest rates of 11.5%.

several PDAMs of East Java, so that they can borrow under new SLAs for further service extension. ***By allowing defaulting PDAMs to borrow again from the Government, and by providing poor performing, and thus non-creditworthy, PDAMs with the cheapest financing through grants and concessional loans, the incentive to improve financial performance is very limited.***

13. **Financial Performance.** Not surprisingly, despite Government support, not all PDAMs show good financial performance. Because accounting practices vary among LGs, financial statements presented by PDAMs do not easily allow to evaluate and compare performance. BPKP, the Government's auditor, was able to audit about 85% of the PDAMs at the end of 1995, but only 78% of them had generated enough information for adequate financial analyses. Also, the rapid increase in quantity of PDAMs audited may have affected the quality of audits conducted. DG PUOD rates the financial performance of PDAMs according to 12 criteria measuring efficiency, profitability and debt structure. In 1995, about 57% of large PDAMs (50,000 connections and more) were reported "healthy" or "very healthy" but only about 20% of small PDAMs (20,000 connections or less) were reported "healthy". There is, however, no direct relation between the size of a PDAM, the tariff it is allowed to charge and its technical and financial performance.

14. **PDAM Tariffs.** The PDAM tariff structure usually does not meet any of the four basic principles of water tariff-setting: economic, financial, social equity and administrative simplicity[6]. While the average PDAM tariff was Rp485/m^3[7] at the end of 1994: (a) cash costs (operation and maintenance plus debt service) would require that it be set at an average of Rp510/m^3; (b) compliance with MoHA regulation (O&M, depreciation and interest on loans) would lead to an average Rp 765/m^3; and (c) the long term marginal cost (LTMC) would be an average Rp710/m^3. Further, the tariff structure may include more than 20 categories which typically range from 0.8A for social users to 10A or more for large industrial users (with "A" being the base rate). Official connection

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6 Pricing Principles. ***Economic efficiency*** requires that the price be set at the long term marginal cost (LTMC) of providing incremental supply of water, because it maximizes the sum of the consumer and water distributor benefits, signals the cost of supply capacity expansion to users and implies that no excessive profit would be earned by the water utility; however, marginal cost pricing should be practiced in a manner that does not reward inefficiencies, such as high UfW or staff ratio. ***Financial viability*** requires that the price of water be set at a level that covers operations and maintenance, depreciation expenses and provides an acceptable rate of return on revalued assets. ***Social equity*** in pricing water supply aims at ensuring that the poor can obtain an adequate quantity of water at an affordable price. ***Simplicity and stability*** of pricing over time is necessary so that customers understand it, be able to respond to signals and adjust their consumption accordingly, and the utility can administer prices easily.

7 The average tariff per m^3 here is obtained through regression analysis, rather than through simple or weighted averaging. Regression analysis is such that it reflects the majority of tariffs and discounts the effects of a few extreme high or low tariffs. All other figures mentioned in this paragraph have been obtained by regression analyses and are comparable to an average tariff.

ch ges of about Rp300.000[8] can often be paid in installments. but connections are co dered a profit center.

15. Because the average tariff is lower than the LTMC. those who are connected are encouraged to use more water than socially justified; at the same time those who are not connected. but willing to pay cannot have access to service because many systems are operated at design capacity. Actually. those who benefit from subsidized tariffs are higher income households. while lower income households rely on water from vendors at a much higher price. Also. because the higher block is higher than the LTMC, it forces large water consumers. such as businesses and industries. to use substitutes. thus depriving PDAMs of substantial revenues. The complex tariff structure also tends to encourage "manipulation" of meter readings so that customers are charged lower rates. The tariff structure is thus suspected of increasing commercial UfW. Finally. the connection fee. even if paid in monthly installments. is often too high for low income households.

16. **Planning and Project Implementation.** Because the water supply sector is capital intensive. it is essential to seek the least cost solution through quality planning. but medium term planning (10 to 15 years) is not yet a standard PDAM practice. Also. current practices in contract packaging for the procurement of goods and works. implementation arrangements and the use of technical assistance have the tendency to increase the cost of inputs. sometimes substantially.

17. **Size and Geographical Limits of Operations.** As of end 1994. 230 PDAMs served less than 10.000 connections. Because of such small operations[9], PDAMs cannot attract nor afford good managers. At the same date, of 33.200 PDAM staff only about 100 were sanitary engineers or about 5% of the 1,900 Indonesian graduates in this specialty (about 30 graduate each year). In addition, there is currently no labor market in the water supply sector, and many PDAM managers, even in large kotamadyas, are senior municipal civil servants on a rotational assignment. Staff training is an ad hoc activity: most PDAMs do not have training plans and budget. PERPAMSI plays a role in human resources development and training and has begun work in career planning and certification for manager. Even so. PDAM staff are too often identified with their LGs rather than with an Indonesian water supply industry. Also. since PDAMs' activities are constrained to LG boundaries, it is currently difficult to jointly address technical or managerial issues in neighboring PDAMs to provide better service at a lower cost.

18. **Attractiveness to the Private Sector.** Although the Government has indicated that it wishes to limit its financial support to the water supply sector and that PDAMs would have to finance their own capital expenditures programs increasingly through cash

8 A survey of 27 PDAMs of various sizes show an average revenue of Rp380.000 per new connection in 1995 prices.

9 The annual revenue of a PDAM serving 10.000 connections is typically in the range of US$200.000 equivalent.

generation or from the capital market, the current incentives for PDAMs and LGs to follow this strategy are very weak. As said above, this is due, at least in part, to the fact that PDAMs cannot be rewarded for efficient delivery of services and shortfalls of poor performers can be made up through grants and concessional loans. ***Because of the technical and financial status and management conditions described above, financing the development of the water supply sector is still perceived to be a risky business by private lenders and equity investors.***

19. The Government expects the private sector to become a major actor in the provision of water supply services; however, the private sector participation (PSP) initiatives have experienced many difficulties because the conditions that would provide some confidence to potential investors or international operators do not exist yet. Also, domestic capabilities are still limited. Dozens of PDAMs have been approached by potential partners and have signed memoranda of understanding (MOUs) with private companies, mostly for the development of new water production capacities. Negotiations are generally not concluded because PDAMs often cannot clearly define their objectives or lack the know-how and accountability to arrive at contracts that would serve the public interest best and be attractive to private companies. Thus far, too much emphasis has been put on providing additional production capacity and accessing private financing ources and not enough on expanding distribution and improving technical, commercial .id financial operations, an obvious prerequisite to improving access to capital markets.[10]

D. THE CHALLENGE AHEAD

20. **Urban Population Forecast.** Indonesia's total urban population, estimated at 67 million at the end of Repelita V (end of 1993 - beginning of 1994), or about 34% of the total population, should reach 76 million at the end of Repelita VI (end 1998), and 91 million and 106 million at the ends of Repelita VII (end 2003) and Repelita VIII (end 2008) respectively. The share of the urban population would gradually increase from 37% in 1998 to 45% in 2008. Just under 70% of the total urban population is currently located on Java, 17% on Sumatra and 14% on Kalimantan, Sulawesi, Bali and the Eastern Islands combined. Also, about two-thirds of the urban population is currently located in metropolitan areas or clusters of cities of more than half a million people. This percentage is not expected to change in the near future. Between 1993 and 2008, the average growth rate of the urban population is expected to be about 3.4%, meaning that an average of three million people will be added each year to Indonesia's cities.

21. **Future Development Scenarios.** In order to estimate the investment and financing needs of the urban water supply sector during Repelita VII and VIII, as well as their consequences on the water tariff, four main scenarios have been simulated using a model. The model was run by major region of Indonesia (Sumatra, DKI Jakarta, Java

[10] Except in Jakarta, where the Government is seeking a solution to PAM JAYA's stagnating performance through long term concessions with joint ventures of local investors and international operators.

excluding DKI Jakarta, Bali, Eastern Islands, Kalimantan and Sulawesi) and for the entire country and by category of PDAM (DKI Jakarta, metropolitan PDAMs and smaller PDAMs). For each scenario, basic assumptions were made on: (a) consumption elasticity to tariff and income increases; (b) construction and O&M costs; (c) reduction of UfW and of the cost of inputs; and (d) financing conditions[11]. For all scenarios, revenues are supposed to cover O&M costs, debt service and contribute at least 25% towards the investment program.

22. **Scenarios 1a: "Business as Usual".** Scenario 1a envisages no significant changes in the way the water supply business is conducted. In particular UfW would remain at about 40% and the cost of inputs would continue to suffer from the current procurement practices. Also, connection fees would remain at the current level, and limit the growth rate of residential connections to about 6.25% per year, as it is currently. The tariff structure would still discriminate against non-domestic users, thus limiting commercial and industrial demand. Tariffs would be increased by an average of 25% every three years, as it is the current practice, with a first increase in 1998. ***Table 2 shows that despite investment levels of Rp4,300 billion and Rp5,300 billion, at 1995 prices, during Repelita VII and VIII,*** somewhat higher than what is currently planned for Repelita VI, the overall "service" ratio of 38% in 1995 would increase only to 43% and 49% in 2003 and 2008 respectively. However, ***the unserved urban population of 42 million in 1995 would increase to 52 and 54 million respectively at the same time.***

23. ***Government grants and loans on concessional terms would still cover about two-thirds of investment needs*** and total Rp2,500 billion and Rp3,300 billion, at constant 1995 prices, for Repelita VII and Repelita VIII respectively. Loans on commercial terms,

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[11] The following assumptions were made for financial forecasts:

- consumption elasticity to tariff increase: minus 0.3 for domestic consumers and minus 0.1 for non domestic consumers;
- consumption elasticity to income increase: plus 0.4;
- all earnings are retained by the PDAM for reinvestment in expansion programs, and thus no dividends are paid out to local governments for their equity share throughout the projection period, because the service level would remain below 75%;
- construction cost - production facilities: Rp50 billion and Rp30 billion per additional m^3/s for metropolitan and smaller PDAMs respectively;
- construction costs - distribution facilities: Rp1.8 billion and Rp1.2 billion per additional 1,000 connections for metropolitan and smaller PDAMs respectively;
- O&M costs: Rp420/m^3 for metropolitan and smaller PDAMs; Rp525/m^3 for DKI Jakarta;
- concessional loans from the Central Government to PDAMs: repayable over 15 years, including three years of grace and 11.5% interest rate;
- private financing of water supply project: 20% equity investment, 80% commercial loan for metropolitan PDAMs and 100% commercial loans for smaller PDAMs;
- return on private equity invested in water supply projects: 26%;
- loans on commercial terms: repayable over 10 years, including three years of grace and average 18% interest rate;
- PDAM bonds: maturity of ten years, with an annual coupon of 18%.

private equity and bonds would be limited to DKI Jakarta and would represent a total of only about 12% of the overall investment program during the next two Repelita. There should be no need to increase water tariffs in Jakarta at 1995 prices, that could remain at about Rp1,500/m^3. After the 1998 tariff increase, tariffs in metropolitan and smaller PDAMs would have to be marginally increased at 1995 prices from Rp650/m^3 in 1998 to Rp830/m^3 in 2008.

24. **Scenario 1b: "Business as Usual, but with 62% Service Coverage in 2008".** It is hardly acceptable to envisage an increase in the unserved population, as a consequence of the "business as usual" scenario. Thus, scenario 1b aims at a 70% service ratio in 2010, that would be translated into a service ratio of 62% in 2008 and a slight reduction in the unserved population at the same date. For this however, a more aggressive commercial policy would have to be implemented towards residential customers, by providing small consumers with a new connection at a very low fee[12], as well as commercial and industrial customers by implementing a tariff structure that does not discriminate against them. If implemented, such a scenario would require investment levels of Rp7,000 billion and Rp10,800 billion during Repelita VII and VIII respectively. Five million residential connections would be built between 1998 and 2008, at an average growth rate of 8.7% per annum and non residential consumption would be multiplied by a factor of 3.3 between these two dates. However, with the overall sector performance remaining similar to what it is now, in particular with regards to UfW and cost of inputs, and tariff increases of an average 25% every three years limiting the sector's borrowing capacity, the cash shortfall would have to be met through a Government financial support on the order of Rp4,500 billion and Rp7,500 billion for Repelita VII and VIII respectively, at 1995 prices, compared to Rp2,500 billion and Rp3,300 billion for scenario 1a.

25. **Scenario 2a: "62% Service Coverage in 2008 with Increased Private Sector Participation".** Under scenario 1b, the level of Government support to the water supply sector becomes unsustainable, especially if the water supply industry does not improve its performance. Experience in countries having faced a similar situation shows that this cannot be achieved if major changes in the attitude of the main actors in the sector, are not pursued. Thus, ***scenario 2a envisages increased private sector participation in service delivery, because this is the simplest way to implement financial incentives to improve performance.*** In scenario 2a, it is assumed that overall UfW would be reduced by about one percentage point per year, thus decreasing operating costs by the corresponding amount, and that all equipment or works procured under privately sponsored projects would be about 15% lower than for those under publicly implemented projects. Obviously, the private sector would have to rely exclusively on commercial sources to finance its projects. Scenario 2a also envisages that Government support to metropolitan PDAMs would be gradually phased out; however, Government support to

[12] In the proposed connection policy, about 75% of the new residential customers would be provided a connection free of charge; cost of construction would be financed by a small surcharge (about 5%) on the water tariff (see below discussion on pricing of water supply services).

smaller PDAMs would remain significant. As in scenario 1b, adjustments in the current pricing policy would be made to favor new residential connections and increased consumption of businesses.

26. Scenario 2a envisages a tariff increase in 1998, that would to be followed by annual adjustments sufficient to meet cash requirements (O&M, debt service and investment program). Table 2 below shows that the amount to be invested in the sector would reach Rp6,350 billion and Rp9,600 billion during Repelita VII and VIII respectively, at 1995 prices. Tables 5 and 6 give a breakdown of the investment program for the two next Repelita by region and size of PDAM. For Repelita VII, about 85% of the investment program would be absorbed by Sumatra (17%) and Java (68%, of which 11% for DKI Jakarta).

27. Despite a much larger investment program than for scenario 1a, and a much larger share of it financed on commercial terms, the tariff level required by scenario 2a would still be affordable. In fact, the water tariff in Jakarta does not have to be increased in 1998 and could even be decreased (in 1995 terms) before the end of Repelita VII as a result of expected increased efficiency in operations. For metropolitan and smaller PDAMs, the 1998 tariff increases should be in the range of 16% and 4% respectively to reach an average Rp755/m^3 and Rp675/m^3 (in 1995 terms). The tariff would reach Rp890/m^3 and Rp680/m^3 respectively for metropolitan PDAMs and smaller PDAMs in 2008 (in 1995 terms).

28. **Scenario 2b: "62% Service Coverage in 2008 with Maximum Private Sector Participation"**. Scenario 2b tries to measure the consequences of the hypothetical case where, after a transitional period (Repelita VII), the Government would completely cease subsidizing the water supply sector, starting with Repelita VIII. All other assumptions being similar to the ones of scenario 2a, table 3 below shows that it would not be unrealistic to envisage such an option in the medium term, because the tariff level required would remain within the range of what consumers say they are willing to pay if the water supply service is reliable[13].

29. Table 4 shows that aiming at increased private sector participation would halve the Government support needed per additional person served with piped water from Rp340,000 to Rp180,000 (scenarios 1b and 2a). ***However, the level of the Government financial support to the water supply sector would be significant during Repelita VII.*** For example, in scenario 2a, likely to be a feasible option, out of a total investment of Rp6,350 billion, the Government would still have to provide Rp2,400 billion. Table 5 shows that ***more than 80% of the Government support, or about Rp2,000 billion,***

[13] A survey carried out in 1996 in five small urban centers of Kalimantan, Sulawesi and West Timor, (Tenggarong, Banjarbaru, Maros, Tomohon and Soe) show that depending upon current water supply conditions, between 50% and 100% of households with a connection are willing to pay Rp1,000/m3; these figures fall to 40% and 90% for a tariff of Rp2,000/m3. Among households without connections about 50% are willing to pay Rp1,000/m3 and 40% Rp2,000/m3.

should go to the Java and Sumatra regions, although about 90% of the financing on commercial terms, or Rp2,000 billion, is expected to take place in these two regions (all figures in 1995 terms).

30. The main assumptions and consequences of these scenarios are summarized in tables 1 and 7 below.

Table 1: Comparison of Scenarios 1a, 1b, 2a and 2b
Main Assumptions

	Scenario 1a	Scenario 1b	Scenario 2a	Scenario 2b
UfW	Remains at average current level of 40%	Remains at average current level of 40%	Decreases by one percentage point per year	Decreases by one percentage point per year
Cost of Inputs	Remains at current level	Remains at current level	Minus 15% on all privately financed and implemented project	Minus 15% on all privately financed and implemented project
Residential Connection Fee	Rp380.000 (at constant 1995 prices)	75% of the new residential connections would be provided free of charge	75% of the new residential connections would be provided free of charge	75% of the new residential connections would be provided free of charge
Tariff structure	Discriminates against non residential customers	Two blocks only	Two blocks only	Two blocks only

Table 2: Comparison of Scenarios 1a, 1b, 2a and 2b
Service Ratio, Investment Program and Financing Plan

	Scenario 1a	Scenario 1b	Scenario 2a	Scenario 2b
Service Ratio [14]				
1995	31% 38%	31% 38%	31% 38%	31% 38%
1998	33% 40%	35% 41%	35% 41%	35% 41%
2003	38% 43%	44% 49%	44% 49%	44% 48%
2008	44% 49%	58% 63%	58% 62%	58% 62%
Served population				
end of Repelita VI (1998)	30 mn	30 mn	30 mn	30 mn
end of Repelita VII (2003)	39 mn	44 mn	44 mn	44 mn
end of Repelita VIII (2008)	52 mn	66 mn	66 mn	66 mn
Unserved population				
end of Repelita VI (1998)	46 mn	46 mn	46 mn	46 mn
end of Repelita VII (2003)	52 mn	46 mn	46 mn	46 mn
end of Repelita VIII (2008)	54 mn	40 mn	40 mn	40 mn
Invest. and Financing Plan				
Repelita VII	**Rp4,300 bn**	**Rp7,000 bn**	**Rp6,350 bn**	**Rp6,200 bn**
Internal cash generation	26%	26%	27%	27%
GOI grants	36%	39%	29%	13%
GOI loans on concess. terms	23%	26%	9%	9%
Loans on commercial terms	10%	6%	26%	42%
Private equity	3%	2%	5%	5%
PDAM bonds	2%	1%	4%	4%
Repelita VIII	**Rp5,300 bn**	**Rp10,800 bn**	**Rp9,600 bn**	**Rp9,100 bn**
Internal cash generation	26%	25%	28%	28%
GOI grants	38%	41%	26%	0%
GOI loans on concess. terms	25%	28%	0%	0%
Loans on commercial terms	7%	4%	35%	60%
Private equity	2%	1%	6%	7%
PDAM bonds	2%	1%	5%	5%

[14] The first figure corresponds to the "connection" ratio, the second figure corresponds to the "service" ratio, that includes households served by residential connections and public standpipes.

Table 3 : Comparison of Scenarios 1a, 1b, 2a and 2b
Tariff Increases Needed (1995 Rp/m^3)

	Scenario 1a	Scenario 1b	Scenario 2a	Scenario 2b
Average Tariffs				
DKI Jakarta				
1995	1.500	1.500	1.500	1.500
1998	1.350	1.350	1.300	1.300
2003	1.350	1.350	1.150	1.150
2008	1.350	1.350	1.150	1.150
Metropolitan PDAMs				
1995	650	650	650	650
1998	680	680	750	760
2003	640	640	770	780
2008	740	740	890	950
Smaller PDAMs				
1995	650	650	650	650
1998	680	680	670	670
3	640	640	680	680
8	740	740	680	800

Table 4: Comparison of Scenarios 1a, 1b, 2a and 1b
Government Financial Support (1995 Rp)

GOI Financial Support	Scenario 1a	Scenario 1b	Scenario 2a	Scenario 2b
Repelita VII				
GOI grants	Rp1.500 bn	Rp2.700 bn	Rp1.800 bn	Rp 800 bn
GOI loans on concess. terms	Rp1.000 bn	Rp1.800 bn	Rp 600 bn	Rp 500 bn
Total	**Rp2,500 bn**	**Rp4,500 bn**	**Rp2,400 bn**	**Rp1,300 bn**
Add'l population served	9.5 mn	13.3 mn	13.3 mn	13.3 mn
Per add'l pop. served	**Rp265,000.**	**Rp340,000**	**Rp180,000**	**Rp100,000**
Repelita VIII				
GOI grants	Rp2.000 bn	Rp4.500 bn	Rp2.500 bn	-
GOI loans on concess. terms	Rp1.300 bn	Rp3.000 bn	-	-
Total	**Rp3,300 bn**	**Rp7,500 bn**	**Rp2,500 bn**	-
Add'l population served	12.2 mn	21.6 mn	21.6 mn	21.6 mn
Per add'l pop. served	**Rp275,000**	**Rp350,000**	**Rp120,000**	-

Table 5: Scenario 2a - Repelita VII
Investment Program and Financing Plan per Region (1995 Rp billion)

	DKI Jakarta	Metro PDAMs	Smaller PDAMs	Total	Financ. Plan		
					Cash generat.	GOI Support	Comm. Financ.
Region							
Sumatra		530	540	1,070	290	470	310
Java	960	1,530	1,840	4,330	1,180	1,510	1,640
Bali		180	-	180	50	60	70
Eastern Islands		-	190	190	50	100	40
Kalimantan		160	110	270	70	120	80
Sulawesi		160	150	310	80	140	90
Total (Rp bn)	**960**	**2,550**	**2,840**	**6,350**	**1,720**	**2,400**	**2,230**
Total (%)	15	40	45		27	38	35

Table 6: Scenario 2a - Repelita VIII
Investment Program and Financing Plan per Region (1995 Rp billion)

	DKI Jakarta	Metro PDAMs	Smaller PDAMs	Total	Financ. Plan		
					Cash generat.	GOI Support	Comm. Financ.
Region							
Sumatra		750	880	1,630	450	470	710
Java	870	2,450	3,230	6,550	1,800	1,700	3.050
Bali		320	-	320	100	30	190
Eastern Islands			290	290	70	130	90
Kalimantan		240	150	390	110	90	190
Sulawesi		240	210	450	120	120	210
Total (Rp bn)	**870**	**4,000**	**4,760**	**9,600**	**2,650**	**2,530**	**4,420**
Total (%)	9	42	49		28	26	46

Table 7: Scenario 2a - Evolution of the Financing Conditions

	Repelita VII (1999-2003)	Repelita VIII (2004-2008)
DKI Jakarta		
Internal cash generation	30%	30%
GOI grants		
GOI loans on concess. terms		
Loans on commercial terms	48%	48%
Private Equity	12%	12%
Bonds	10%	10%
Metropolitan PDAMs		
Internal cash generation	25%	30%
GOI grants	from 45% to 10%	10%
GOI loans on concess. terms	from 30% to 0%	0%
Loans on commercial terms		40%
Private Equity		10%
Bonds		10%
Smaller PDAMs		
Internal cash generation	25%	25%
GOI grants	45%	45%
GOI loans on concess. terms	from 30% to 0%	0%
Loans on commercial terms		24%
Private Equity		6%
Bonds		

E. KEY ELEMENTS OF THE POLICY FRAMEWORK

31. **Can the Water Supply Sector "Graduate"?** If indeed the above assumptions are correct: (a) financing a "significant share" of the investment program on commercial terms would still be affordable by the users; and (b) the financial support to be provided by the Government for each additional person served with piped water could be reduced by half if the private sector were to provide this financing. Then, it is clear that the highest return activity for the sector is putting in place the framework required to make private participation and financing happen. The saving to the economy would even be higher because raising tax revenue (to fund the non-internally generated sources) involves other economic costs, that could also be reduced. Also, attracting commercial financing for developing the water supply sector would free Government financing for developing sewerage and sanitation, a sector that is currently under-developed and unlikely to attract private financing in the near future.

32. ***But access to affordable commercial sources to finance the development of the water supply companies would not materialize on a large scale if conditions that make the perception of the sector risky are not alleviated.*** For example, investors would certainly feel more comfortable if: (a) the decision-making process, in particular with regards to the choice of investment programs, procurement or the setting of tariffs were

transparent: (b) the framework for the private provision of service were comprehensive; and (c) reliable technical, commercial and financial data on the current operations were made available. Also, the "graduation" process would be greatly facilitated if Government's financial support to the sector followed a pattern similar to that of the private sector. This would imply being more selective by directing financing first to PDAMs that are improving their overall performance, and thus their creditworthiness.

33. Six main policy directions are proposed to achieve rapid expansion of the water supply service to unserved households and businesses, to improve the quality of service and to reduce the cost of its provision, and to make the water supply sector more attractive to commercial financing.

Policy Direction 1. Establish an "Arm Length" Relationship between the Owner of Water Supply Assets and their Manager

34. **Separate Ownership of Assets from their Management.** A LG ultimately responsible for the provision of piped water should be mainly concerned with the rapid expansion and reduction of the cost of service to make water affordable to all consumers. The simplest way of achieving these two objectives is to link them to financial incentives within the framework of enforceable contracts. ***This sets the basis for separating ownership of the facilities from the management function. This could help address some of the shortcomings identified above. More specifically it could: (a) limit ad-hoc local political interference in the management of the water supply service; (b) facilitate "performance contracts" and private sector participation in the delivery of water supply service; and (c) allow "managing companies" to group themselves to more efficiently address issues common to adjacent water supply systems.***

35. **Limit Political Influence.** To limit political influence in the day-to-day management of water supply companies and increase transparency of the decision-making process, it could be beneficial to: (a) ***avoid having the head of a LG being systematically appointed as chairman of the PDAM Board of Directors; and*** (b) ***include representatives of customers and professional managers to support, or even replace, the government employees who are de facto members.*** A training program of the members of Boards members should focus on policy issues such as planning, procurement, pricing, private provision of public services and regulation.

36. **Envisage Performance Contracts, but with Caution.** Another step towards improving quality of service would be through "performance contracts" between the PDAM Board and its management and staff. Performance contracts could fix performance objectives such as number of connections per category of customer, continuity of service, water quality, UfW, and include clauses that would allow for the distribution of profits to PDAM management and staff upon achievement of the set objectives. ***Experience worldwide has shown, however, that success stories are few, because performance contracts between two public entities are rarely enforced and enforceable.*** Often the granting authority does not meet its obligations with regards to

the timely allocation of a water right or approval of tariff increases: also, independent measurement of performance could become an issue. Prototype performance contracts would have to be drafted and could be tested in selected PDAMs of all sizes, but ***the best way to improve performance is to involve the private sector in the delivery of service, because contracts can more easily be enforced*** (see paras 39 and following).

37. **Regroup Operations.** International experience tends to show that the minimum efficient size of a water utility company includes between 50,000 and 100,000 connections. On Java and Bali, and to a lesser extent Sumatra and Sulawesi, ***separating asset ownership from management could more easily allow PDAM to regroup their technical and/or commercial operations. This regrouping could result in either (a) the formation of public regional service companies jointly owned by participating PDAMs, or (b) the provision of service by private companies under contract with each PDAM or, better their representative "syndicate".***

38. **Replace Dividends to LG by Operating Fees.** Most LGs expect their PDAM to distribute dividends. ***The separation of ownership from management should encourage the central Government to replace the concept of a "dividend", by the one of an "operating fee" that would come, as a substitute source of revenue for the LG, on top of the water tariff and be collected by the manager on behalf of the owner.*** In the case of a PDAM under a performance contract with a LG, the "operating fee" should at least cover the operating costs of the Board. In the case of a private operator under contract with the PDAM or the LG, the operating fee would have to be set at a level that should allow the LG to meet its financial commitment, in particular the debt service.

Policy Direction 2. Establish a Regulatory Framework for Private Sector Participation in the Delivery of Water Supply Services

39. **Take Advantage of Worldwide Experience.** Private sector participation (PSP) could very well be the main development in the water supply sector during the years to come, but worldwide experience shows that is more likely to succeed if: (a) political commitment at all levels of government is ensured; (b) consensus among the many stakeholders has been reached; and (c) the public authority has defined its objectives clearly and has put in place a transparent decision making process and a conflict resolution mechanism. Consequently, ***PSP requires careful preparation and cannot be achieved overnight.***

40. **Do the Homework First.** Once PSP is envisaged, ***all options must be first analyzed with the assistance of independent and experienced consultants.*** In particular, risks of all types (political, economic, financial, technical and legal) must be assessed and appropriate mechanisms to mitigate them should be adopted. Table 7 gives the main characteristics of the various options that are suitable for Indonesia. Among these options, ***service and management contracts*** are the easiest ones to implement, in particular for PDAMs where the private sector is not yet willing to take commercial or financial risks. ***Concession contracts*** are much more elaborate options that transfer these

risks to the private party, typically for 20 years or more; they require thorough analysis prior to soliciting proposals. ***Lease contracts***, i.e., concession contracts where only the commercial risk is transferred to the private company (the public authority still remains responsible for financing and implementing the major capital expenditure program) are worth considering, when financing the development program from commercial sources is not feasible. ***BOOT*** (Build, Own, Operate and Transfer) schemes are appropriate solutions only for new water production units; they ***cannot address key problems of rapid expansion of service to customers, improvement of its quality and reduction of its cost.***

41. **Prepare Standard Contracts.** In Indonesia, as in most other countries, ***private provision of water supply services will mostly be regulated directly by a contract.*** Therefore, it is essential that the regulatory framework to be put in place address issues such as the feasibility, clarity and accuracy of contracts, award and approval procedures, and enforceability of contracts. Contracts also have to be accurate, and ***standard service, management, lease and concession contracts should be prepared for the use of local governments and PDAMs***. Transparent and streamlined bidding, evaluation, and approval procedures are also needed to give private companies a clearer picture of the framework in which they would have to operate.

42. **Open the Selection Process.** ***Open competition*** for the selection of a private partner, after proper prequalification on technical and financial grounds, is often the preferred solution, because it ***provides the most transparent result, and allows users to benefit from the lowest bid***. Direct negotiations or competitive negotiations could be justified when innovative solutions have to be found or proprietary technologies are chosen, e.g., for water treatment. However, this method lacks transparency, in particular because it is often difficult to check if a service of similar quality could not have been provided at a lower cost. ***Experience has shown that direct negotiations do not really shorten the process of arriving at a reasonable deal and do not significantly reduce the cost of preparing proposals***. In any case, direct negotiations could be carried out only with reputable contractors and with the assistance of experienced technical, financial and legal advisors. Throughout East Asia, the Memorandum of Understanding (MOU) process, mostly for unsolicited proposals for BOOT for new production facilities, has failed because of the absence of independent prior analysis and the public sector's lack of experience in negotiations of this nature. ***Open competition should therefore also be the preferred solution for more complex contracts such as concessions, leases and BOOTs.***

Table 8: Main Features of Various Contractual Arrangements for Private Provision of Water Supply Services

Option	Service Contract	Management Contract	Lease Contract	Concession Contract	BOOT (for production facility)
Main Objective Pursued	limited improvement of operations	overall improvement of operations	overall improvement of operations (with transfer of commercial risk)	overall improvement of operations and mobilization of private capital	mobilization of private capital
Typical Contract Duration	1 to 2 years	3 to 5 years	5 to 10 years	20 to 40 years	20 to 40 years
Contractual Relations with Users	public authority	private manager on behalf of public authority	lease contractor	concessionaire	no direct relation with users
Commercial Risk Taken by	public authority	public authority	lease contractor	concessionaire	public authority through "take or pay" arrangement
Financing of Investment	public authority	public authority	public authority and lease contractor	concessionaire	concessionaire
Financing Working Capital	public authority	public authority	lease contractor	concessionaire	concessionaire
Financing Risk Taken by	public authority	public authority	mostly public authority	concessionaire	concessionaire
Remuneration of Private Company	lump sum, work done, unit price	cost-plus and productivity bonus	part of user rate	user rate	bulk water rate
Responsibility for Setting User Rates	public authority	public authority	public authority	concession contract	BOOT contract

43. **Create the Function of Regulator**. It is often argued that a tightly specified contract can remove the need for direct regulation. For more complex concession or lease contracts. while a very detailed contract can help protect the private company from politically motivated changes in service requirement, specifications that are too rigid, may also limit quick response to changing economic, social and technical conditions; the latter may be needed especially when the initial information base is limited. Even for simpler management contracts, there is always a need to closely monitor performance against the contract or to allow minor variations in contract specifications. ***There is, therefore, a rationale for creating a regulatory function whose main duties would be to determine allowable increases in water tariffs and appropriate service standards, to monitor private companies' performance and contractual compliance, to arbitrate complaints between private companies and their customers, or disputes between the granting authority and the contractor, and to impose sanctions for failure to meet agreed standards.***

44. Experience has shown that having the regulatory framework in place when the private operator starts operations is essential. To ensure accountability, the regulator's duties should be clearly specified by law. Also, a transparent decision-making process should be prescribed, and decisions should be subject to review by courts. Regulatory activities should be subject to annual audits. To ensure independence from politicians and/or the regulated industry, appointments must be made only on professional criteria. The regulator and his key staff should be protected from arbitrary removal from office before the end of their tenure and should be paid competitive salaries to minimize the risks of corruption. Staff should also be barred from political activity and having financial interests in the water supply industry or its substitutes, e.g., the drilling industry or bottled water. ***Also, the regulatory function should be funded out of direct levies on utilities and consumers, not from the Government budget.***

45. **Subcontract Some of the Regulatory Functions**. All necessary conditions to establish a successful regulatory function may not currently exist in Indonesia. However, Government should envisage its creation as soon as possible to meet expected demand. ***Since regulatory skills are still scarce***, it is advisable to consider initially establishing a regulatory function at the national level. It might possibly even cover several infrastructure sectors such as power, telecommunications, toll roads, water, and sewerage. Experience has shown that it is very difficult to convert a public utility company into a regulatory body because of the very different skills needed. ***The feasibility of contracting out some elements of regulation*** (such as the monitoring of compliance with service standards and the financial audits) ***to reputable private auditors and certification agents should be examined.***

46. **Promote Domestic Private Expertise**. The number of companies that can, based on their past international experience, implement long term concession contracts is limited to only about half a dozen in the world. Because demand for their expertise may exceed their supply capacity soon, these companies are very selective and are involved in joint ventures with local business partners in only the most promising operations. ***To***

develop a domestic private capacity, it is essential to: (a) create a market by encouraging PDAMs to outsource some of their activities, as part of their performance contracts, and (b) adapt the market to the capacity of the potential providers[15]. The provision of water supply is a collection of several areas of expertise (commercial, O&M, financing and construction...) that could initially be unbundled. Awarding small to medium sized service and BOOT contracts, after a properly organized bidding process, is the most obvious solution to the problem. Depending upon the performance of such contracts, consolidation of expertise could later be favored through inviting purely domestic firms to submit proposals to more comprehensive management, lease or concession contracts. In LGs which consider PSP through service or management contracts, current PDAM staff should be given the possibility, or even encouraged, to create their own companies and submit proposals.

Policy Direction 3. Streamline Water Sector Financial Management

47. Access to the capital market would be possible only if commercial lenders or equity investors perceive the water supply sector as a much less risky business than it is the case now. All the proposals included in this Policy Framework aim at achieving this objective.

Emphasize PDAM Self Financing. Throughout the industrialized world, the water supply industry finances its development mainly through cash generated from operations. Because of the shortcomings identified earlier, very few PDAMs are currently able to contribute significantly towards their investment program. ***PDAMs' cash generation must be enhanced through increased revenues and reduced costs.*** Often tariffs need to be increased, but many PDAMs, the easiest way to increase revenues is through additional sales those currently using substitute sources of water. In many PDAMs also, costs need to be reduced to efficient levels through more careful planning of complementary investments (production and distribution capacity for instance), improved procurement practices, streamlined commercial management, increased staff efficiency, or reduced UfW. This can be achieved only if PDAMs operate in the incentive framework suggested above.

49. **Clarify Transitional Conditions for Government Grants and Loans.** During Repelita V, PDAMs absorbed about Rp1,800 billion or 43% of the total investment made by the Government in the urban sector. About 50% of PDAM investment was in the form of loans, a small proportion was self financing and the remainder was provided in the form of grants. In order to achieve a 50% service ratio at the end of Repelita VII (2003), the Government would need to inject at least Rp2,400 billion if private sources of funds can be mobilized, and up to Rp4,500 billion if this does not materialize (table 4).

Public utilities (power, water, sewerage...) are already privately managed in the large private real estates that are being developed outside of Indonesia's large urban agglomerations.

50. So far the Government has given grants to PDAMs to meet basic coverage targets. As of 1998, block grants to LGs will be increased. LGs could use part of these grants to support their PDAM's investment program, but it is likely that this would only be a limited contribution, given the competing demands. Above forecast show that it is feasible to gradually move Government concessional loan[16] conditions closer to commercial ones, as a means to improve PDAMs creditworthiness, and thus to phase out loans on concessional terms during a transitional period that could in theory be limited to Repelita VII.. ***With higher cost of borrowed funds, specific grants for the water supply sector would still be needed during Repelita VII, but on a declining basis*** (table 7). Criteria for accessing grants directly from the central budget or loans on concessional terms would have to be defined. The respective share of the grant and loan elements should depend upon typical PDAM sizes, financial situation, but first of all performance. ***PDAMs should compete for Government funds***. Those that have shown a performance improvement and can demonstrate demand for expanded service should be able to access more favorable financing terms.

51. ***In parallel, loan repayment to the Government should be enforced better.*** The current lending instruments, whether SLAs or RDA, are not operating according to financial principles since loans have been made to PDAMs with weak or non-existent debt service capacity, and had to eventually be transformed in grants. ***Transferring the loan initiation and appraisal responsibility to domestic banks that would take the financial risk is an option that should be pursued during Repelita VII.*** Such banks could onlend funds borrowed by the Government, in particular from the ADB and IBRD as a means to (a) move lending conditions closer to commercial ones[17]; (b) increase flexibility in funding PDAM projects; and (c) establish the needed discipline. However, such domestic banks are still unfamiliar with the PDAM market and would need assistance to develop their appraisal capacity. ***Thus, initially, their role should be limited to financing smaller extension projects, while the SLA arrangement should be retained for larger loans***, with conditions that should remain the same regardless of the ultimate source of funds.

52. **Promote Alternative Financing Means**. Bonds could be issued by the larger PDAMs, consortia of PDAMs, LGs or domestic banks on their behalf. The prospects have been assessed at some Rp200 billion per year. Assistance for bond issuing is

16 Concessionary loans were a means to reduce grants and to introduce PDAM to the healthy notion of borrowing, since commercial loans were not available to PDAMs and the latter could not afford them without parallel grants. Interest rates have regularly been increased to the current conditions, with the ultimate objective of reaching commercial terms. For a PDAM, what matters is the average cost of financing; a mix of 50% grant with 50% concessional loan at 11.5% costs the same as a mix of 75% grant and 25% loan at 20%. The Government prefers a higher proportion of loans at a lower interest rate because it is sufficient to cover the cost of its borrowed funds and it reduces the need to raise tax for the grants at a high cost to the economy.

Such loans would be made on "commercial" terms, even if the funds onlent are provided by the Government, because these banks would add to the cost of funds a spread that would cover their processing costs and risk factor.

warranted as is a review of investment guidelines from MoF for insurance companies and pension funds, that limits holdings to 10% of any issue. Other financing means, such as shares and securitization of existing loans to improve the PDAM debt structure should also be explored.

53. **Facilitate Access to the Capital Market.** Potential commercial lenders or equity investors perceive high risks in the water supply sector, and all proposals on this Policy Framework aim at reducing this risk. ***To further reduce the risk, there is also a need to produce more reliable data on the technical, commercial and financial situation of the PDAMs, past trends and expected revenues.*** Collecting these data should be one of the PERPAMSI responsibility, however, certification of these data by independent technical and financial auditors is essential to providing comfort to potential private investors.

54. MoHA already practices some kind of "benchmarking" of PDAMs performance by classifying them in "very healthy" to "non healthy" categories, using a series of 12 financial criteria. ***More elaborated benchmarking techniques should be introduced in particular to analyze costs drivers and establish industry standards and best practices. This would help public or private investors make decisions on appropriate financing and attached conditionalities, and would help LGs negotiate performance contracts with the PDAM or private providers of service and, of course, tariff increases or justments.*** This task is typically that of the independent "regulator" of the public water supply sector, but such an agency does not exist yet in Indonesia. The Government may want to consider the creation of a "National Water Supply Authority" that would regroup some of the responsibilities that are currently with DG Cipta Karya and DG PUOD. In the meantime, DG PUOD should be requested to ***initiate the benchmarking exercise by outsourcing it to independent technical and financial auditors or rating agencies.***

55. Until the changes recommended in this paper, regarding autonomy of PDAMs management and tariff level and structure, are implemented and a track record of improved management has been establish, ***private sponsors of water supply projects will seek guarantees against, among other, the revenue risk*** (for example through "take or pay" contractual arrangement for BOOTs***), payment risk by the purchaser*** (in particular for BOOTs where there is only one or a very limited number of clients), ***early termination risks and regulatory risks.*** Private guarantors and insurers should primarily be providing guarantees against revenue and payment risks, while the Government should focus the guarantees it would provide against termination and regulatory risks. Government owned banks or instruments put in place by international organizations such as the World Bank or its affiliate MIGA can be used for this purpose.

Policy Direction 4: Simplify Pricing Policy

56. **Simplify the Tariff Structure.** The major elements of the recommended tariff tructure are: (a) a two-part tariff, consisting of a small fixed fee for covering dministration and meter maintenance costs and a tariff rate per cubic meter of water consumed; (b) two consumption blocks, with the first one being a "life line" block of up

to 10 m^3 per month; (c) no minimum consumption required and minimum charges limited to only the fixed fee; (d) a life line rate set such that the first block would not represent more than 4% to 5% of the total expenditure of an average low-income household; (e) a base rate set such that the overall average tariff represents a balance between economically efficient marginal cost and financially viable average costs; and (f) slightly lower tariffs for public taps, schools and hospitals, and slightly higher tariffs for businesses and industries.

57. **Set a Life Line Rate** so that consumption within the first block would not cost more than 4% to 5% of the total expenditure of an average low-income household. For example, for a household of seven with a per capita monthly expenditure of Rp15,000 (i.e., per household monthly expenditure of Rp105,000), a life line rate of Rp400/m^3 would supply the first 10 m^3 of water at a cost of Rp4,000, which is 3.8% of the total household monthly expenditure; a rate of Rp500/m^3 would mean a 4.8% of the total expenditure. The resulting consumption of about 50 liters per capita and per day (lcd) is consistent with available PDAM data that show that 20% to 30% of households connected to piped water use less than 10 m^3 of water per month.

58. **Set the Base Rate** for consumption above 10 m^3/month ***so that the overall average tariff is a compromise between marginal full (economic) cost and average full (financial) cost.*** Economies of scale exist for the majority of the PDAMs. Smaller PDAMs, selling less than two million m^3 of water per year, have higher average costs than corresponding long run marginal costs, while the reverse can be noticed for larger PDAMs. However, the tariff currently defined by MoHA guidelines appears to lie between the financial cost and the long run marginal cost. Consequently, in practical rate design, the MoHA cost can be used as a very useful reference when tradeoffs have to be made between economic efficiency and financial viability.

59. **Favor Connection of Low Income Households.** The typical fee for a new connection often represents a major deterrent for the poorest segment of the population. While several PDAMs now propose payment in installments over a period of up to 36 months, it could also be envisaged to ***provide connections free to all customers who can be served by a small diameter (15mm) connection, if the tertiary distribution network exists within reasonable proximity.*** The required tariff increase needed to cover the cost of construction of these connections is very small, typically less than 5%. ***However, in order to protect the PDAM against inactive connections, the customers could be asked to make a refundable advance payment on their water bill.***

60. **Adjust Tariffs Automatically Between Two Negotiations.** Proper mechanisms to revise tariffs are as important for a PDAM's financial position as proper setting of the tariff level and tariff structure. ***Negotiations of the tariff level and structure should take place every four to five years between the PDAM and its Board of Supervisors.*** Negotiations should take into account not only the expected investment program and corresponding financing needs, but also improvement of the PDAM's overall performance. Periods shorter than four years would not provide sufficient financial

incentives to PDAMs to implement programs that would improve productivity as part of its "performance contract" with the LG. ***In between two approvals, tariffs should be automatically adjusted using a cost index formula based on actual cost composition*** (manpower, energy, chemicals, pipes,...). This simple principle would avoid (a) erosion of PDAM revenues and undermining their capacity to extend service, and (b) lumpy tariff increases that are difficult to obtain from local governments and local assemblies.

61. **Consider Inclusion of a Sanitation Fee.** In theory, the economic cost of providing water should also take into account the cost of collecting and disposing of the waste water generated. In practice, this is often difficult due to a lack of knowledge about waste water costs. Moreover, in the case of most Indonesian cities, still a large share of the water consumed and disposed of in the water bodies comes from alternative sources such as ground water that are not charged for at all. Adding a sanitation surcharge to piped water could encourage some users to revert to poorly regulated alternatives. ***For the time being, a sanitation fee using for example the property tax as a basis would be more equitable.***

Policy Direction 5: Improve Planning, Design and Implementation of Water Supply Projects

62. **Improve Planning.** ***It is essential to develop water supply systems, that are generally very capital intensive, within the framework of systematic, long term planning, with the main objective of seeking least cost solutions, and reaching a broad consensus among all stakeholders on the technical, institutional, financing and cost recovery options chosen.*** Real demand and willingness to pay for piped service must be properly assessed to avoid inadequate dimensioning, phasing or location of extensions. Reduction of UfW has to be realistic, and the choice of new water sources has to be made in a regional context, taking into account compensation to be paid to those affected. But, seeking the least cost solution should not be limited to comparing technical options, and should also include an analysis of the most appropriate institutional and financing arrangements. The justification for developing joint water production facilities or for seeking proposals for a BOOT for a new production facility should be supported by a detailed analysis. The benefit expected from private sector involvement in a project would not be obtained if negotiations take several years because of uncertainties regarding project justification delay the process of arriving at a deal satisfactory to all parties.

63. **Improve the Quality of Technical Assistance.** The water supply sector depends heavily on consultants for project identification, preparation implementation and institutional development, but it is not clear whether it gets the best out of this TA. Unwritten or misinterpreted rules, unclear criteria for short-listing of firms, lengthy negotiations and contract signing processes may have hampered top firms from injecting new ideas in the sector. Although this issue is not limited to the water sector, ***it would be beneficial for all parties to take a step back and look candidly at what the current practices are that limit access to the best available expertise.***

64. **Improve Procurement.** Improving the packaging of contracts and procurement methods of project implemented by PDAMs would also increase investors' confidence. PDAMs avoid awarding large contracts that need mandatory review from Central Government agencies. They cannot award large contracts because budgeting practices do not allow for award of multi-year contracts for locally financed projects. As a result of the "slicing" of projects in small packages, there is general consensus that the water supply sector attracts very few qualified contractors. ***Grouping works in larger packages and using stricter prequalification procedures would attract better quality contractors to the sector.*** A water supply project mostly consists of pipelines and plants. ***To reduce the cost of pipelines, PDAM should call for bids for combined supply and laying,*** with the choice of material being left to the bidder. Already, the domestic manufacturing industry is able to submit competing proposals for large diameter pipes (concrete and steel), and it is only by opening the market further to other materials that local manufacturing of ductile cast iron pipes could be encouraged. ***To improve the design of water treatment and pumping plants, PDAMs should consider design and build contracts after open competition among pre-qualified specialized companies***[18].

65. **Improve Competition.** Finally, many supply and civil works contracts seem to be awarded on a "rotational" basis among a limited group of suppliers or contractors, on prices that are calculated using official price lists, rather than after actual open competition. ***An independent audit of Government procurement procedures carried out in 1994 showed that this practice likely results in a 30% mark-up on equipment contracts and much lower construction quality compared to results obtained by the private sector.*** Real competition, open to international suppliers and contractors, should become the rule for the water supply sector, because it would reduce cost of inputs to the lowest level possible.

Policy Direction 6. Emphasize the Identity of the Indonesian Water Supply Industry through Increasing the Role of its Professional Association

66 PERPAMSI's role ***should be strengthened and extended*** to help build up the ***identity of the Indonesian water supply industry.*** PERPAMSI should take the lead in three main areas: (a) setting-up of a quality data base on the water supply sector; (b) human resource development; and (c) certification of techniques and technologies and dissemination of best practice. In addition, PERPAMSI should lobby for implementation of a water resource development program that takes into account the major concerns of the water supply industry with regards to the timely availability of water and the protection of its quality. ***PERPAMSI would initially need technical and financial assistance to develop the skills required to deliver the above work program. This assistance could be provided by the central Government, but after an initial period, PERPAMSI's operational budget should be mainly replenished from fees paid by its***

[18] Tender documents should be explicit on processes and technologies that are acceptable, on technical specification for the output, the method used for comparing bids and the penalties that would apply in case of non compliance with standards.

members. One way to develop the needed skills would be to intensify collaboration with water supply associations of countries that have already implemented similar activities.

67. **Establish a Quality Data Base**. As mentioned above, PERPAMSI is the logical choice to establish a quality data base that would have to be certified by independent technical and financial auditors for the sake of credibility.

68. **Enhance the Human Resources Development Role**. PERPAMSI should be given enhanced responsibilities in assisting PDAMs to optimize staffing and improve recruitment and training. ***PERPAMSI should develop advisory skills to help PDAMs address staff productivity issues***, which is low by international standards, and to prepare medium-term staffing plans and implement them.[19] ***PERPAMSI should also update*** existing selection criteria for various key positions in PDAMs, and ***help develop a mechanism to enable PDAMs to advertise vacancies widely*** and encourage PDAMs to seek qualified applicants on a province-wide basis if not on a nation-wide basis. PERPAMSI should monitor appointments and promotions to director and manager level positions and report on any violations of industry selection criteria. PDAMs should be encouraged to identify the incumbents of key positions who do not meet minimum criteria, and should be assisted in preparing developmental plans to upgrade skills over a three to five year period.

69. **Intensify Training Activities**. ***PERPAMSI should*** build on the work it is already doing in the area of training ***and conduct a training needs assessment for PDAM staff***. It should work closely with the Bekasi Training Center, as well as leading universities and other important providers of water sector training, to ***develop and/or update training curricula for critical needs, especially management training needs***. It should accredit providers of water sector training in Indonesia, and bring out an annual training calendar of water sector training offered at various leading training institutions in Indonesia. ***PERPAMSI should provide guidance to PDAMs in developing annual staff training plans, including setting aside the requisite budgets***. All training should, however, be demand-driven and identified by the PDAMs. Training costs should be borne by the PDAMs. The Bekasi Training Center could be converted into an autonomous agency, requiring revenues from fees and other income to meet at least operating expenses. It could eventually be privatized.

70. **Become a Technical Reference Center**. PERPAMSI should take the lead in carrying out independent testing and certification of new technologies, equipment and software available on the market. It should boost dissemination of best practices among PDAMs, since it is essential that actual experience with particular types of meters, pipes,

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[19] Options to be considered include: (a) holding staffing numbers steady during periods of expansion; (b) not replacing staff who retire or resign; (c) contracting services to the private sector, and transfer the staff; (d) offering early retirement packages where appropriate; and (e) a combination of the above. PERPAMSI should help develop a consensus on some of these matters, develop industry-wide approaches, and offer necessary guidance to individual PDAMs in implementing them.

treatment processes or commercial management software serve as the basis for making judgments and recommendations for improvement. One important point would be to initiate discussions with Indonesian industry and participate in the feasibility study for the local manufacturing of ductile cast iron pipes to meet the expected domestic demand. Also, the need for standardization of simple water treatment plants ("package treatment plants") could be investigated through a independent detailed survey of PDAMs' actual needs and experience so far with operating such plants.

TERMS OF REFERENCE

Technical Assistance

for the

Establishment of a PDAM Benchmarking System

Urban Development, Settlements, Public Housing and Spatial Development Bureau

National Development Planning Agency

Technical Assistance Project for Public and Private Provision of Infrastructure

(TAP4I IBRD Loan 3913-IND)

December 1998

1. Background

The Government of Indonesia (GOI) has traditionally financed its 275 PDAMs (Perusahaan Daerah Air Minum), or municipal water utilities, through grants and/or subsidized loans. Allocation and administration of financing to PDAMs has been assisted by the information maintained by each agency relevant to PDAMS. Bappenas uses this information for national planning, Ministry of Home Affairs (PUOD/MOHA) for providing institutional guidance, Ministry of Public Works (MPW) for providing technical guidance and evaluating foreign loans and associated investment programs, MOF for appraising subsidized loans (RDA and SLA) and auditing, and PERPAMSI (the association of water utilities) as a general source of available data on PDAMS.

While each of the ministries has a specific purpose for its own database, the information, which is tracked in the databases is largely redundant. Moreover, the existing databases suffer from a lack of access; inaccurate data; significant time lags (e.g. 2 years) in information availability; and data discrepancies. During a random check of the 1997 data for MOF and MOHA databases, 53 of the 275 PDAMs had different financial ratings. The existing situation not only wastes resources through duplication but may also contribute to inconsistent policy formulation and inappropriate financial resource allocation.

GOI has identified the establishment of one common interministerial PDAM benchmarking system as a priority for the urban water sector as discussed in the Indonesia Urban Water Supply Sector Policy Framework paper of October 1997. This benchmarking system would establish a credible information base for the multiple ministries, which oversee PDAMs under their respective responsibilities. It would assist GOI in the allocation of public financing and identification of candidates for eventual access to private financing.

The overall benchmarking system exercise is defined as follows:

1) identification of indicators (financial, technical and managerial) to be monitored for benchmarking;

2) design of a rating structure to be included in the database; and

3) establishment of sustainable operation and maintenance, and financing for the benchmarking and rating system.

GOI has decided to outsource the design, and operation and maintenance of the benchmarking system to an independent private company to act as a Technical Partner to GOI. The company is expected to be experienced in the following:

1) municipal water utility financial analysis;

2) provision of credits or credit guarantees to public utilities; and

3) designing and implementing comprehensive database systems for financial, technical and managerial information regarding public utilities, in particular in the urban water supply sector.

GOI will finance the two phases of this technical assistance out of TAP4I. Thereafter, the database is expected to be funded by annual rating fees to be charged to each PDAM to be included in the database. Consultant Team is expected to identify an appropriate fee structure during the course of this assignment and engage in subsequent 5 year contracts with GOI for operation and maintenance of the database.

This Consultant Team, therefore, should be able to assist some of those PDAMs which have only limited financial management capability and require remediation.

2. Objectives

The objective of the benchmarking system is to provide timely and accurate data for GOI. This will enable it to:

1) Apply commercial principles in providing public financing (i.e. grants and subsidized loans) to PDAMS;

2) help PDAMs formulate sensible long-term development plans; and

3) give appropriate guidance regarding PDAMs' institutional managerial issues.

The effective implementation of market principles and financial discipline in allocation of public financing is expected to facilitate eventual capital market access by qualified PDAMs and to encourage other PDAMs toward qualification for capital market access in the long run.

The specific objective of this Terms of Reference is for a Technical Partner to provide technical assistance to GOI to design a PDAM benchmarking database and to implement the pilot phases of the database.

3. Scope of Works

3.1 Policy Implications

Critical to the success of the benchmarking exercise is the effective participation of PDAMS. It is envisioned that government financing to PDAMs in the form of grants and/or subsidized loans will be contingent upon the PDAMs' participation in the benchmarking exercise.

In addition, it is expected that the systematic segmentation and categorization of PDAMs will eventually provide the factual basis for policy design for the urban water sector such as application of Indonesian Accepted Accounting Principles and independent audits. For certain

PDAMS, consolidation (merger) to form economically sustainable-sized entities may also be envisioned. Rather than applying blanket policy revisions, the benchmarking database is expected to identify the groups, or segments, of PDAMs and to apply appropriate policies to these PDAMS. Because the database will be updated each year the policies will be designed to take into account the improvements in individual PDAM performances.

3.2 Identification of Sustainable Funding System

One limitation of institutional arrangements in the sector has been that funding is available for discrete projects but rarely on a sustained basis. It is expected that the value of the database will increase over time as changes in PDAM performance are monitored. Therefore, it is crucial that a sustainable source of funding is available for the continued operations of the benchmarking system. As in other rating systems where companies pay a fee to be rated, the proposed system is expected to charge PDAMs a fee to be included in the database. The fee will cover the costs of data collection, verification, maintenance, and operations. PDAMs will be required to pay this fee in order to be considered eligible for any public financing.

Consultant Team is expected to identify the total annual costs required to maintain the database and a fee structure for individual PDAMS. In addition, any type of access charges to users who want information from the database should also be included in the cost structure. At first, these can include payments from the primary users, which are expected to be government agencies. Over time, the database is expected to have an increasing number of private investor users.

3.3 Segmentation

The 275 PDAMs vary widely in size from those serving more than 300,000 customers to those serving fewer than 300 customers. Operational complexity and financing needs will vary for these PDAMs and the information required to make financial decisions will correspondingly vary. Therefore, as an initial design issue, Consultant Team is requested to propose a segmentation of the PDAMs with the appropriate information and benchmarking requirements. Previous studies have used the number of customers as a segmentation criterion. However, a segmentation based on size or number of customers does not easily allow PDAMs to move from one segment to another. Since the objective of the benchmarking database is to facilitate access to financing and, ultimately, to capital markets, the proposed segmentation should be based on financial management and ability to access capital markets. There should be opportunity for smaller PDAMs to benefit from good financial management and large PDAMs to improve financial management.

Three segments are proposed:

1) PDAMs which are able to access capital markets;

2) PDAMs which should be able to access capital markets with some effort; and

3) PDAMs which structurally or institutionally, cannot access capital markets.

The level and type of information required to rate PDAMs in the first segment will be of greater rigor. Defining the rating criteria for this group will involve examination and reforming some of the existing regulations that affect PDAMS. For example, although PDAMs currently comply with the special accounting rules issued by MOHA, PDAMs in the first segment may need to adopt Indonesian Accepted Accounting Principles. Moreover, private investors will require audited financial information from an independent auditor rather than the government auditor, BPKP.

PDAMS, as an industry, have not performed well financially. Therefore, many PDAMs will require careful monitoring of financial leverage and performance. However, some PDAMs may not be able to improve their performance without additional technical assistance. Consultant Team is expected to identify the components of financial management improvement required for selected PDAMs and pass them on to PERPAMSI.

3.4 Data Quality

One of the critical weaknesses in all the current databases is that all the systems are dependent on the data which is provided by the PDAMs. Although most of the financial data should come from audited financial statements, problems in interpreting the requirements and transcribing the necessary information, as well as some problems in audit quality, have resulted in problems at the data entry point, rendering the data results meaningless. Consultant Team is expected to quality-control the data at entry by designing the simplest format for data to be included in the database and closely monitoring the actual data input and analysis. These issues are expected to be particularly important during the pilot phases I and II of the database design. A Data Room will be established and operated during the bidding stage to allow the bidders to evaluate the type and quality of information available for some sample PDAMs as well as the databases currently being maintained by the ministries concerned.

3.5 Data Scope

The existing databases maintained by the various agencies have a wide scope of technical, financial, and managerial/organizational information. Because of the resources required to collect and maintain the information, it is important to identify the minimum level of data required. In addition, current databases use mostly ratings rather than the raw data. For example, instead of the actual debt-to-equity ratio, ratings from 1 (greater than 70%) to 4 (less than 30%) are assigned. It requires some research in order to uncover the raw financial data on which the ratings are based. Consultant Team is requested to recommend both the level and form of information to be recorded in the database, taking into account the needs of the potential users of the database and the resources required to maintain the database. Consultant Team should ensure that the database does not become a catchall for all data regarding PDAMS, since that will create the risk of an unmanageable database system. Some tradeoff in information and manageability may need to be made.

3.6 Ongoing Maintenance Process

The existing databases suffer from inadequate maintenance systems. PDAMs do not submit data on time, data input into the system are done sporadically and with significant delay, and ratings are assessed without transparency. The regional network of the ministries, such as PERPAMSI's regional administrators, MPW's PMDUS, and BPKP's regional offices, are currently being used and can be used to prepare the database. Consultant Team is requested to design and put into operation a sustainable maintenance procedure, including schedules and responsibilities for data collection, verification, and processing. While the existing data collection and verification network can be used, Consultant Team is free to propose new systems, a private network, a technical system, or other options.

3.7 Work Schedule

The assignment is divided into two phases.

Phase I: Design

The first phase will last for five months and consist of identification of appropriate monitoring indicators, conceptual design for the ratings system, establishment of computer data base system computer based verification of the proposed segmentation scheme, and ratings for 15 selected PDAMs from the three segments. Each bidding company should propose a combination of PDAMs, which best fits their proposals.

Phase II: Implementation

Based on the methodology developed for the first phase, Consultant Team will make a proposal for the output, which can be achieved during the implementation phase (Phase II). The proposal should include a description of the proposed approach, the number of PDAMs in each segment which can be adequately rated and analyzed, the proposal for staffing with individual person-days, and the proposed schedule. Keeping the objective of the benchmarking exercise in mind, preference will be given for depth of coverage rather than number of PDAMs included during this phase. Phase II is expected to include up to 100 PDAMs and last for seven months.

4 Management of the Services

Bappenas, will be the Executing Agency for the technical assistance services and will enter into a contract with Consultant Team for the conduct of these TA services based on these terms of reference.

The Project Implementation Unit (PIU) will be PERPAMSI. PERPAMSI will designate a Project manager to act for and on it's behalf in all matters related to the contract.

GOI will appoint an interministerial steering committee composed of DG level representatives from Bappenas, MOHA, MPW, MOF and PERPAMSI. The Steering Committee will convene periodically to make strategic decisions regarding the benchmarking system.

A Working Group/Task Force will be established with representatives from each of the above Steering Committee member ministries and chaired by a representative of PERPAMSI. This Working Group will undertake the day-to-day implementation issues and will process the necessary administrative and institutional steps. Consultant Team will work with the Working Group/Task Force to prepare the recommendations for the decision of the Steering Committee.

5. Project Budget and Overall Schedule

This technical assistance is divided into Phases I and II to provide maximum information and to facilitate informed and credible bids. Funding has been made available through PMU TAP4I, under the provisions of IBRD Loan 3913-IND.

The budget for Phase I is $350,000, including fees and expenses. Phase I is expected to last for five months and be awarded as a lump-sum contract.

The budget for Phase II is $212,000, including fees and expenses. Phase II is expected to last for seven months and be awarded as a lump-sum contract.

At the end of Phases I and II, the Technical Partner's report will include a proposal of the annual cost to continue the benchmarking service and a methodology for sustainable funding. GOI reserves the right at that point to bid the contract to other companies for a five year contract, based on the annual cost proposal. The original Technical Partner will have first refusal of any lower bid by matching the cost proposal.

6 Inputs to be Provided by GOI

6.1 Data Resources

Central, provincial and local governments and PDAMs will make all relevant data and operational records available to the Technical Partner.

6.2 Counterpart Assistance

PERPAMSI will assign full time counterpart to work with the Technical Partner. The number of full time counterpart staff depends on the best methodology proposed by Technical Partner Provincial and local governments and particularly the PDAMs will assign staff to work with Consultant Team as counterparts. The counterparts' principal task will be to facilitate the implementation of the services whilst gaining a sound understanding of the methods and approaches used.

6.3 Staff Support and Consultation

Central provincial and local governments will ensure that appropriate senior officials are available for consultations and for the review of outputs, throughout the progress of the assignment.

6.4 Support Facilities

Consultant Team will establish a project office in Jakarta and will provide all necessary supporting services and facilities, as required for the timely completion of the assignment. PDAMs will provide temporary office space and support facilities for the use of the Technical Partner's staff when collecting data and undertaking data reviews and other activities in the respective local governments and PDAMs.

7 Project Outputs

The outputs in Phase I and Phase II should consist of the following:

7.1 Manual of Operations

The benchmarking system design should be documented in a manual of operations. The manual should document instructions on implementation procedures for the ministries concerned, PDAMS, and others as applicable, such as private financiers. It should also include an annual timetable for implementation. The Manual of Operations should be completed at the end of Phase I.

7.2 Design of Surveillance System and Diagnostic Report

Compiling benchmarking information of PDAMs is not a one-sided effort. If Consultant Team finds that the PDAMs' existing MIS system, audited reports, availability of various operational data, etc. do not meet the standards for inclusion in the database, Consultant Team should produce a diagnostic report for those PDAMs based on a surveillance system. A surveillance system, therefore, should be designed for those PDAMS. The level of details of the surveillance should be differentiated so that those in need of close surveillance and active remediation are more elaborately documented, while those requiring lesser levels of surveillance and little or no remediation receive concise recommendations for improvement. The diagnostic report should follow a standard structure to be determined and include, but not be limited to, the following:

1) whether the financial reporting regulations applicable to the PDAM are reasonable;

2) whether the PDAM is actually following these regulations;

3) identification of specific regulations not met;

4) key changes required in the company's MIS, organizational structure, personnel and other management arrangements; and

5) for PDAMs in the third segment, institutional reform or restructuring required such as consolidation (merger).

The surveillance system and standard structure of diagnostic report should be documented in the manual of operations at the end of Phase I.

7.3 Diagnostic Reports

The format for diagnostic reports should be developed in Phase I and diagnostic reports should be completed for the 15 PDAMs selected during Phase I, at the end of Phase I. The majority of diagnostic reports are expected to be included in Phase II. These diagnostic reports should be passed on to the PDAMs themselves, local governments the ministries concerned and other PDAM advisory TA teams, if any, under ongoing projects such as Bank-funded IUIDP projects. PDAMs which couldn't be included in the database, because of inadequate data will be identified so that a remedial program to upgrade data availability can be undertaken to allow the PDAMs to be included in the database in the future.

7.4 Monitoring Reports

The rating process is expected to identify PDAMs with a range of financial capabilities and conditions. Consultant Team is expected to design and implement an ongoing monitoring system to track the credit-worthiness of PDAMs already included in the database, in particular those highly-levered PDAMs and those PDAMs which require intensive surveillance on issues identified during the rating process. The monitoring system should provide the users with the earliest possible warning when credit-worthiness of a PDAM begins to become troubled so that remediation to avoid default or other negative financial consequences can be initiated as swiftly as possible.

The format for the monitoring reports should be developed in Phase I and monitoring reports should be completed for the applicable of the 15 PDAMs selected during Phase I, at the end of Phase I. The majority of monitoring reports are expected to be included in Phase II.

7.5 Progress Reports

The objective of the assignment is to establish a working database with a sustainable funding strategy. However, Consultant Team and the Working Group should develop an acceptable progress reporting schedule to keep the Steering Committee informed and able to make effective decisions. There will be a maximum of 3 progress reports in Phase I and 4 in Phase II. Amongst other things, key design choices which were debated during the development of the database should be documented in the progress reports.

8. Qualifications of Technical Partner

8.1 Personnel

The Consultant is responsible for the provision of all the professional, technical and support staff considered necessary for the satisfactory completion of the Technical Assistance. The Consultant is encouraged to undertake the assignment in association with a suitably qualified Indonesian consulting firm.

8. 1. 1 Professional/Technical Skills Required

All staff members nominated to participate in the Technical Assistance shall be fluent in the English language and shall have a minimum of five years relevant professional experience on similar assignments in comparable Asian environments. Ability to communicate in the Indonesian language and computer literacy while not essential, are strong advantages.

It is anticipated that technical expertise will be required in the following areas:-

A. International consultants should have experience in analysing, preparing evaluating Benchmarking System. Additional experience in developing countries is also appreciated. The consultants should have experience in Indonesia and should be able to speak English and Bahasa Indonesia. The following expertise are required :

   - One Management Expert with experience in developing Benchmarking System especially in Water Utility for about 8 - 12 years.

   - One Accounting Expert with experience in preparing, appraising and auditing corporate financial report and determining indicators for Benchmarking System for about 8 - 12 years.

   - One Financial Management Expert with experience in analysing, preparing and appraising project investment proposal in water utility for various source of finance, evaluating appropriate financial scheme and designing appropriate indicators for financial benchmarking.

B. National consultants should have experience in analysing, preparing and evaluating institutional, managerial and financial aspects of water utility projects. Additional experience in preparing joint public and private investment project is also appreciated. The following expertise are required but not necessarily be limited to :

   - One Management Specialist with relevant experience of 8 - 12 years.
   - One MIS specialist with relevant experience of 8 - 12 years.
   - One System Analyst with relevant experience of 8 - 12 years.
   - Two Accounting Specialist with relevant experience of 8 - 12 years.
   - Two water Supply Engineers with relevant experience of 8 - 12 years.
   - One Institutional Specialist with experience of 8 - 12 years.

8.1.2 Team Leadership

The Consultant will nominate a senior team member to act as Team Leader. In addition to his/her technical expertise, this individual will have strong communication and management skills and will have acted successfully in a leadership and/or managerial role on previous multi-disciplinary assignments. The Team Leader will have worked in areas similar to those envisaged for these TA Services, requiring the integration and co-ordination of work by expatriate and indigenous Consultants with Counterpart staff.

8.2 Support Facilities

The Consultant will be responsible for arranging and bearing the cost of all the support facilities and services required for the satisfactory performance of the Technical Assistance Services.

8.3 Technology Transfer

The Consultant's team members will integrate their activities on a day-to-day basis with the Counterpart staff provided by PERPAMSI. In view of the GOI's intention to maximize the role of PERPAMSI, it is intended that the expertise gained during the course of this Technical Assistance will enable the PERPAMSI to operate the Benchmarking System with a minimum of external support.

8.4. Quality of Consultant's Proposal.

An invitation for proposals will be issued to a limited number of companies with prior proven experience in public utility analysis evaluation and financial ratings of municipal credits.

Each proposal must include the following information:

1) description of the company's experience in public utility analysis/evaluation and managerial and financial ratings of municipal credits, in particular water utilities (10% of weighting in bid evaluation);

2) the proposed project team with individual roles, expected man-days of each proposed team member, and CV of each proposed team member (55% of weighting in bid evaluation); and

3) the project team's approach and workplan for the assignment (35% of weighting in the bid evaluation).

TECHNICAL ASSISTANCE
FOR
THE ESTABLIHMENT OF A PDAM BENCHMARKING SYSTEM

List of Consultants Invited to Submitt Proposal

1.	PT. Prasetyo Utomo in association with Arthur Andersen and Lyonaise Des Eaux Services Associe	(Indonesia)
2.	Pricewaterhouse Coopers	(Australia)
3.	Deloitte Touche Tohmatsu	(USA)
4.	PT. Waseco Tirta in association with PT. Mitra Lingkungan, PT. Duta Consult and Sinclair Knight Merz.	(Indonesia)
5.	DHV	(Netherlands)

Presentation Material

Water Utility Rescue Program and the Role of Perpamsi[1]

by: B. Chatib[2]

I. Introduction

Infrastructure development, particularly of water utilities, has indeed been able to increase the capacity of service to the community. About 35.4 million people, or about 48.5% of the urban population, enjoy the service. The capacity of the 303 PDAMs (Local Government Owned Water Supply Companies) throughout Indonesia had increased from 9,000 l/sec in 1969 at the beginning of the First 5-Year Development Plan (Repelita I), to 79,850 l/sec by the end of 1997.

In spite of that, the companies are not financially capable of bearing the costs for construction and development of the water supply system all by themselves. Almost all the systems are greatly dependent on government development programs, or soft loans from government or foreign donor institutions, among others, from the World Bank. It is also extremely difficult for the companies to increase the welfare of their employees, which is undeniably a crucial element for sound management of the companies.

Despite various efforts, the level of unaccounted for water is still relatively high; the national average is about 31.8%. This condition has reduced the opportunity for providing better services for more people. It has also reduced the opportunity for increasing income of the companies. The condition is worsened by the limited ability of most people to pay for the water service. Thus, it is difficult to adjust the tariff rate structure as the problem is frequently associated with political issues, both local and national.

The monetary crisis experienced by a number of Asian countries has greatly impaired the Indonesian economy. Its immense impact has also affected the PDAMs, especially as the water utilities belong to the local governments. The effect of the monetary crisis has greatly impaired the continuation of operation and maintenance, reducing the capability for paying back the loan and obstructing the ongoing developments due to lack of funds.

There are at least 90 PDAMs, or 30% of the existing PDAMs, which are really in big trouble. Those PDAMs are the ones with income less than operation costs. Some of them have been suffering since the beginning of 1998.

Such condition cannot be allowed to continue indefinitely. There is a great need for appropriate and strategic solutions and undertakings. Based on these facts, Perpamsi (The Association of

[1] Presented at 1999 Water Supply and Sanitation Forum. How to Finance Sustainable Demand-Driven Service, April 8-9, 1999, World Bank, Washington, DC.

[2] Professor at the Environmental Engineering Dept. ITB-Indonesia; Executive Director of Perpamsi.

Indonesian Water Supply Companies) will help and will cooperate with related institutions to develop a PDAM Rescue Program. The cooperation with international financial agencies like the World Bank is a good and promising opportunity, considering the very limited capacities in the country. On behalf of Perpamsi, we are here representing our members, the PDAMs in Indonesia, affirming our support for the World Bank program designed for assisting the water utility in our country, which is now facing a lot of difficulties.

II. Overview of the Water Sector

The PDAMs have been established as local government companies based on Law No. 5 year 1962 pertaining to local government companies. PDAM is a local government owned business establishment that provides services and manages public utilities for drinking water supply. Of the 303 PDAMs established between 1962 and the present time, 301 PDAMs are owned by the second level local governments (municipalities or regencies) and 2 PDAMs are owned by the first level local governments (provinces).

The Minister of Home Affairs, through Decree Letter No. 800.690.154 dated March 5, 1996 pertaining to classification of PDAMs, decided the following classification:

Class A,	1 - 10,000	customers
Class B,	10,000 - 50,000	customers
Class C,	50,000 - 100,000	customers, and
Class D,	>100,000	customers.

In relation with the above classification, the PDAMs are distributed very unevenly. 218 PDAMs are categorized as small (71.9%), 77 PDAMs medium-sized, whereas only 8 PDAMs can be categorized as large or very large (2.6%). Thus, it is understandable why most of the existing PDAMs lack both the technical and financial capacities for developing themselves, as most of the consumers are households.

In terms of the number of customers, the 8 largest PDAMs have 32.3% of the total number of 3,862,274 customers belonging to all the PDAMs in Indonesia. The medium-sized PDAMs have 41.2% and the small PDAMs only 26.5% of the total number of customers. At the same time, the monthly revenue of the 8 largest PDAMs reaches 41.6% of the total revenue of the PDAMs. The above illustration indicates that most PDAMs are financially weak, are in a difficult situation and they have little opportunity to develop.

Geographically, the distribution of PDAMs is also uneven, as 103 PDAMs (34%) are on the island of Java. Out of that number, 51 PDAMs are of large and medium size which represent 60% of the total number of large and medium PDAMs in Indonesia. The other 52 PDAMs are small PDAMs, which represents only 26% of the total number of small PDAMs in Indonesia. The illustration is quite reasonable as almost 60% of the Indonesian population live on the island of Java.

The production capacity of the 303 PDAMs throughout Indonesia is 79,848 l/sec or about 6,898,867 m^3 per day. Out of that amount, the 103 PDAMs on Java have a capacity of 46,584 l/sec or 58.3% of the total capacity. Development of water supply facilities has indicated a production increase of about 10,000 l/sec every 5 years. A quite spectacular increase was reached during the Sixth 5-Year Plan (Repelita VI) in 1994-1998. From the year 1994 to 1997, there was recorded an increase of about 18,300 l/sec, which stopped later on as a result of the economic and monetary crises that hit Indonesia.

Based on the water resources used, 50,197 l/sec (62%) is from surface water, as seen mostly in the islands of Java, Sumatra, Sulawesi, and East Timor. Most cities (large, medium or small), are dependent on surface water. Utilization of ground water resources, springs, and deep wells are prevalent in Bali, West Nusa Tenggara, East Nusa Tenggara, Maluku, and Irian Jaya.

The total number of customers of all the PDAMs is 3,862,274, comprised of households (87.9%), commerce and industries (6.6%), social institutions (1.7%), government institutions and the armed forces (2.4%), public taps and public toilets (1.4%). The number of connections for commercial institutions and industries is relatively small, whereas they represent a high potential for the PDAMs to enable a cross subsidy to help the low-income communities and to increase revenues. This is among others, the reason why many PDAMs, the small ones in particular (whose consumers are mostly the households), have difficulties in developing themselves to become self-supporting.

Another aspect worth considering is regarding the number of the PDAMs' employees. The total number of employees is 35,874, out of which 90.6% are company employees. Only 9.4% (or 3,347) are government civil servants. Nonetheless, all top level and middle level management is still in the hands of the government civil servants. This is also one of the factors that makes it difficult for the PDAMs to develop themselves to become business-oriented entities.

In terms of the ratio of employees to customers, the national average is one employee to serve about 111 consumers or 9 employees per 1000 connections. This is still below the figure considered optimal and achievable for Indonesia, namely 5:1000. This ratio is far below the figure that has been reached by most developed countries, namely 2:1000. Such condition is indeed a burden for the companies. The current actual ratio is much higher for the PDAMs in the regencies where most of them are small and medium-sized establishments. This is, of course, a great burden from the aspect of employee costs. (Table 2-1)

Table 2-1. Relation Connections-Ratio for Municipality-Regency

	Municipality		Regency	
Connections:	**No. of PDAMs**	**Ratio**	**No. of PDAMs**	**Ratio**
>50.000	7	6.8	1	10
10.000 – 50.000				
30.000 – 50.000	12	8.6	.4	8.2
10.000 – 10.000	13	8.8	40	11
5.000 – 10.000	14	10		
7.500 – 10.000			44	12
5.000 – 7.500			14	13.2
0 – 5.000	7	13.4		
3.000 – 5.000			46	16.0
1.000 – 3.000			44	18.7
0 – 1.000			16	30.5
Total	53	7.8	249	11.7

Data : directory 1996
Ratio : employees per 1000 connections.

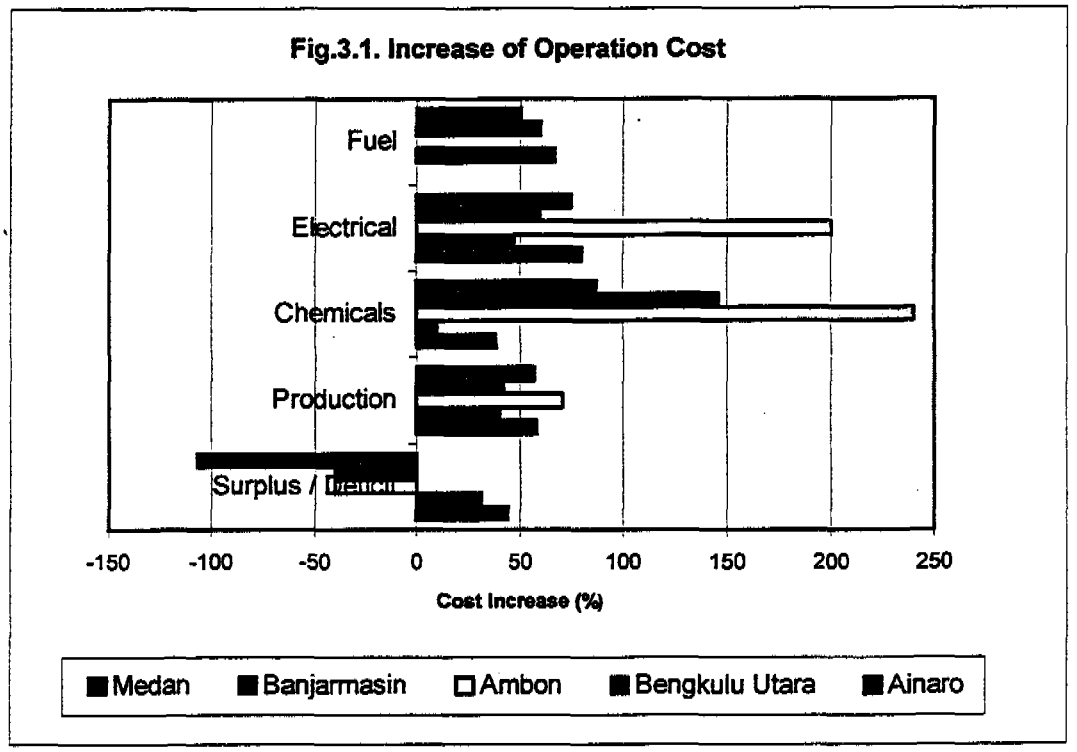
III. Impacts of the Monetary Crisis on PDAMs

The monetary crisis has had mayor negative effects for PDAMs, especially the smaller and weaker PDAMs, in the following aspects:

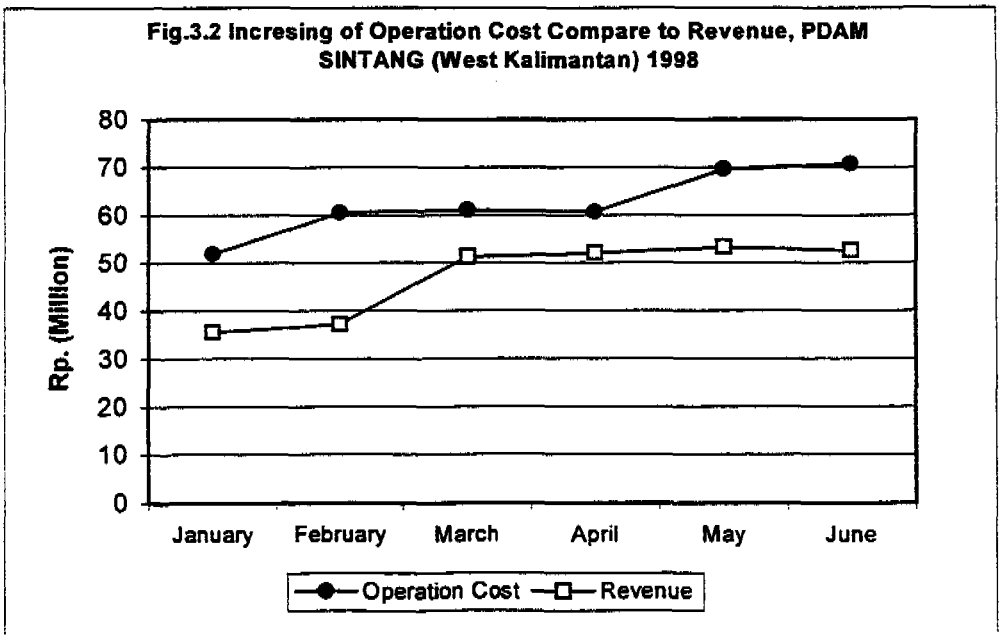
- Dramatic increase in operation costs:
  - chemicals (for water treatment), the cost has, in general, tripled
  - electricity, an increase of 20 - 70%
  - fuel, cost increase up to 30%
  - spares for pumps, plants, water meters, pipes and fittings, the cost is in general doubled.
- Problems in trying to increase the tariff, especially as the majority of connections are households.
- Decrease of consumers' ability to pay, thus reducing the company's revenue.

The increase of operational costs or of prices of components of operations differs from one PDAM to the other, depending also to their geographical locations, because of transportation costs. Indeed, price increases of components for operation is not affecting all the PDAMs as it depends on the production and distribution systems of the respective PDAMs. The PDAMs that

use surface water as a resource typically experience an increase in the operational costs, due to price increases of chemicals and electricity. Others that use deep wells as water resource typically suffer from the price increase of electricity. An illustration of the higher operational costs of a number of the PDAMs is presented in the following figure. (Fig. 3-1)



Some of the PDAMs have tried to increase their revenues. However, due to the price increase of certain components for operation, there is still a deficit. The following figure shows the experience of PDAM Sintang during the first six months of the year 1998.



Increasing the tariff is indeed a way out in this period of crisis to augment company revenue. However, considering the present economic condition, it is extremely difficult for local governments to permit the PDAMs to do so. The local government is afraid that tariff increase will add another burden to the community, especially to the low and medium income people. The fact is that the low-income people are the majority of consumers of small PDAMs, the PDAMs of regencies in particular. Another worry is that the tariff increase will trigger the community to act unlawfully, causing an increase of destructive water tapping, illegal connections and destruction of water meters. In this present distressing condition, such actions could happen.

Difficulties in increasing water tariffs are not only the problem of this period of crisis. Before the crisis, the difficulty in getting a permit for tariff increase was mainly due to political reasons. Therefore, many PDAMs had not increased the tariff in the past years (some in fact even since 1993) so the tariffs had not kept pace with inflation. From 1993 to 1997, the normal inflation rate before crisis was about 12% per year. Thus, the PDAMs should already experience a deficit of about 60%. This fact is, among other the reasons, why many PDAMs do not have any savings and could not pay their debts. On top of that, inefficiencies in internal operation and management have also worsened the situation and financial condition of PDAMs. One can say that many PDAMs are not ready to face the crisis.

These negative impacts have major implications for the daily operation of PDAMs in the following matters:

- Reduced maintenance of supply and distribution system, which results in irregularities of supply of water and sometimes, reducing the quality of water received by the consumers. This, in-turn, increases customer complaints and problems of payment of water bill.
- Negative cash flows, which may result in the following:
  - no increase in staff salaries, even to keep up with the inflation rate,
  - no money set aside for depreciation,
  - problems in paying back of past loans,
  - problems with credit worthiness for new equipment or materials.

However, it is important to note that the positive effect of the monetary crisis has been that it showed clearly where the real problems are within the PDAMs as far as efficiency and cost recovery are concerned. Besides, the problems encountered in this period force both PDAM management and the Central Government to develop new policies and procedures to make PDAMs more professional and efficient.

IV. Water Utility Rescue Program

a. Efforts for Rescuing the PDAMs

Drinking water service by the PDAMs for the communities has been decreasing, in terms of both quality and quantity. The PDAMs have faced difficulties in keeping up production and distribution due to the increasing operation and maintenance costs. This is a serious matter, and to prevent the PDAMs from collapsing and thus becoming unable to render services to communities, something has to be done. Therefore, Bappenas, Ministry of Home Affairs, Ministry of Public Works, Ministry of Finance, and Perpamsi have cooperatively exerted their efforts to overcome the problems that resulted from the monetary and economic crises, by formulating a Rescue Program for the PDAMs. The objective of the program, among others, is to look for emergency aids for the ailing PDAMs.

The main objective of the PDAM Rescue Program is to secure continuation of drinking water supply for the communities served by PDAMs. The target is a stable financial condition of the PDAMs to enable them to serve the communities with drinking water.

In broad outline, the Rescue Program is comprised of three main activities, as follows:

1. Striving for financial and technical assistance for the PDAMs as part of the rescue program.
2. Solving the debt repayment problems of PDAMs; including debts to the government as well as to international finance agencies like ADB and the World Bank.
3. Completing ongoing investment projects so that they may provide services and generate revenues as soon as possible.

The PDAMs debts are a major concern of the Ministry of Home Affairs, Ministry of Public Works, and Ministry of Finance. The solution is in the hands of the PDAMs and the respective ministries. The fact is that almost all the PDAMs with debts are unable to pay back their loans, thus their appeal to the government for a rescheduling program. This appeal seems to be difficult to fulfil as the central government is also experiencing financial problems in meeting their commitments to third parties; especially if all the debts must be borne by the central government.

As far as ongoing projects are concerned, these become the competence of the Ministry of Public Works. Therefore, the solution to this problem should become a part of the Ministry of Public Works program.

There is still the question of rescuing the PDAMs that are directly affected by the monetary crisis to the extent of not generating adequate revenues to cover cash costs of operations and maintenance, as explained earlier. The Rescue Program **does not intend to reward PDAMs for poor efficiency by providing subsidies**. However, for selected PDAMs with high-cost structures and low abilities of the people to pay, some subsidy may be appropriate.

Two main activities are being developed: *firstly*, identification and taking inventory of critical PDAMs, and *secondly*, finding assistance for these PDAMs. For this purpose, a small team or task force has been established, comprised of members of related ministries and institutions, including Perpamsi. Later, the small team was expanded to become the Water Community Forum. Its members are not limited to the above mentioned institutions, but also non-government

organizations and financial agencies, among others, ADB and the World Bank. Through this forum, all problems facing water utilities are communicated, solutions are designed and coordinated using informal approaches.

Rating the PDAMs as critical, stable, or sustainable is the first stage of identification and inventory of the PDAMs. The rating is based on the ratio of income over operational costs. To identify the priority PDAMs that should be included in the Rescue Program, the following criteria are being used:

1. Ratio of income over operational costs is < 1
2. High level of unaccounted for water, $> 30\%$
3. Number of consumers, 7000 or less
4. Surface water as resource, needing chemicals for treatment
5. Low efficiency of bill collection, $< 50\%$
6. Ratio of employees per 1000 customers, $> 10{:}1000$
7. Average balance at the end of each month is less than 2 months' operation and maintenance expenditure
8. Low water tariff, $< Rp400/m^3$.

Using the above criteria, the team (comprised of members of different institutions) has listed 90 PDAMs in the critical category, potentially needing speedy assistance of an emergency nature. Some of those PDAMs in crisis are presented in Table 4.1 as below.

Table 4-1. Some of PDAMs in Crisis

NO	CITY / REGENCY	POPULATION	CAPACITY	WATER RESOURCE			UFW	CUSTOMER	COVERAGE	RATIO REVENUE / OP.COST
				GROUND WATER		SURFACE WATER				
				SPRING	DEEP WELL					
			(L/Sec.)	(L/Sec.)	(L/Sec.)	(L/Sec.)	(%)		(%)	(%)
1	PESISIR SELATAN	93.936	17			120	33	4.736	44,95	0,99
2	SAWAHLUNTO	66.300	75	5	-	70	35	2.788	30,27	0,44
3	BUNGO TEBO	68.930	53	-	53	-	35	5.190	54,48	0,71
4	BELITUNG	114.912	75	-	-	80	31	2.515	23,32	0,49
5	BENGKULU UTARA	77.825	107	100		7	23	4.661	45,68	0,50
6	LEBAK	169.944	72	-	60	12	24	5.531	41,76	0,97
7	BLORA	143.276	140	15	35	90	30	7.092	18	0,75
8	JEPARA	328.716	93	-	93	-	41	4.491	11	0,74
9	BATANG	203.360	50	-	50	-	20	5.420	18,94	0,91
10	TEGAL	154.126	87	100	-	-	34	6.278	28,71	0,97
11	AILEU	11.879	17	7	10	15	5	431	20,62	0,45
12	SINTANG	70.470	65	35	-	55	45	4.379	41,83	0,75
13	BANGGAI	146.264	98	-	-	200	25	8.699	53	0,80
14	MUNA	37.700	84	-	-	84	40	3.550	77,12	0,90

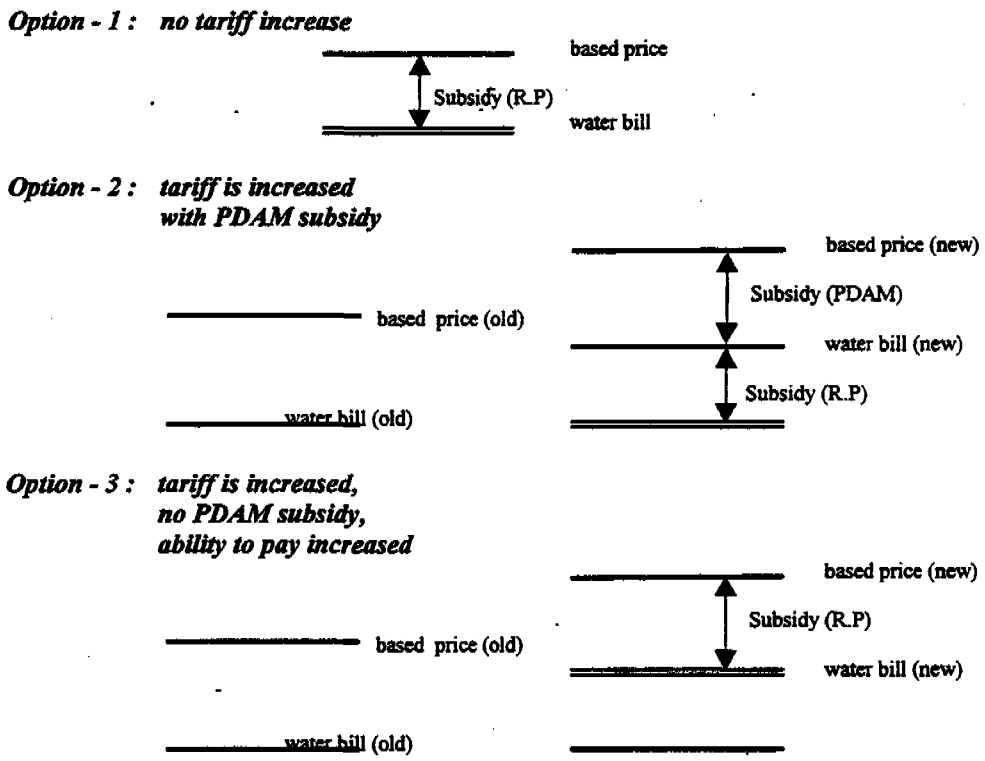
It is clearly shown from the sample that most of PDAMs which have treatment plants and/or deep wells have a low ratio of revenues to operations and maintenance costs; meaning a high deficit.

At the beginning, the team is still hoping to get assistance for the Rescue Program from various sources; from the government as well as from donor agencies. It is hoped that these agencies can give assistance to the critical PDAMs through one or several of the following ways:

- Bridging the difference in operation and maintenance costs due to increase prices of chemicals, fuel and electricity, for 2 fiscal years, 1998/1999 and 1999/2000.
- Equipment and technical assistance to increase efficiency and effectiveness of drinking water supply service to the consumers.
- Experts' assistance for reevaluation of loans and rescheduling.
- Subsidies for low income customers to bridge the difference between the water bill and their abilities to pay (both the old tariff and the new, higher tariff).

Regarding the last option, Perpamsi has developed a simple concept, as shown in the figure below. (Fig. 4 -1). The concept has been submitted to Bappenas. However, we have not yet received any response. In fact, the proposal is in line with the principles of providing assistance through the social safety net. Using this model, the community can continue to receive or have access to safe drinking water and the PDAMs, on the other hand, will have a better income. The low-income customers are facing the risk of disconnection whenever the PDAM can no longer afford to provide services due to decreasing income.

Fig. 4-1 . Subsidy to Low Income People Water Billing



Unfortunately, we are currently facing a situation where none of the above mentioned aids may be realized. Government institutions as well as donor agencies seem to have a different view in dealing with the problem during this period of crisis. We can understand their considerations regarding the matter; but the fact is that immediate actions for a rescue program are necessary.

b. Water Efficiency Team (WET) Study

Realizing the difficulties in obtaining grants/subsidies for the PDAMs to temporarily help overcome their problems, efforts are currently directed to the PDAMs internal management. The Water Efficiency Team will look for certain parts of operational, technical and administrative practices that can be made more efficient. The team is also looking into possible potentials for increasing income, including utilization of idle capacities, reduction of non-revenue water and appealing to the local government to release the PDAM temporarily from the obligation of contributing to the local government revenues.

Technical Assistance for the Water Efficiency Team has been developed as an amendment to task order # 800 of USAEP/USAID. The objective of this TA is to help the establishment of remedial technical, financial and management reforms for priority water enterprises through an assessment of their condition and recommendation for improvement. Priority water enterprises include both those from the list of 90 potentially critical PDAMs which are on the verge of collapse due to fixed tariffs and higher operation cost during the monetary crisis and those which serve a large number of people.

As a main activity, WET make visits of three to four days each to the priority PDAMs to perform **administration audits** (potential for efficiency through better billing, improved meter reading and recording, reduction of billing time, increase of collections, improvement of analysis of new connections costs, water production, profitability, cost center identification and responsibilities, maintenance records, inventory, and purchasing systems) and **technical audits** (potential for efficiency through plant re-rating, non revenue water reduction, systematic maintenance, system configuration, hydrology, and others.)

Detailed analyses of a number of PDAMs were started in November 1998 by a WET team, consisting of experts of Chemonic (USAEP Consultant) and Indonesian Sanitary and Environmental Engineer Association (IATPI) and Perpamsi. By the end of February 1999, 20 PDAMs were analyzed and reports produced indicating strengths and weaknesses of each PDAM, specifically looking at financial and performance indicators of the initial 220 PDAMs studied, seven PDAMs were found to be in need of immediate support, including :

- loans (grace period 1 year, interest 12 - 15 %) for small investments to increase distribution network and install household water meter
- replace broken water meters to reduce U.F.W
- selling of unused assets (pumps, cars, etc) to generate cash
- freezing of staff to reduce running costs
- small increases in tariff (up to 25%), where possible
- exerting pressure on local government to stop asking for unrealized profit distributions from PDAMs

The above interventions are intended to bring a quick increase in income, resulting in a positive cashflow again. This can then be used to pay of suppliers, make additional investments, etc.

c. Assistance to PDAM Rescue Program

The World Bank proposes an interesting offer under the PDAM Rescue Program. The objective of this rescue program is to assist PDAMs to meet impact of crisis and to take this opportunity to improve operational and finacial efficiency consistent with the overall direction of water sector reform.

Some importants program features that are considered to meet our interest are, among others:

- Forms of assistance which include providing cash to meet O&M gaps, funding to meet shortfalls in counterpart financing for completing committed investments, small capitals expenditures that will yield quick revenue increases (*e.g.* meters, pipes to reduce UFW) and rescheduling of existing debt service obligations.

- The assistance is open to all PDAMs, whether they have an existing loan from the World Bank or the Asian Development Bank or not.

- Direct channeling of IBRD, ADB or other funding agency loan funds from MoF to PDAM via SLA with the subsidized SLA rate (currently 11.5%, denominated in rupiah)

- Quick implementation arrangements which will start immediately.

The assistance is to be provided by funding agencies, subject to some pre-conditions that will be strictly applied, as follow:

1. PDAMs should prepare Financial Recovery Action Plans (FRAPs)
2. No grants for either O&M or capital expenditures; loans at SLA rates
3. No PAD (i.e., dividend) payments to be made to local governments until FRAPs have been implemented and 75% service coverage has been achieved
4. Supervisory Board have been reformed

Those pre-conditions presented above are fair enough and understandable as to guarantee that the assistance received by PDAMs can be paid back. Financial Recovery Action Plans (FRAPs) include implementation of immediate and steady medium-term tariff increases, accelerated increases in connections (if water capacity exists), UFW reductions, efforts at cost reduction for chemicals, power, etc., control on number of staff, improved collection efficiency and collection period and maintaining positive ratio (revenue>expenses). These are considered to be driving factors towards financially healthy PDAMs. FRAP should ensure that PDAMs will have become financially sound again after the assistance.

The campaign for limiting payments of PDAM profits to local governments during the monetary crisis until 75 % service coverage has been achieved, in accordance with the circulate letter of the Ministry of Home Affairs, has been done by officials of DG PUOD. Some local governments have already been contracted and have shown their commitment on this issue.

The Supervisory Board is indeed open to be reformed under a new regulation published by MoHA. This body will have transparency and stronger capacity to oversee the management of the PDAMs. It will bring in a representative of the customers and an expert in the water sector, so that the Supervisory Board will be less dominated by government officials. With this new arrangement, each side (the supervisory body and board of directors), has a clearly defined job

description and responsibility. It will bring PDAMs more independence in doing their own business for the sake of providing good services to the community.

To support for achievement of the objectives of the PDAM Rescue Program, two TAs have been provided by the World Bank :

1. Technical assistance for processing assistance to PDAMs, and
2. Technical assistance for developing public relations campaigns for implementation by PDAMs.

We understand that this program is a good offer and promising. However, it is important also that the implementation process should be quick and simple with less beurocracy, and can be started early as possible.

Perpamsi strongly supports the Rescue Program of the World Bank with the above-described features. Perpamsi considers the program as a very good opportunity that the PDAMs can utilize for obtaining funds for reinvestments so they can survive. Perpamsi is not only supporting the program, the association has also requested that Bappenas and related institutions readily approve the program. This is indeed a good opportunity from the few available opportunities.

The program is important because:

1. It is a funding resource for reinvestment of small PDAMs as a follow up of the findings of the Water Efficiency Team.
2. If the PDAM can use such assistance wisely, this will also open an opportunity for the company to deal with the other problems, among others the settlement of past debts.
3. It opens opportunities to improve service performance, to gain the trust of the community, and thus opens the opportunity for tariff increase.
4. If the company can successfully pay back its debts within the framework of this program, this will increase the company's self-confidence, thus enabling the PDAM to improve its management efficiency and professionalism.

V. Role of Perpamsi

a. Overview of Perpamsi

Perpamsi, the Association of Indonesian Water Supply Companies, is a professional association that unites all drinking water utilities in Indonesia. As the majority of its members are local government owned companies, Perpamsi is a semi-official association under the auspices of the Ministry of Home Affairs and other related ministries. Since its establishment on April 8, 1972, to date 303 PDAMs are registered automatically as active members of Perpamsi. Various companies, joint venture companies with PDAMs, or companies with concessions to provide

drinking water services, can readily become members of Perpamsi, based on the new statutes and rules of Perpamsi.

All the members are grouped into five regional coordinating areas, and each province has a provincial commissariat. The groupings are meant for enabling the concentration of various activities and undertakings in each of the respective regions, in accordance with the interests of the respective local areas, with their specific local condition and different conditions of the PDAMs. This way, it is expected that the programs developed by Perpamsi for the interests of its members can be rightfully appropriate.

The main function of Perpamsi is of bridging the interests of its members with the governing bodies at the central level; assisting its members in improving the capacities in business management and development; facilitating in the realization of integrated efforts, as well as in the exchange of information on drinking water supply and other drinking water issues.

The main problem in developing water utilities is the poor quality of the human resources, both the number as well as their capacities in management and technologies. Being aware of this problem, Perpamsi is placing human resources development as one of the important programs, and giving it first priority. The human resource development program is aimed at assisting the government and the PDAMs to upgrade and develop the needed human resource, as basic capital towards efficient and professional management. Human resource development programs are geared for high and middle level management, as well as for technicians and administrative staff. The programs are conducted either by Perpamsi or in cooperation with education and training institutions, in the country as well as abroad.

Programs for high level management are usually conducted through the organization of seminars and workshops, to open and broaden their insights, and through **functional training**. Development of the middle management and staff is carried out through education and training.

Just to mention one or two examples, more than 500 technical staff have benefited from the basic training on water supply engineering since 1988, in cooperation with ITB and ITS, two prominent engineering institutions in Bandung and Surabaya. Three strategic management training had been conducted since 1996 for top level managers, in cooperation with Research Triangle Institute. About 60 managing directors have participated in the above-mentioned training program.

The other main program of Perpamsi is the strengthening of the operational base of the companies. The important effort in this case is of providing assistance, and in cooperation with the government, preparing the PDAMs to become a limited company, including the development of its legal bases. The limited company structure is strategic in nature, for developing a favorable business climate. Although business and profit oriented, the limited company shall not neglect its main function of serving the community.

Private sector participation in drinking water companies is not only considered as an alternative, it has already become a necessity, as a financial and engineering effort for water supply development. Therefore, efforts to support programs of partnership with the private sector are also an important program of Perpamsi. Perpamsi will readily help and cooperate with the government to enhance such partnership programs.

One of the strategic in which Perpamsi is also involved is the benchmarking of PDAMs. The PDAMs are rated in their readiness for partnership. This program is also one of the programs of the World Bank for Indonesia. Perpamsi, as the implementing agency, will work together in cooperation with the appointed consultant. Perpamsi will do its best for the success of the program.

b. Perpamsi's Role in the Rescue Program

In the earlier discussion, the role of Perpamsi in the rescue program is clearly described. Considering its position in the inter-institutions program, Perpamsi will play an active role as coordinator of the small team to take inventory of the PDAMs in crisis. Perpamsi is one of the first institutions to recognize the need and to take initiative for developing the rescue program. During the Board of Management Meeting in July 1998, it was decided to focus its work program to rescuing the PDAMs in critical condition.

In carrying out its role in the Rescue Program, Perpamsi's:

- Is always ready to assist and cooperate with the government and other parties in programs that will help the PDAMs to overcome their difficulties.
- will take the necessary initiatives, so that every undertaking within the rescue program framework can be properly carried out.
- will help in coordinating every undertaking in the rescue program with members or related institutions.
- will give priorities to programs that are related and supportive to the rescue program.
- Will assist the participating PDAMs in the rescue program, among others in the provision of experts, specific training that is needed, settlement of administrative processes and legal aspects, and others.

Especially concerning the rescue program of the World Bank, ever since the first introduction of the concept, Perpamsi has shown its attention and interest to support the program. Perpamsi had also expressed its willingness to act as the TA managers, as was expected in the beginning by the World Bank. Nevertheless, due to bureaucracy and the status of Perpamsi as a non-government institution, the function of TA Manager is the hands of the Directorate General of Cipta Karya. However, Perpamsi still is willing to play an active role although only in helping the coordination among PDAMs.

Whatever the role is, Perpamsi will do its best. Perpamsi will cooperate as well as it possibly can with related parties. This is especially due to the fact that Perpamsi is most concerned with the present condition of the PDAMs. Perpamsi does not want to have its members drowned one after another.

VI. Conclusions

In concluding the discussion, I would like to stress again that, whatever the structure, the Rescue Program is still very much needed. A quick and appropriate undertaking can alleviate especially the small and weaker PDAM[illegible]rom their sunken position due to the economic and monetary crises.

Blaming the past condition of PDAMs of being not efficiently and not professionally managed will not solve the problem. Most important is to rescue them so that they can be in operation again; then gradually improve the performance and services of the PDAMs.

I [illegible]ly believe that the present condition will provide lessons for the PDAMs, and especially their m[illegible]agers. Therefore, I am also sure that within the soul of every PDAM manager has grown a wish to improve management and increase greater responsibility towards the company.

Th[illegible]refore, on behalf of Perpamsi, I would like to stress again our determination to help the P[illegible]Ms to get out of the d[illegible]ficulties they are facing. We greatly appreciate the help of other parties and we are ready to cooperate in the implementation of the program.

Finally, allow me to express my gratitude and appreciation, personally and on behalf of Perpamsi, for the opportunity to present this brief information to this distinguished forum about the condition of the Indonesian water utilities in this period of crisis and the efforts for im[illegible]ovement.

Washington DC, April 8, 1999

EXTERNAL IMPACT OF ECONOMIC CRISIS TO SURAKARTA WATER UTILITY
(PDAM SURAKARTA)

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World Bank Water Forum
April 1999

PDAM SURAKARTA

Surakarta is the third most important location and the second largest city in Central Java Province, Republic of Indonesia, with the total population of 570,166 in 1998. The city can easily be reached within one hour by plane from Jakarta or Bali (see **Map 1**)

Surakarta has had a piped water supply since 1928. In later years (1980) the system has been expanded and it now covers the entire area of Kotamadya (municipality) of Surakarta, as well as small areas outside the city boundary.

Present Situation

At present, water production facilities in Surakarta consist of:

- Cokrotulung spring : 400 l/s
- 12 deep wells : 266.29 l/s
- Sungsang spring : 200 l/s
  (under construction and will be completed in 1999)

Existing water supply facilities and service area (see **Map 2**):

- Population in service area : 570,168
- Population served : 51.6 %
- Consumers connection : 43,570 units
- Total water produced : 666.29 l/s
- Total volume sold : 13,883,000 m^3/year
- Unaccounted for water : 33 %
- Basic tariff : 225 Rp/m^3
- Average tariff : 545 Rp/m^3

Apart from piped water supplied by the utility, many people still have their own private wells. In fact, the volume of water produced by private sources is probably larger than the utility has produced, although the quality is questionable. Based on the number of house connection in 1998, around 51.6% of the urban population is served by the water utility.

In 1994/95, with the World Bank support, a Five-Year Medium Term Investment Plan was prepared, which includes loan for developing water supply provision in the city (IBRD Loan 3749-IND)

Project Implementation

Since 1994, PDAM Surakarta received loan from the World Bank to implement water supply sector, which consists of augmentation of production and distribution extension. The project also includes construction of new and rehabilitation of existing sewerage system. Summary of financing plan for 1994/95 to 1999/00 is summarized in table below, in Indonesian Rupiah (Rp8,000 per US$ 1 in February 1999)

		COST	TOTAL
PRODUCTION AUGMENTATION			
1	Well drilling, pump station, pipe collector and reservoir	2,966,180,000	
2	Sungsang spring, 200 l/s and spring protection	6,552,200,000	
3	Iron and manganese treatment plant	362,700,000	
4	M/E equipment, Jebres reservoir	260,000,000	
			10,141,170,000
	DISTRIBUTION EXTENSION		
1	Supply and install distribution pipe	11,298,060,000	
2	House connection	5,883,980,000	
			17,182,040,000
WATERLOSS REDUCTION PROGRAM			
1	Pipe rehabilitation	2,840,930,000	
2	Zoning program	1,245,870,000	
3	Supply of water meter and equipment	1,413,000,000	
4	Meter workshop	67,000,000	
			5,566,800,000
TOTAL INVESTMENT			**32,890,010,000**

Project is planned to be implemented in five years. For various reasons, project implementation has shifted one year, and the project is now planned to be completed in September 2000.

Graph I shows planned, allocated and actual utilization of funds for the project period (1994/95 – 1999/00) has shown a one year shift from the original five year plan.

Impact of Economic Crisis

Impact of economic crisis in 1997 has resulted in reduction of the people's aaffordability to install new connection, delay in tariff increase and decrease billing efficiency. The impact to PDAM Surakarta is recognized in:

Internal impact:

- Price increase for chemicals at approximately 100%
- Increase in overhead cost for approximately 8.11%
- Price increase for pipes at approximately 25%

External impact:

- Decrease in people's purchasing power, thus reducing new connections
- Delays in tariff increase planned for 1998

Emergency Actions to Relieve the Impact

To overcome the crisis, an emergency action plan was declared by the PDAM on:

- Increasing operating revenues
- Making more efficient use of operating expenses
- Public information campaign

Graph II (upper line) shows that the operating revenue improved in 1998 and is projected to increase in the coming years. In 1998, these two major activities were undertaken:

1. About 2,500 consumers previously disconnected because of unpaid bills were targeted. There was a house-to-house campaign to get them to settle their unpaid bills and reconnect by paying only 10% (Rp30,000) of the normal connection fee.

2. Water pressure was adjusted to increase the consumption of many consumers, bringing their consumption to the next higher tariff bracket, at the sacrifice of a smaller number of consumers who have a higher consumption.

Graph II (lower line) shows a decrease in operating expenses in 1998. A few months after the May 1998 riots, there was almost zero economic activity in the city. This resulted in a big drop in production, resulting in a decrease in operating expenses, in spite of the 80% inflation for that year.

Graph III shows the effect of economic crisis in Surakarta which can be seen to start in the last quarter of 1997. This was worsened by the political situation in May 1998, so that by the second quarter of 1998 collection efficiency dropped by 2%.

A public information campaign was undertaken from May to July 1998. Neighborhood meetings were held in areas with big decreases in collection. This brought up by the collection efficiency again. The PDAM's collection efficiency in December of 88.88% is its highest so far. With these efforts, the PDAM is still able to fully pay its debt service.

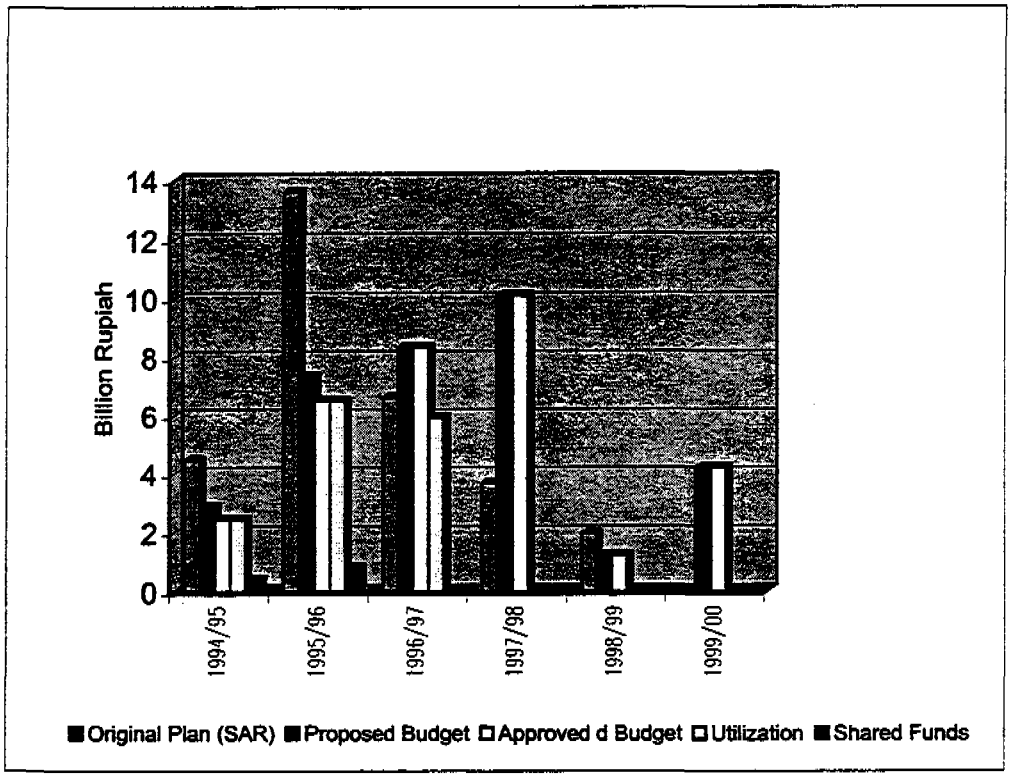
Other Innovations

Communication campaign. With assistance from the World Bank, PDAM is initiating public and consumer communication campaign, which includes:

- Video presentation
- Public relation campaign, eg booklets, leaflets, radio spots, etc.
- Press release
- Workshops with NGOs
- Community meetings
- Information dissemination
- Exhibitions
- Communication through traditional shows (eg. Ketoprak show)

Operations Audit. In April 1999, an audit of the PDAM will be carried out by Arthur Andersen, funded by the World Bank. With this audit, the PDAM hopes to improve the efficiency of its operations.

Graph I: Planned, Allocated and Utilization of Funds

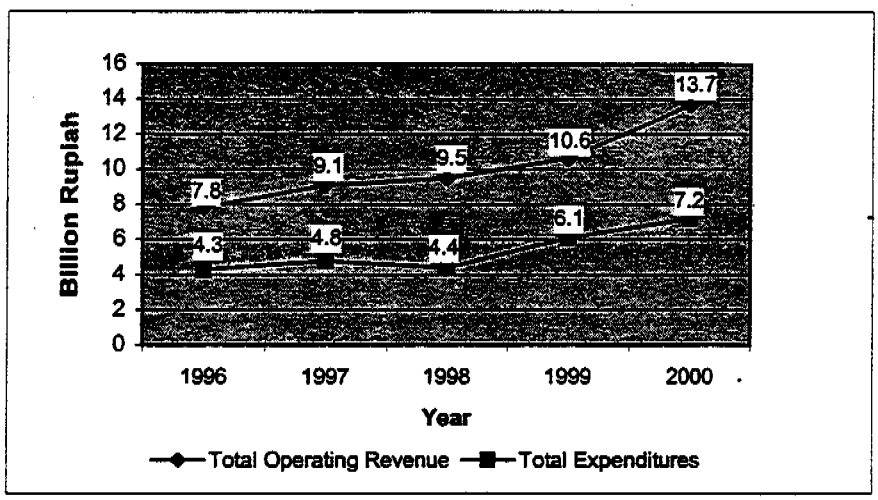


Billion Rupiah

Fiscal Year	Original Plan	Budget Proposed	Budget Approved	Utilization	Shared Funds
1994/95	4.4980	2.8772	2.4420	2.4337	0.4302
1995/96	13.6210	7.3482	6.5335	6.5187	0.8147
1996/97	6.6350	8.3664	8.3664	5.9467	0.0000
1997/98	3.6970	10.1217	10.1217	0.0000	0.0000
1998/99	1.9800	1.2360	1.2360	0.0000	0.0000
1999/00	0.0000	4.2208	4.2208	0.0000	0.0000
Total	30.4310	34.1703	32.9204	14.8991	1.2449

Graph II: Impact of Crisis to Operating Revenues and Expenditures

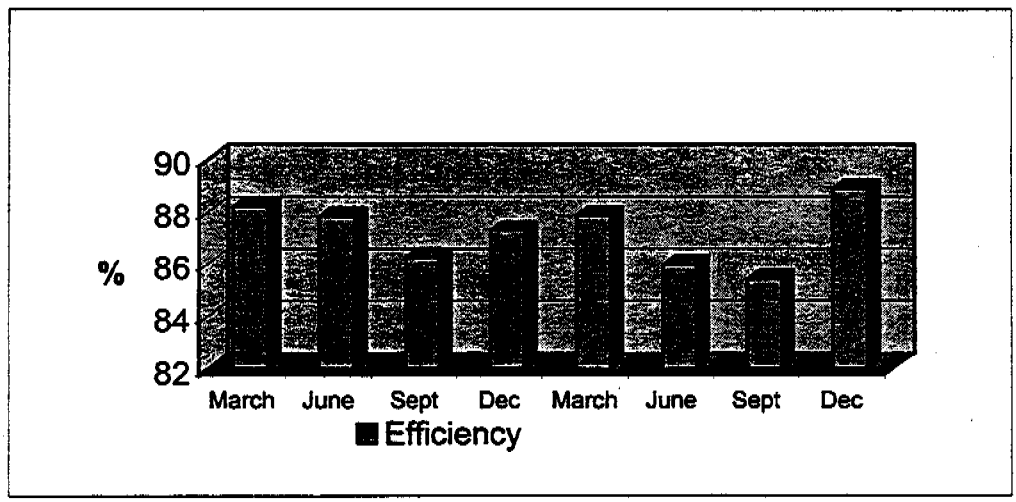
(and Future Expectations)



Billion Rupiah

Year	Operating Revenues	Expeditures
1996	7.8	4.3
1997	9.1	4.8
1998	9.5	4.4
1999	10.6	6.1
2000	13.7	7.2

Graph III: Collection Efficiency in 1997 and 1998



Year	1997	1997	1997	1997	1998	1998	1998	1998
Month	March	June	Sept	Dec	March	June	Sept	Dec
Efficiency	88.21	87.84	86.25	87.29	87.86	85.97	85.43	88.89

SURAKARTA WATER UTILITY (PDAM Surakarta)

External Impact of Economic Crisis

WORLD BANK WATER FORUM, APRIL 1999

SURAKARTA WATER UTILITY

- Present Situation
- New Investment
- Impact of crisis on PDAM Surakarta
- PDAM Emergency Plan
- Other Innovations

MAP OF INDONESIA AND CENTRAL JAVA

WORLD BANK WATER FORUM, APRIL 1999

EXISTING WATER SUPPLY FACILITIES AND SERVICE AREA

PDAM SURAKARTA

- Surakarta is the third most important location and the second largest city in Central Java Province with population 570,166 in 1998
- Surakarta has had a piped water supply system since 1928
- In later years (1980) the system has been expanded and it now covers the entire area of the city as well as small areas outside city boundary

PRESENT SITUATION

- Apart from piped water supply by PDAM, many people have their own private wells. In fact, water volume produced by private sources is probably larger than the PDAM production, but the quality is not preferable.

- Based on the number of house connections in 1998, around 51.6% of the urban population is being served by PDAM

PRESENT SITUATION

PDAM Surakarta water production facilities:

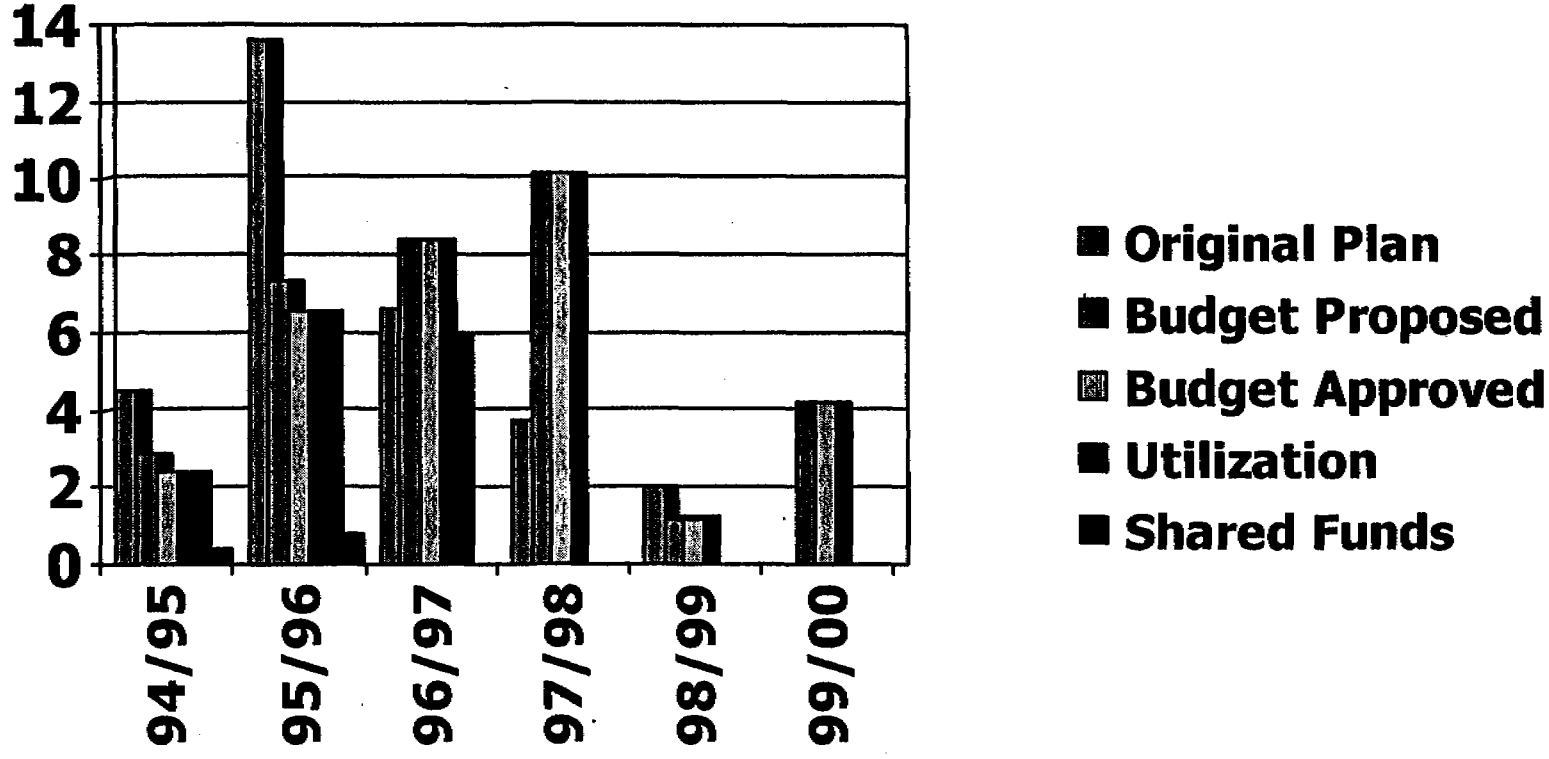
- Cokrotulung spring, 400 l/s
- 12 deep wells, 266.29 l/s
- Sungsang spring, 200 l/s, (to be completed in 1999)

NEW INVESTMENT

- In 1994/95, with the support of the World Bank, a Five-Year Medium Term Investment Plan (PJM) for Surakarta was completed, which includes loan for new water supply investment (IBRD Loan 3749-IND)
- The project also includes rehabilitation and construction of sewerage system

PROJECT FUNDING

PLANNED, ALLOCATION AND UTILIZATION OF PROJECT FUNDS
(Billion Rupiah)



WORLD BANK WATER FORUM, APRIL 1999

IMPACT OF CRISIS

Internal impact

- price increase by 100% (chemicals) and 25% (pipes)
- increase if overhead costs by 8.11%

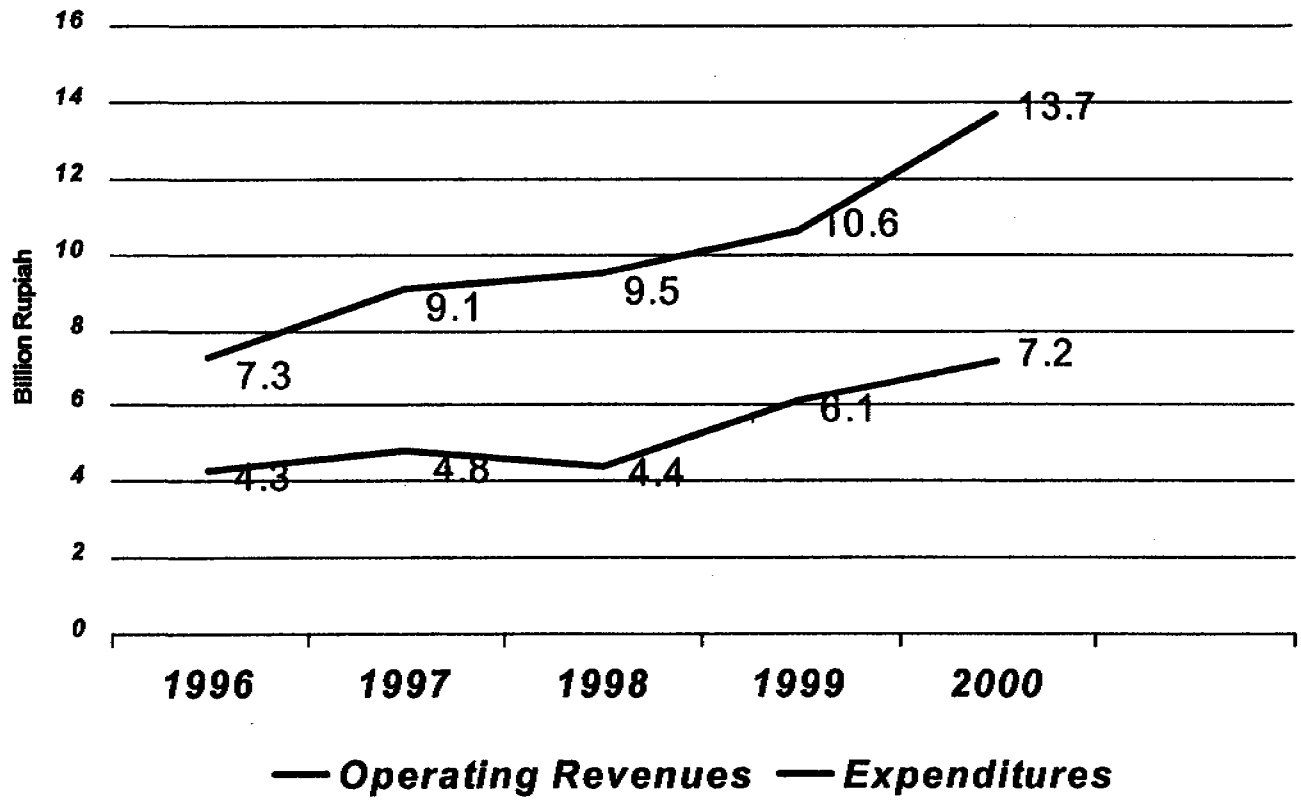
External impact

- reduce people's purchasing power
- delays in tariff increase, planned for 1998

WORLD BANK WATER FORUM, APRIL 1999

IMPACT OF CRISIS

TO OPERATING REVENUES AND EXPENDITURES AND EMERGENCY ACTIONS



WORLD BANK WATER FORUM, APRIL 1999

PDAM EMERGENCY ACTIONS

- Increasing operating revenues
- Making more efficient use of operating expenses
- Public information campaign

PDAM EMERGENCY ACTIONS
INCREASE REVENUES

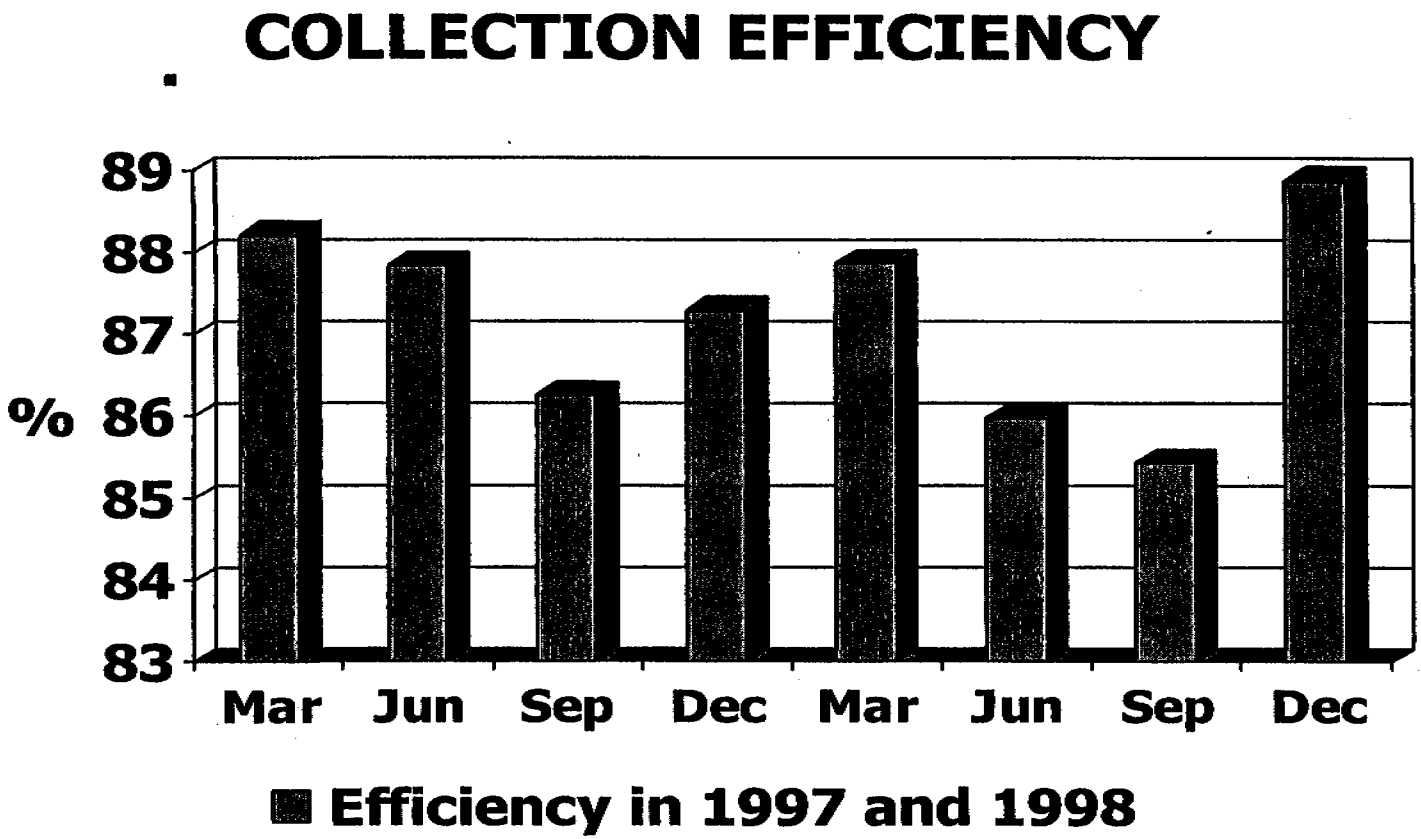
ACTIVITIES UNDERTAKEN

- House-to-house campaign to HC with unpaid bills and reconnect with 10% fee
- Adjust water pressure to expand services to more consumers

PDAM EMERGECNY ACTIONS
PUBLIC CAMPAIGN

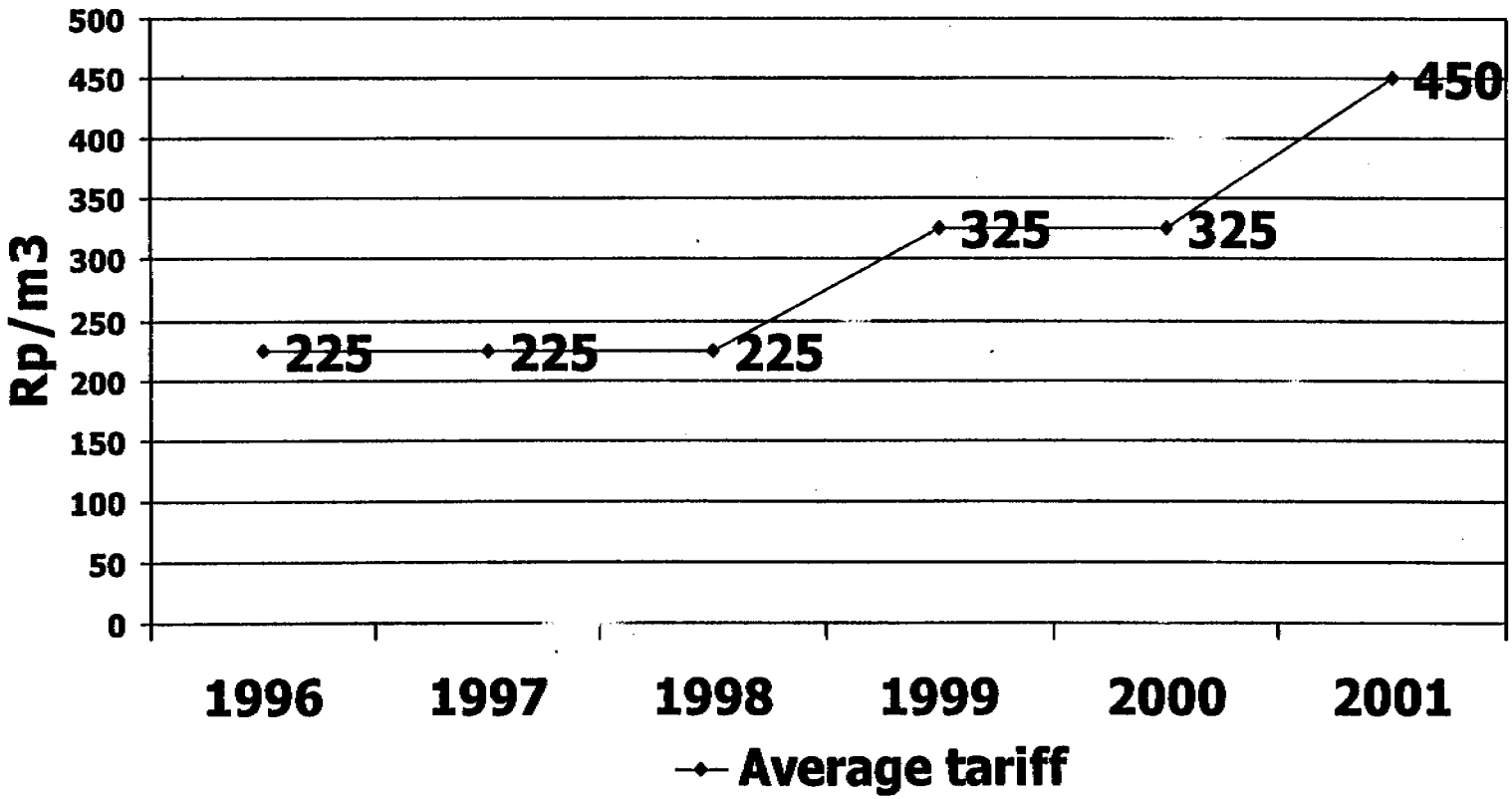
- Political riots in Surakarta (May 1998) resulted in almost zero economic activity in the city, causing in a decrease in operating expenses
- Public information campaign was undertaken from May to July 1998, bringing up the collection efficiency again (the highest being 88.88%)

PDAM EMERGENCY ACTIONS



WORLD BANK WATER FORUM, APRIL 1999

TARIFF INCREASE
(HISTORICAL AND PROJECTION)



WORLD BANK WATER FORUM, APRIL 1999

OTHER INNOVATIONS

COMMUNICATION CAMPAIGN

- With the World Bank assistance, PDAM is initiating public and consumer communication campaign

- It includes video presentation, public relations, press release, workshops, community meetings, information dissemination, exhibition and traditional shows (kethoprak show etc.)

OTHER INNOVATIONS

OPERATIONS AUDIT

- In April 1999, the World Bank will assist in conducting operations audit, to be carried out by Arthur Andersen

- The objective is to know real capability and credibility of PDAM Surakarta in having access to commercial loan

CONCLUDING MESSAGES

- Crisis hit the country including all water utilities in Indonesia
- PDAM Surakarta has strong confidence to survive from crisis by actions and innovations
- Be optimistic and keep smiling

WORLD BANK WATER FORUM, APRIL 1999

BUREAU CENTRAL D'ETUDES POUR LES EQUIPEMENTS D'OUTRE MER
(BCEOM - FRANCE)
Engineering Services

Project Leader, in charge of the main following projects :

1980 - 1983	:	*Casablanca sewerage system Feasibility Study and Master Plan (Morocco) (IBRD funding)*
1977 - 1980	:	*Engineering studies for the construction of New Cities near Agadir (Morocco)*
1971 - 1977	:	*Water Supply and sewerage of Addis Ababa (Ethiopia) 5 years (IBRD funding)*

Short term missions in :
- Thailand (Irrigation)
- Tunisia (Sewerage)
- Yemen (Utilities)
- Lebanon (Utilities)
- Madagascar (IBRD Consultant)

REUNION ISLAND (French overseas department)

1969 - 1971	:	*Engineer of the "Direction Departementale de l'Agriculture" in charge of the Water Supply and Waste collection Master Planning*

Languages	:	French	(mother tongue)
		English	(Fluent)
		Italian	(Fluent)
		Bahasa Indonesia	(notions)

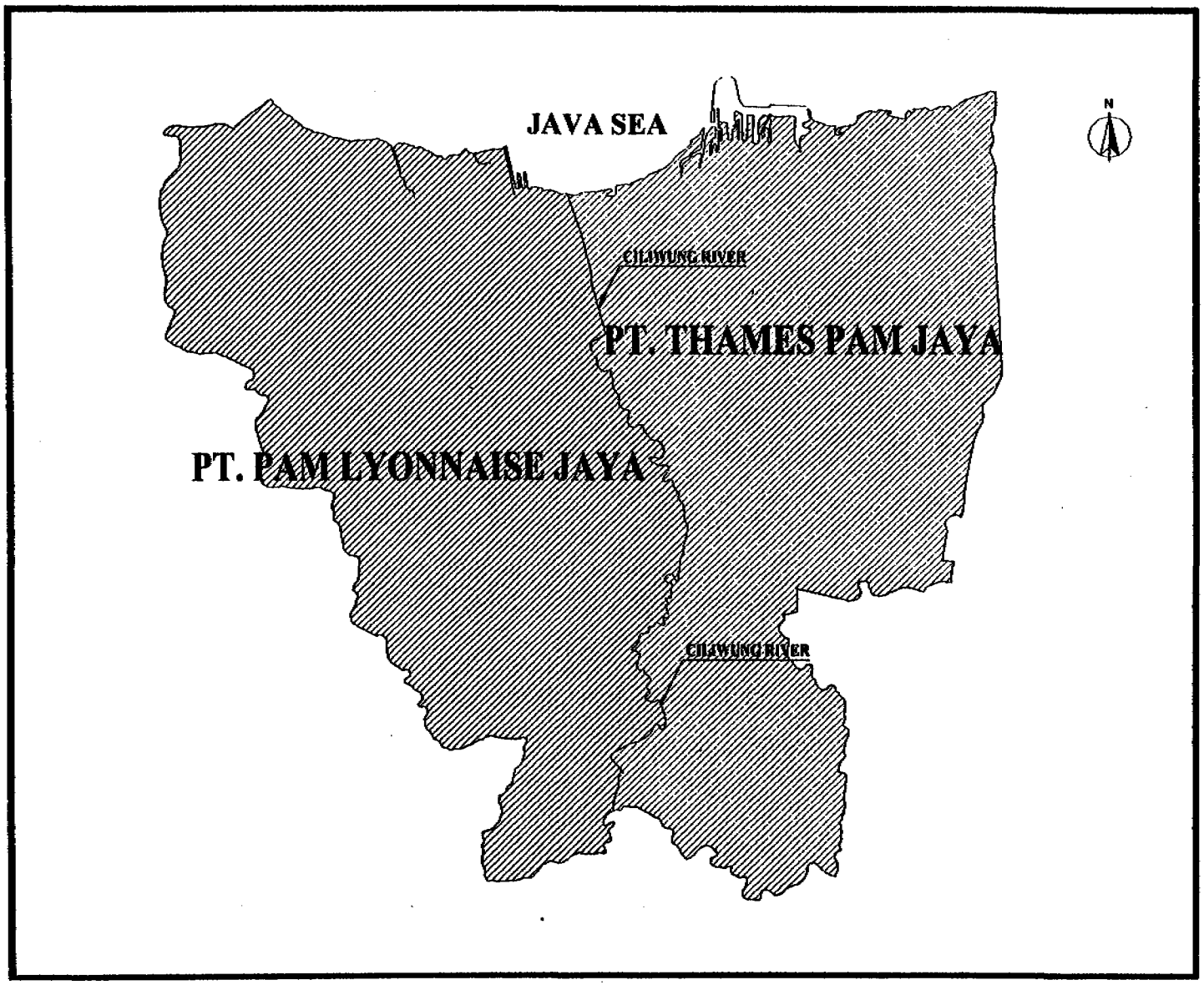
PT PAM LYONNAISE JAYA
PALYJA

JAKARTA WATER SUPPLY CONTRACT

151

GENERAL OVERVIEW

Suez Lyonnaise des Eaux Group


JAVA SEA
N
CILIWUNG RIVER
PT. THAMES PAM JAYA
PT. PAM LYONNAISE JAYA
CILIWUNG RIVER

PALYJA

Background

PALYJA

- July 1995 — Beginning of the Negotiation Process
- October 1995 — Definition of the Terms of Reference
- March 1996 — Finalization of the Feasibility Study
- April 1996 — Beginning of the Contractual and Financial Negotiations (123 sessions)
- 7 June 1997 — Signature of the Cooperation Agreement
- 28 January 1998 — Signature of the Addendum to the Cooperation Agreement
- 28 January 1998 — Signature of the Escrow Account Agreement
- 1 February 1998 — Effectiveness of the Contract
- July 1998 — Finalization of the Financing :

Syndicated Loan	70 M$
E.I.B.	61 M$

All preconditions met

Nature of Business and Objectives

PALYJA

- DRINKING WATER CONCESSION - WEST JAKARTA - 25 Years
- COOPERATION AGREEMENT SIGNED BY PAM JAYA,
  former City Water Company → Witnessed by the Governor of DKI Jakarta
  → Letter of Comfort signed by the MoF through DKI
- INITIAL SHAREHOLDING : 60% Salim Group
  40% SLDE
- SALIM'S SHAREHOLDING PURCHASED BY SLDE IN JUNE 1998
- ONGOING DISCUSSIONS :

  → DKI Jakarta for a 10% Shareholding

Nature of Business and Objectives

PALYJA

- FULL CONCESSION - 25 years
  - → Production
  - → Distribution
  - → Billing
  - → Collection

  . West Jakarta Population ~5.5 millions (2.2 served today)
  . Number of customers billed monthly ~210,000
  . Remuneration = Fixed "Water Charge" in Rupiah/m3 billed and collected

- COMMITMENT TO DEVELOP THE EXISTING INFRASTRUCTURE TO REACH CONTRACTUAL TARGETS (ESSENTIALLY VOLUMES)
  - → Rehabilitation and Development of the Network, including Primary Network
  - → Rehabilitation of Production Facilities
  - → No Significant Additional Production Capacity over the First 5 Years

- COMMITMENT TO REACH TECHNICAL TARGETS : Contract of "Ends", not "Means"

- OBJECTIVES HAVE BEEN NEGOTIATED BASED ON A FIRST 5-YEAR INVESTMENT PROGRAM

- SUBSEQUENT 5-YEAR INVESTMENT PROGRAMS WILL BE NEGOTIATED PERIODICALLY

Nature of Business and Objectives
Technical Targets

PALYJA

- To produce drinking water after 10 years
- Non Revenue Water decreased from 53% to
  - → 35% after 5 years
  - → 25% after 10 years
  - → 20% after 20 years

  } in reality starting point ~ 60%
- Connection rate of 70% after 5 years, 100% after 25 years
- Volumes sold increased from 89 Mm3 to 174 Mm3 after 5 years
- 220,000 New Connections in 5 years (doubling)
- Network pressure reaches 0.75 bar in 2002
- Network repairs made within 6 to 72 hours depending on pipe diameter

Indexation Formula

PALYJA

- WATER CHARGE ≠ TARIFF
- REFLECTS OPERATIONAL COSTS FLUCTUATIONS
  - → Power (passed on)
  - → Chemicals (national index)
  - → Metal Products (national index)
  - → Labor Costs (passed through for PAM JAYA seconded employees)
  - → Raw and Treated Water Costs (passed on)
- REFLECTS FOREX LOSSES WHEN REALIZED (passed on)
- REFLECTS LOCAL INTEREST RATE FLUCTUATIONS FOR LOCAL BORROWING (passed on)
- CAPEX Component - (national cost of construction index)
  - → Freezing of CAPEX component under negotiation

Nature of Business and Objectives
Collection

PALYJA

Collection risk held by PALYJA

Collection rate assumed contractually = 98%

The collection is fully reconciled with the billing

The collection is centralized to PALYJA / PAM Jaya Escrow Account (ABN AMRO)

Disbursement from the Escrow Account strictly regulated

→ Priority # 1 = MoF rescheduled debt and PAM Jaya
Priority # 2 = PALYJA - for its share
Priority # 3 = PAM JAYA - for the balance

If insufficient tariff, priorities # 1 and # 2 are reversed

Number of Employees

(31 January 1999)

PALYJA

INDONESIAN WORKFORCE		
Employees Seconded	1486	(1497 as of 1st February 1998)
Direct Employees	85	
Daily Workers	242	
	1813	

EXPATRIATE WORKFORCE	
Expatriates	13
Locally hired expatriate	1
CSNE	2
	16

159

Objectives of the Ongoing Negotiations

PALYJA

- → to allow the freezing of the tariff in 1999
- → to obtain the control of the deep wells and increase naturally the average tariff (as negotiated in the contract)
- → to reschedule a second time the repayment of the MoF debt
- → to replace PAM JAYA by a proper regulator at the city level
- → to finance the residual shortfall
- → to associate the city by the sale of a 10% shareholding

World Bank Involvement

PALYJA

World Bank has accepted to be involved in the on going negotiations

- REGULATORY BODY
  - → Presently PAM JAYA is also regulatory body (Conflict of Interests)
  - → World Bank finances consultant to study the establishment of a regulatory body

- INDEPENDENT ASSESSMENT
  - → World Bank finances consultant to execute independent assessment of the general fairness of the contract

PT PAM LYONNAISE JAYA
PALYJA

JAKARTA WATER SUPPLY CONTRACT

IMPACT OF EXTERNAL SHOCKS

Suez Lyonnaise des Eaux Group

POLITICAL SHOCKS

PALYJA

1. TAKE OVER MAY - JUNE 1998 / HISTORY

• RIOTS IN JAKARTA	19 MAY
• EVACUATION OF BRITISH /FRENCH NATIONALS	20 MAY
• INSTRUCTION OF GOVERNOR ON " CONTINUITY OF SERVICE"	22 MAY
• TAKE OVER BY PAM JAYA	23 MAY
• RETURN OF EXPATRIATES	23 MAY
• DISCUSSIONS WITH GOI / DKI / PAM JAYA	
• AGREEMENT ON CONDITIONS TO HAND OVER	01 JUNE
• HAND OVER TO PRIVATE PARTNERS	05 JUNE

POLITICAL SHOCKS

PALYJA

2. CONDITIONS SET BY GOI FOR HAND OVER (AGREEMENT SIGNED 1 JUNE 1998)

- BINDING AGREEMENT TO SELL SHARES FROM SALIM TO SLDE
- SLDE TO OFFER SHARES TO DKI JAKARTA
- APPOINTMENT OF A DIRECTOR NOMINATED BY DKI
- RESIGNATION OF ALL COMMISSIONERS / DIRECTORS APPOINTED BY SALIM
- REMOVAL OF ALL KEY EMPLOYEES NOMINATED BY SALIM

POLITICAL SHOCKS

PALYJA

3. TARIFF VS WATER CHARGE

- LAST INCREASE OF TARIFF APRIL 1998 (+ 20%)
- INFLATION FOR 1998 : 80%
- WATER CHARGE INDEXATION FOR 1998 : 63,5 %
- DECISION OF GOVERNOR DKI JAKARTA : NO INCREASE IN TARIFF UNTIL YEAR 2000, FOR POLITICAL REASONS
- CONSEQUENCE : STARTING JANUARY 1999 WATER CHARGE > TARIFF
  - ➜ DEFICIT FOR 1999
- PROPOSAL BY PRIVATE PARTNERS TO MITIGATE
- ON GOING NEGOTIATIONS

POLITICAL SHOCKS

4. AKAINDO LAWSUIT

PALYJA

- AKAINDO : ASSOCIATION OF WATER SUPPLY CONTRACTORS IN JAKARTA
- SEPTEMBER 1998 : AKAINDO SUES PRIVATE PARTNERS
  - → "CONTRACT OBTAINED BY KKN HENCE NOT VALID"
  - → "NO REAL INVESTMENT"
  - → "CONTRACT DAMAGING THE PEOPLE OF JAKARTA"
  - → "REQUEST FOR CANCELLATION OF THE CONTRACT"
- HEAVY MEDIA CAMPAIGN AGAINST PRIVATE PARTNERS
- CLARIFICATIONS / DISCUSSIONS
- REPORT BY INDEPENDENT ACCOUNTING FIRMS (ARTHUR ANDERSEN) PREPARED
- AMICABLE SETTLEMENT OF THE CLAIM FEBRUARY 1999
- COOPERATION WITH AKAINDO STARTED (TRAINING ON WORK SUPERVISION)

POLITICAL SHOCKS

PALYJA

5. CONTRACT "CLARIFICATIONS"

- AFTER JUNE 1998 MEMBERS OF THE CITY COUNCIL REQUESTED CONTRACT TO BE "RENEGOTIATED"
  - → "Contract signed under political pressure, too profitable for the private partners"
- PAM JAYA AND CITY COUNCIL SUBMITTED A LIST OF POINTS TO BE RENEGOTIATED
- WORLD BANK REQUESTED TO FINANCE AN INDEPENDENT ASSESSMENT
- TERM OF REFERENCE FOR INDEPENDENT ASSESSMENT FINALIZED BY WORLD BANK MARCH 1999
  - → "Focus on the efficiency, balance and transparency of the contracts"
- CONSULTANTS APPOINTED TO START AFTER ELECTIONS (JUNE 1999)

POLITICAL SHOCKS

PALYJA

6. DEEP WELLS

- REDUCTION OF DEEP WELL USAGE = ONE OF THE MAIN GOALS OF THE CONTRACT (ENVIRONMENTAL ASPECT)
- DECREE TO BE ISUED BY DKI JAKARTA
  - → Closure of deep wells when piped water available
  - → Tax per m3 deep well 20% more expensive than piped water
- DECREE NOT ENFORCED FOR "VARIOUS" REASONS
  - → If enforced, increases average tariff and brings a partial solution to the tariff insufficiency
- RESULT : SHORTFALL FOR PALYJA > 10 Million M3 IN 1998
  - → Water sold objectives not met
  - → Loss of revenues

POLITICAL SHOCKS

PALYJA

7. REGULATORY BODY

- CONTRACTUALLY, REGULATORY BODY IS PAM JAYA
- PAM JAYA TO ACQUIRE SHARES IN PALYJA ON BEHALF OF DKI

  → CONFLICT OF INTEREST
- WORLD BANK IS REQUESTED TO HELP IN FINDING AND FUNDING CONSULTANTS
- CONSULTANTS (NERA) IN PLACE STARTING MARCH 1999

ECONOMIC SHOCKS

INDONESIA 1/2

PALYJA

- COLLAPSE OF THE RUPIAH
  - → 2.400 Rp / USD IN JUNE' 97 (SIGNATURE)
  - → 17.000 Rp / USD IN JANUARY'98 (EFFECTIVENESS)
  - → 8.025 Rp / USD AS OF JANUARY'99

- HYPERINFLATION
  - → 80% IN 1998
  - → + 300 % FOR CHEMICAL PRODUCTS

ECONOMIC SHOCKS

INDONESIA 2/2

PALYJA

- EFFECT ON ECONOMY
  - → WIDE DISRUPTION OF THE ECONOMY
  - → RUNS ON BANKS (LIQUIDITY DIFFICULTIES)
  - → PRICING OF GOODS BECOMES IRRATIONAL
  - → MAIN DIFFICULTY : TO AVOID THE "DOLLARISATION"
  - → SKYROCKETTING INTEREST RATES
  - → COMPLETE FREEZING OF LETTER OF CREDIT ISSUANCE
  - → NO TRUST IN ANY INDONESIAN COMPANY OR BANK, EVEN OWNED BY FOREIGN COMPANIES, TRUST BASED ON CASH /PLEDGING OF CASH

ECONOMIC SHOCKS

IMPACT ON PALYJA

PALYJA

- STARTING 12/98 : ALL FINANCIAL FACILITIES MUST BE GUARANTEED BY PARENT COMPANY OR PLEDGING OF CASH
- PALYJA HAS TO DEVELOP IMAGINATIVE SCHEMES TO HELP IMPORT SUPPLIERS TO ISSUE LETTERS OF CREDIT AND OBTAIN SHORT TERM LOAN FACILITIES (PLEDGING OF CASH)
- PALYJA HAS TO CONSTANTLY ADAPT TO INCREASING DIFFICULTIES AFFECTING SUPPLIERS AND CONTRACTORS AND TO MINIMIZE ITS DOLLAR PAYMENTS
- OVERALL, ECONOMIC AND POLITICAL SHOCKS HAVE REPRESENTED A PHENOMENAL COMPLEXITY FOR PALYJA AND LOSS/RISK FACTOR FOR SLDE

FINANCIAL SHOCKS

PALYJA

- FINANCING OF THE INVESTMENTS SUPPOSED TO BE ON NON RECOURSE PROJECT FINANCING BASIS
- IMPOSSIBLE DUE TO THE CRISIS
- FINANCING RAISED WITH EXCEPTIONAL SLDE GUARANTEE
  - → European Investment Bank M$ 61.3
  - → Syndicated Loan : 7 International Banks M$ 70.0
- NO C.O.F.A.C.E. COVERAGE DUE TO VERY HIGH POLITICAL RISK
- BUT EIB COVERS THE MAIN POLITICAL RISKS:
  - → Expropriation
  - → War and Civil Disturbance
  - → Non - transfer of currency

Private Sector Participation in Jakarta Water Supply

World Bank Support for Private Sector Participation in Jakarta Water Supply

1. The World Bank supported improvements in water supply in the greater Jakarta area under the Second Jabotabek Urban Development Project (JUDP 2, Loan 3219 – IND) to the tune of $105 million, of which about $92 million was for the Jakarta water utility, PAM Jaya. The project became effective in February 1991 and closed in December 1997, after a one year extension.

2. The project's Implementation Completion Report (ICR) assessed the project to have substantially achieved its physical, management, and financial objectives, and that most of the benefits anticipated had been realized. In the case of Jakarta water supply, the project resulted in more balanced production and distribution capacities and the service ratio (at 50%) was slightly higher than forecast. Tariffs were increased as agreed, and financial and economic rates of return were achieved. However, because of the deterioration in raw water quality, the overall quality of piped water did not significantly improve. Further, unaccounted for water (UfW) increased by two percentage points to 56% during the project.

3. From about the second half of 1994 the Government and the Bank began work on identifying future investments in Jakarta water supply, and in exploring opportunities for private sector participation in Jakarta water supply. (The detailed work was done by consultants, financed under a Japanese grant.) As the government decided to negotiate cooperation agreements (concession type contracts) with two private consortia, led by Lyonnaise des Eaux and Thames Water respectively, on a non-competitive basis, the Bank dropped its plans for the follow-up project. At government request, the Bank agreed to the use of the balance of the grant funds to engage consultants to assist government in negotiating the cooperation agreements with the two consortia. In June 1997, PAM Jaya signed the cooperation agreements, which became effective in February 1998.

4. Following the changes in government in May 1998, at the request of the Governor of Jakarta, the structure of the two private consortia was changed; the original local investors were removed and it was agreed that PAM Jaya would hold 10% of the equity in each consortia. In parallel, because of the economic crisis in the country and an inflation rate of over 80% in 1998, the costs of operation also increased, and significant tariff increases were considered necessary, even though such increases might not be feasible. Finally, questions were being raised in several fora, including the legislature, on the fairness of the cooperation agreements.

5. In October 1998, the provincial government of DKI Jakarta and the private sector operators sought Bank assistance in three areas to address issues relating to the Jakarta cooperation agreements:

(a) Use of loan funds from an on-going project (which provides technical assistance to support the private provision of public infrastructure in the country) to assist the government in discussing the joint proposal from the concessionaires regarding tariff increases due in January 1999 and related matters;

(b) Assistance in the establishment of a Regulatory Body for the cooperation agreements; and

(c) Assistance with an Independent Assessment of the Cooperation Agreements.

6. *Review of proposals from the private operators.* Consultants were selected by DKI Jakarta for this purpose and the work is advanced, with agreement stated to be reached on most of the pending issues. *The Bank has, however, maintained an arm's length relationship on this activity and is not a party to the discussions between DKI Jakarta and the concessionaires.*

7. *Establishing a Regulatory Body.* The Bank, working in conjunction with government agencies and the concessionaires, finalized the TOR for consultants to carry out the work. National Economic Research Associates (NERA) has been engaged by the Bank (using grant funds) to work with government on this exercise. NERA's draft report is due in May 1999.

8. *Independent Review of the Cooperation Agreements.* In consultation with government, the concessionaires, and the Bank's Legal Department, we have prepared draft final terms of reference for this assessment. We are currently seeking confirmation from the national government that it would like such an assessment to be carried out. Thereafter, the study will be advertised in Development Business, and consultants will be selected by government for the work. The Bank will seek grant funds to finance this study and provide assistance to government in this matter as appropriate.

THE JAKARTA WATER COOPERATION AGREEMENTS
REGULATORY ISSUES

Background

Under the present cooperation agreements for water supply in Jakarta, a number of key regulatory functions (the monitoring of compliance with service obligations and information requirements by the private parties, discussions for the adjustment of water charges, and preliminary responsibilities for dispute resolution) have been delegated to PAM Jaya by DKI Jakarta. DKI Jakarta has retained the key regulatory function of determining appropriate tariff adjustments. Now that PAM Jaya has become a shareholder in the private parties, it is no longer appropriate for it to retain its regulatory functions. DKI Jakarta has accordingly asked for assistance in designing a new regulatory arrangement.

The World Bank is now preparing draft terms of reference for work to determine what a new regulatory arrangement might look like - both what kind of unit might be put in place in the short term to ensure the fair and professional implementation of the regulatory tasks, and what kind of unit might be appropriate in the longer term.

Key Questions

There are three main kinds of questions to be answered:

- Which functions should be given to the regulatory unit?
- How should the regulatory unit be structured?
- If the kind of arrangement that DKI Jakarta - and the national government - might prefer to have in the longer run isn't feasible in the immediate future, what might be done to get a working unit in place as soon as possible, while leaving open the opportunity for moving to a preferred solution over time?

Functions

Most regulatory agencies in the water sector around the world perform a variety of functions, including, most importantly, monitoring of compliance of the private parties with their contract, adjudicating tariff adjustments, and resolving disputes. In Jakarta, where the tariff and the water charge are determined separately, a key question will be whether the regulatory unit should take primary responsibility for both.

Structure

Water tariffs and water quality issues tend to be highly politically sensitive. This puts a lot of pressure on regulatory decisions. Regulators face the difficult task of reconciling the interests of consumers in receiving good services at the lowest possible price, with the interests of investors - who are committing large amounts of capital over long periods of time - in earning a fair return on these investments. In order to reach outcomes that are fair to both parties, and not subject to undue political interference, regulators need room to act independently - while remaining accountable to society at large. How the regulatory unit is designed has important implications for how independently regulators can act. Key questions here include:

- Are the powers of the regulatory unit powers to make binding decisions, or rather powers to advise on these decisions (e.g., with final decisions over tariffs being made by the Governor)?

- What are the skills required of regulators, how are they appointed, how are they paid, and on what basis may their employment be terminated? (For example, if a regulator can be fired because he makes a politically unpopular decision, he will be unlikely to take tough decisions)

- How is the regulatory unit to be funded? (For example, an agency funded directly from the government's budget may be afraid that unpopular decisions will lead to budget cuts.)

- What are the mechanisms for ensuring that the interests of key stakeholders - in particular, consumers - are heard?

- What are the mechanisms for ensuring that regulatory decisions are taken in an open and transparent fashion? (For example, will regulatory hearings be open to the public? Must the regulator publish the reasons for his decisions?)

Around the world, we find a variety of regulatory arrangements that answer these questions in different ways. However, in general we find that the more independence the regulator has, the greater confidence consumers have that their interests are being protected, and the greater confidence investors have that their investments are safe. Key questions for the Jakarta case include how much independence can feasibly be given to a regulatory unit in the short-term, what kinds of rules and procedures should be put in place to reinforce the independence and professionalism of regulatory decisions, and where the unit should best be located.

Finding a Reform Path

The urgent need in Jakarta is to establish a unit that can take over the regulatory functions currently exercised by PAM Jaya, and to do so in a way that will satisfy the public and political interest in developing processes that are credibly open, transparent and fair.

At the moment, legislation does not exist in Indonesia that would permit the creation of a fully independent regulatory agency for water in Jakarta - i.e., one with full autonomy to make key and binding decisions about such matters as tariff adjustments and the proper resolution of disputes. The immediate challenge, then, is to come up with an arrangement that fits with existing institutions and legislation, is as transparent and accountable as possible, is professionally competent, and has as much independence as can feasibly be given it. This will be the primary focus of the proposed consultancy.

In the longer term, it may be possible to pass legislation that will provide scope for the creation of more independent regulatory agencies across the infrastructure sectors - including water supply. It will be important to leave open ways of adjusting the regulatory arrangements for Jakarta over time, to take advantage of increasing opportunities for relatively independent regulation. Accordingly, a secondary focus of the consultancy will be to give advice on what such a transition path might look like, and what steps could be put in place to ensure that the Jakarta regulatory unit becomes more independent over time.

FINAL DRAFT TERMS OF REFERENCE

TECHNICAL ASSISTANCE SERVICES TO THE PROVINCIAL GOVERNMENT OF DKI JAKARTA IN IMPROVING THE REGULATION AND MONITORING OF PRIVATE SECTOR PARTICIPATION IN WATER SUPPLY IN DKI JAKARTA

1. Background

Daerah Khusus Ibukota Jakarta (DKI Jakarta) intends to appoint a Consultant to assist it and Perusahaan Daerah Air Minum, Daerah Khusus Ibukota Jakarta (PAM Jaya), in defining and implementing arrangements for the monitoring and regulation of water services in the metropolitan area of Jakarta.

The Original Cooperation Agreements

As part of the Government of Indonesia's program for the privatization of water services, in June 1997 PAM Jaya signed cooperation agreements, comparable to concession contracts, with investors for the privatization of the treatment and distribution of water in West and East Jakarta. These agreements became effective on 1 February 1998. The partner selected for West Jakarta was PT Garuda Dipta Semesta (GDS), and for East Jakarta, PT Kekar Thames Airindo (KATI). Each partner was a consortium of international and domestic investors. The river Ciliwung forms the boundary between the two regions, and there is a cross-boundary water supply agreement governing transfers of water between the two regions. Pulau Seribu is excluded from the agreements, and water supply to these islands remains fully the responsibility of PAM Jaya.

Under the cooperation agreements, PAM Jaya remains legally responsible for the treatment, distribution and supply of water to Jakarta, and continues to own the assets required for these purposes. The use of these assets and the management, improvement and expansion of them has been licensed to the private partners for a period of 25 years, with the objective of improving the quality, coverage, efficiency and cost-effectiveness of water supply in Jakarta. About 80 percent of PAM Jaya's staff were seconded to the private companies; the remainder continue to be employed by PAM Jaya.

The cooperation agreements obligate the private partners to achieve specified technical targets and service standards at annual and five-yearly intervals. These targets and standards include the volume of water sold and billed, the quality of water supplied to consumers, the pressure of water supplied to consumers, the percentage of non-revenue water, and the service coverage ratio. At the time of implementation, the private partners were expected to invest a total of about Rp. 1,500 billion[1] over the first five years to

[1] At the June 1997 exchange rate of Rp.2,450 = USD1.00.

improve the existing treatment works and extend existing distribution systems. A framework for the investment program was established in feasibility studies prepared by the private partners which form part of the cooperation agreements.

The agreements provide for revenue sharing between the private partners and PAM Jaya. The revenue share of the private partners is determined on the basis of a flat water charge for all units of billed consumption. The starting water charge, and procedures for its adjustment over time, are set out in the cooperation agreements. Tariffs to water consumers, which vary by customer category and level of consumption, are set independently of the water charge, and are intended to cover both the water charge and PAM Jaya's budget requirements.

Under the cooperation agreements, regulatory responsibilities are split. Responsibility for the monitoring of the implementation of the agreements rests with PAM Jaya. Adjustments of the water charge are to be determined in the first instance on the basis of formulae set out in the agreements. Five-yearly adjustments to the charges to accommodate revisions of the investment plan, and extraordinary adjustments in the event of external shocks, are left as a matter for discussion between PAM Jaya and the private partners, including through discussion committees. Responsibility for the approval of tariff adjustments rests with DKI Jakarta. Dispute resolution is to be handled by reference to external experts and, in the final event, international arbitration.

Changes Since February 1998

In the period since the cooperation agreements were implemented, Indonesia has seen major political and economic change. These changes have had important implications for the agreements.

In June 1998, at the request of the Governor of Jakarta, the structure of the two private consortia was changed, with the removal of the original local investors. As Indonesian law requires that at least 5 percent of the equity in ventures of this kind be held by local investors, it was agreed that PAM Jaya would hold 10 percent of the equity in each of the consortia. The names of the consortia were subsequently changed to PT Pam Lyonnaise Jaya (PALYJA) for West Jakarta, and PT Thames Pam Jaya (PT TPJ) for East Jakarta.

Given the transformation of PAM Jaya's role (to become a joint owner of each of the private consortia), the allocation of regulatory responsibilities to PAM Jaya is no longer considered appropriate. More generally, given the desire to increase transparency in the oversight of private sector arrangements, there is a case for re-evaluating the appropriate allocation of regulatory functions, and the design of the agency to take primary responsibility for these functions.

As the two private consortia are already in place in Jakarta, there is a strong interest in moving rapidly to clarify the rules of the game under which they will operate and, in particular, the way in which the regulatory provisions of the cooperation agreements will

be applied. In this sense, there is some urgency in putting in place new regulatory arrangements to accommodate the changed role of PAM Jaya. At the same time, however, issues related to the design and implementation of infrastructure providers are likely to assume importance on the national policy agenda, as the Government of Indonesia addresses how best to facilitate and regulate renewed private sector investment in the infrastructure sectors. Accordingly, arrangements put in place to meet immediate and urgent concerns about the proper regulation of the Jakarta contracts should be (a) compatible with broader policy directions in infrastructure regulation, and (b) designed to be able to fit into any future national arrangements for regulation of the water and sanitation sector.

In addition to the review of regulatory issues that is the focus of the present Terms of Reference, two further reviews are planned or underway. First, the parties are currently in discussion as to how substantial tariff increases might be avoided at a tariff review scheduled for January 1999. Second, concurrently with the regulatory review, a review will be carried out to assess the general reasonableness of the two cooperation agreements.

2. Objectives and Scope of Work

The Consultant shall assist DKI Jakarta in identifying the scope, functions and institutional structure for a unit to monitor and regulate the two cooperation agreements for water supply in Jakarta. In this context the Consultant shall, first, review the cooperation agreements and associated documents, current arrangements for the application of regulatory functions both under the cooperation agreements and more broadly in the water and sanitation sector, and available documentation on regulatory initiatives in the other infrastructure sectors.

The Consultant shall prepare detailed recommendations on the following issues:

(1) The clarification and allocation of regulatory functions.

This will include consideration of the appropriate allocation of regulatory functions currently resting with PAM Jaya and DKI Jakarta, and with the discussion committees. In this context, the Consultant shall also specify those regulatory responsibilities that should fall under the purview of any other branch of Government or sectoral Ministry. These responsibilities should be delineated clearly from the roles and responsibilities assigned to the regulatory unit.

(2) The design and location of regulatory institutions.

These recommendations should include, *inter alia*:

- The design and location of a regulatory unit to take over (as a minimum) the monitoring responsibilities currently allocated to PAM Jaya. Options to be considered include:

    * the creation of an independent regulatory unit with full prerogatives for regulatory decisions and their application; and
    * the creation of a semi-independent regulatory unit with advisory powers, with final decision-making on regulatory issues residing elsewhere (within DKI Jakarta, or at a national level).

- The rules that should guide the staffing and operations of the regulatory institution(s), with the objective of enhancing independence and accountability, including preferred approaches on:

    * the number of regulatory decision-makers;
    * qualifications for the appointment of key decision-makers, the method of appointment, and grounds for their removal;
    * funding arrangements;
    * transparency arrangements;
    * mechanisms for appeal of regulatory decisions;
    * restrictions on conflicts of interest on the part of key regulatory decision-makers;
    * scrutiny of regulatory conduct by auditors or other public watchdogs;
    * mechanisms for inputs by stakeholders;
    * the number and qualifications of support staff;
    * salary arrangements for staff;
    * organizational structure, budgetary and accounting arrangements;
    * the use of independent experts;
    * relationships with other regulatory institutions.

In the event that some splitting of regulatory functions is proposed (for example, if advisory powers are allocated to a regulatory unit, with decision-making powers located elsewhere), the Consultant shall address the above issues, as relevant, for each institution to which regulatory functions are to be allocated.

In making recommendations on these points, the Consultant shall take into account the provisions of the existing cooperation agreements, any interim findings of the concurrent review of the agreements, relevant existing institutional structures and legislative arrangements within DKI Jakarta and at a national level, broader reforms to regulatory arrangements for infrastructure services in Indonesia, and available technical and regulatory expertise.

Given the ongoing nature of reforms in the water sector in Indonesia, the Consultant shall propose mechanisms to allow future adjustments in the structure, financing and staffing

of the regulatory unit, and/or the possible relocation of its functions to a national (sectoral or multi-sectoral) regulatory body.

(3) Options for building regulatory capacity

The Consultant shall advise on areas in which capacity building is likely to be required, either through the contracting out of aspects of the regulatory function, or through staff training, with recommendations as to the preferred approach. Specific recommendations should be made on:

- the potential for and merits of the contracting out of tasks relevant to the monitoring / regulation of the cooperation agreements;

- in those areas where contracting out is not considered preferable or appropriate, on the form and content of a capacity-building program to expand the technical, economic and regulatory competencies of the staff of the regulatory institution(s).

Outputs and Possible Second Phase

The above work will be primarily diagnostic. The Consultant will set out its analysis and recommendations in a draft written report in English. This report will be subject to review by an advisory group to be established by DKI Jakarta, with representation from key sectoral Ministries, the private partners, and non-governmental organizations (potentially including academics, and representatives of consumers and the business sector). The Consultant will also conduct a workshop to discuss its recommendations. Based on this, the Consultant will prepare a final report. This final report will be in prose, and in English, but will be accompanied by a summary report in both English and Bahasa Indonesia.

The present Terms of Reference cover the design phase of changes in regulatory arrangements for water provision in Jakarta. Following review of these proposals, the Consultant may be retained to develop a detailed plan for the implementation of the revised arrangements, and provide DKI Jakarta and PAM Jaya with implementation assistance.

3. Implementation of Work Program

The Consultancy will commence in early February 1999. It is expected that a substantial portion of the work will be conducted in Jakarta. The planned time-line is as follows:

2 weeks from start: *Delivery of an inception report setting out the Consultant's planned approach and work program.*

8 weeks from start: *Delivery of Draft Report*

Week 9 *Workshop on the Draft Report*

12 weeks from start: *DKI Jakarta and the Advisory Group deliver comments on the Draft Report*

14 weeks from start: *Delivery of the Final Report*

4. Support and Funding

DKI Jakarta and PAM Jaya will identify local counterparts with knowledge of the relevant Indonesian institutional and regulatory arrangements, and of water supply arrangements in Jakarta, to support the Consultant team. (Financing these counterparts will *not* be the responsibility of the Consultant team.) The Consultant will be expected to work closely with these counterparts, to ensure mutual transfer of knowledge.

PAM Jaya will provide suitable furnished office accommodation including utilities and air-conditioning. The Consultant will be responsible for arranging and bearing the cost of all other support facilities and services required for the satisfactory performance of this technical assistance.

PAM Jaya will undertake to provide to the Consultant, in a timely fashion and in English, where feasible, all documentation necessary for the successful implementation of the Consultancy. PAM Jaya and DKI Jakarta will also act to facilitate interaction between the Consultant and advisers appointed separately to assist in the more general review of the cooperation agreements, including the January 1999 and June 1999 tariff reviews.

In addition, PALYJA and PT TPJ will make available such data as may reasonably be expected by the Consultant, and will make available staff for consultation with the Consultant, on matters relevant to the fulfilment of this Terms of Reference.

The Consultancy will be financed from Trust Funds to be secured by the World Bank. There will be a fixed fee of USD 100,000 for this Consultancy. The World Bank will also provide assistance to DKI Jakarta in the management of the project.

5. Consultant Qualifications

The Consultant should have a strong knowledge of regulatory principle and practice, and of the water and sanitation sector, based on international experience, including in Asian countries. The Consultant should have experience with establishing regulatory bodies and progressing reforms in the water and sanitation sector, and be familiar with the political, institutional and commercial realities associated with infrastructure reforms in

emerging economies. The Consultant should assemble a team of advisers with expertise in regulation, management, training, and issues of legal, administrative and institutional reform in the water and sanitation sectors.

The Consultant will nominate a senior team member to act as Team Leader. In addition to his or her technical expertise, this individual will have strong management and communication skills, and will have acted successfully in a leadership and/or managerial role on previous assignments of a similar kind.

6. Preparation of Proposals

Interested parties are invited to submit proposals for the entirety of the terms of reference outlined above. Those making proposals may bring relevant outside expertise into the team, including through short-term assignments or sub-contracting. In submitting the proposal, prospective consultants shall identify which members of the team will be responsible for which tasks, and provide relevant background information on their professional qualifications.

Proposals shall include the following information:

- qualifications and relevant professional experience of each team member charged with implementing the tasks outlined in Section 2 above; and
- a detailed work program and schedule, including a mission schedule and overall time to be spent in Indonesia.

Prospective Consultants will be ranked according to the following points system:

Criterion	Points
Expertise and experience of the team leader in private sector participation and regulatory reform in the water sector	30 points
Expertise and experience of team members in private sector participation and regulatory reform in the water sector	25 points
Experience of the firm - on similar projects - in the region	 5 points 5 points
Quality of technical proposal - understanding of objectives - quality of methodology - work program	 5 points 10 points 10 points
Time that the team proposes to spend in Jakarta	10 points

TERMS OF REFERENCE

LEGAL ASSISTANCE TO CONSULTANTS ENGAGED TO PROVIDE TECHNICAL ASSISTANCE TO DKI JAKARTA ON IMPROVING THE REGULATION AND MONITORING OF PRIVATE SECTOR PARTICIPATION IN WATER SUPPLY IN DKI JAKARTA

1. Background

The World Bank is seeking to engage a legal specialist to provide advice on legal matters to Consultant, National Economic Research Associates (NERA), appointed to provide DKI Jakarta with technical assistance on the establishment regulatory institutions for the co-operation agreements for water supply in metropolitan Jakarta.

The Original Cooperation Agreements

As part of the Government of Indonesia's program for the privatization of water services, in June 1997 PAM Jaya signed cooperation agreements, comparable to concession contracts, with investors for the privatization of the treatment and distribution of water in West and East Jakarta. These agreements became effective on 1 February 1998. The partner selected for West Jakarta was PT Garuda Dipta Semesta (GDS), and for East Jakarta, PT Kekar Thames Airindo (KATI). Each partner was a consortium of international and domestic investors. The river Ciliwung forms the boundary between the two regions, and there is a cross-boundary water supply agreement governing transfers of water between the two regions. Pulau Seribu is excluded from the agreements, and water supply to these islands remains fully the responsibility of PAM Jaya.

Under the cooperation agreements, PAM Jaya remains legally responsible for the treatment, distribution and supply of water to Jakarta, and continues to own the assets required for these purposes. The use of these assets and the management, improvement and expansion of them has been licensed to the private partners for a period of 25 years, with the objective of improving the quality, coverage, efficiency and cost-effectiveness of water supply in Jakarta. About 80 percent of PAM Jaya's staff were seconded to the private companies; the remainder continue to be employed by PAM Jaya.

The cooperation agreements obligate the private partners to achieve specified technical targets and service standards at annual and five-yearly intervals. These targets and standards include the volume of water sold and billed, the quality of water supplied to consumers, the pressure of water supplied to consumers, the percentage of non-revenue water, and the service coverage ratio. At the time of implementation, the private partners were expected to invest a total of about Rp. 1,500 billion[1] over the first five years to improve the existing treatment works and extend existing distribution systems. A

[1] At the June 1997 exchange rate of Rp.2,450 = USD1.00.

framework for this investment program was established in feasibility studies prepared by the private partners, which form part of the cooperation agreements.

The agreements provide for revenue sharing between the private partners and PAM Jaya. The revenue share of the private partners is determined on the basis of a flat water charge for all units of billed consumption. The starting water charge, and procedures for its adjustment over time, are set out in the cooperation agreements. Tariffs to water consumers, which vary by customer category and level of consumption, are set independently of the water charge, and are intended to cover both the water charge and PAM Jaya's budget requirements.

Under the cooperation agreements, regulatory responsibilities are split. Responsibility for the monitoring of the implementation of the agreements rests with PAM Jaya. Adjustments of the water charge are to be determined in the first instance on the basis of formulae set out in the agreements. Five-yearly adjustments to the charges to accommodate revisions of the investment plan, and extraordinary adjustments in the event of external shocks, are left as a matter for discussion between PAM Jaya and the private partners, including through discussion committees. Responsibility for the approval of tariff adjustments rests with DKI Jakarta. Dispute resolution is to be handled by reference to external experts and, in the final event, international arbitration.

Changes Since February 1998

In the period since the cooperation agreements were implemented, Indonesia has seen major political and economic change. These changes have had important implications for the agreements.

In June 1998, at the request of the Governor of Jakarta, the structure of the two private consortia was changed, with the removal of the original local investors. As Indonesian law requires that at least 5 percent of the equity in ventures of this kind be held by local investors, it was agreed that PAM Jaya would hold 10 percent of the equity in each of the consortia. The names of the consortia were subsequently changed to PT Pam Lyonnaise Jaya (PALYJA) for West Jakarta, and PT Thames Pam Jaya (PT TPJ) for East Jakarta.

Given the transformation of PAM Jaya's role (to become a joint owner of each of the private consortia), the allocation of regulatory responsibilities to PAM Jaya is no longer considered appropriate. More generally, given the desire to increase transparency in the oversight of private sector arrangements, there is a case for re-evaluating the appropriate allocation of regulatory functions, and the design of the agency to take primary responsibility for these functions.

As the two private consortia are already in place in Jakarta, there is a strong interest in moving rapidly to clarify the rules of the game under which they will operate and, in particular, the way in which the regulatory provisions of the cooperation agreements will be applied. In this sense, there is some urgency in putting in place new regulatory arrangements to accommodate the changed role of PAM Jaya. At the same time,

however, issues related to the design and implementation of infrastructure providers are likely to assume importance on the national policy agenda, as the Government of Indonesia addresses how best to facilitate and regulate renewed private sector investment in the infrastructure sectors. Accordingly, arrangements put in place to meet immediate and urgent concerns about the proper regulation of the Jakarta contracts should be (a) compatible with broader policy directions in infrastructure regulation, and (b) designed to be able to fit into any future national arrangements for regulation of the water and sanitation sector. DKI Jakarta has appointed NERA to provide it with advice on the design of such regulatory arrangements.

2. Objectives and Scope of Work

The Consultant shall assist NERA in four main areas, set out below:

(i) Preparation of a short paper (of 5-10 pages) describing the current legal framework for the Indonesian water sector in general, and the specific arrangements for the Jakarta water concessions. This paper should begin at the highest level, ie, the constitutional provisions regarding the management of water and, if relevant, the provision of (piped) water services, and trace the legislative arrangements from here through to the specific arrangements in Jakarta. It would include – but not be limited to – a description and interpretation of:

- the constitutional provisions regarding water, and the provision of water services;
- the laws which devolve responsibility for water services to local and/or regional government;
- the legal form of water supply enterprises in Indonesia, and of PAM JAYA in particular;
- the legal arrangements governing drinking water quality; and
- the guidelines, regulations and/or decrees which directly affect matters relevant to a water sector regulatory body, e.g., tariff setting powers and principles, the financing of water supply services, etc.

(ii) Prepare a short summary of the main laws which are likely to bear on the framework within which a future water regulatory body would need to be established, e.g.:

- Presidential Decree number 7/1998 on private infrastructure development;
- the competition and anti-monopoly law;
- the proposed consumer protection law;

- the proposed devolution/local government law; and
- relevant features of related regulatory initiatives planned for other infrastructure sectors, i.e., gas, electricity, and telecommunications.

(iii) Provide high level, interactive advice on the legal implications and practicalities of various possible 'models' for the establishment of a water sector regulatory body – to be discussed as these options are worked up by NERA during the course of the assignment;

(iv) Provide a note to NERA indicating the legal underpinning for the selected institutional option for the proposed Regulatory Agency, and outline any amendments required to existing laws (as well need for enactment of any new laws, if essential) to place it on a sound legal footing.

The legal adviser would also attend and participate in the workshop planned for late April to discuss NERA's draft proposals. This role should include the presence of a senior legal adviser of Indonesian nationality who can assist, as necessary, to explain legal aspects of the regulatory proposal to government officials, the project Advisory Committee, and other interested parties.

3. Staffing and Fees

The core team for this assignment should consist of a senior international legal specialist, familiar with Indonesian laws relating to the private provision and regulation of infrastructure and utilities, e.g., water supply, power, telecom, gas, and a senior Indonesian lawyer with a similar background. This may be supplemented by a junior Indonesian lawyer, as appropriate. The work is expected to be completed by May 1999. There will be a fixed fee of US$ 15,000 for this work.

DRAFT TERMS OF REFERENCE

TECHNICAL ASSISTANCE SERVICES TO THE PROVINCIAL GOVERNMENT OF DKI JAKARTA IN REVIEWING ARRANGEMENTS FOR PRIVATE SECTOR PARTICIPATION IN WATER SUPPLY IN DKI JAKARTA

1. Background

Daerah Khusus Ibukota Jakarta (DKI Jakarta) intends to appoint a Consultant to carry out an independent review of existing contractual arrangements for the provision of water services in the metropolitan area of Jakarta.

The Original Co-operation Agreements

As part of the Government of Indonesia's program for the privatization of water services, in June 1997 PAM Jaya signed co-operation agreements, comparable to concession contracts, with investors for the privatization of the treatment and distribution of water in West and East Jakarta. These agreements became effective on 1 February 1998. The partner selected for West Jakarta was PT Garuda Dipta Semesta (GDS), and for East Jakarta, PT Kekar Thames Airindo (KATI). Each partner was a consortium of international and domestic investors. The river Ciliwung forms the boundary between the two regions, and there is a cross-boundary water supply agreement governing transfers of water between the two regions. Pulau Seribu is excluded from the agreements, and water supply to these islands remains fully the responsibility of PAM Jaya.

Under the co-operation agreements, PAM Jaya remains legally responsible for the treatment, distribution and supply of water to Jakarta, and continues to own the assets required for these purposes. The use of these assets and the management, improvement and expansion of them has been licensed to the private partners for a period of 25 years, with the objective of improving the quality, coverage, efficiency and cost-effectiveness of water supply in Jakarta. About 80 percent of PAM Jaya's staff were seconded to the private companies; the remainder continue to be employed by PAM Jaya.

The co-operation agreements obligate the private partners to achieve specified technical targets and service standards at annual and five-yearly intervals. These targets and standards include the volume of water sold and billed, the quality of water supplied to consumers, the pressure of water supplied to consumers, the percentage of non-revenue water, and the service coverage ratio. At the time of implementation, the private partners were expected to invest a total of about Rp. 1,500 billion[1] over the first five years to improve the existing treatment works and extend existing distribution systems. A

[1] At the June 1997 exchange rate of Rp.2,450 = USD1.00

framework for this investment program was established in feasibility studies prepared by the private partners, which form part of the co-operation agreements.

Changes Since February 1998

In the period since the co-operation agreements were implemented, Indonesia has seen major political and economic change. These changes have had important implications for the agreements.

In June 1998, at the request of the Governor of Jakarta, the structure of the two private consortia was changed, with the removal of the original local investors. As Indonesian law requires that at least 5 percent of the equity in ventures of this kind be held by local investors, it was agreed that PAM Jaya would hold 10 percent of the equity in each of the consortia. The names of the consortia were subsequently changed to PT Pam Lyonnaise Jaya (PALYJA) for West Jakarta, and PT Thames Pam Jaya (PT TPJ) for East Jakarta.

Both agreements were reached on the basis of a process of negotiation, rather than having been competitively bid, creating some concerns as to their possible reasonableness. The removal of the two original local investors has served to allay some, but not all, of these concerns. The Government of Indonesia in general, and DKI Jakarta in this particular instance, are concerned both to ensure that contractual arrangements entered under the previous regime are well-designed to protect the interests of both the private parties concerned and Indonesian consumers, and to create greater transparency in future public-private partnerships. In this context, DKI Jakarta and PAM Jaya, and the two private companies PALYJA and PT TPJ, are seeking an independent review of the two co-operation agreements. This review is the focus of the present Terms of Reference.

In addition to the contractual review that is the focus of the present Terms of Reference, two further reviews are planned or underway. First, the parties have been in discussion as to how substantial tariff increases might be avoided at a tariff reviews scheduled for January 1999 and June 1999. Second, a study commenced in February 1999 to design reforms to institutional arrangements for the regulation of the two co-operation agreements. This latter study is motivated by the transformation of PAM Jaya's role (to become a joint owner of each of the private consortia), so that the allocation of regulatory responsibilities to PAM Jaya is no longer appropriate. More generally, given the desire to increase transparency in the oversight of private sector arrangements, a case is seen for re-evaluating the appropriate allocation of regulatory functions, and the design of the agency to take primary responsibility for these functions.

2. Objectives and Scope of Work

The Consultant shall assist DKI Jakarta in reviewing the two co-operation agreements to determine their compatibility with current good practice, by comparison with other concession contracts and long-term agreements for the operations, management and development of water treatment and distribution systems for urban centers. The objective

is not to conduct a detailed, clause by clause review, in particular of the substantive provisions of the co-operation agreements *(such as, for example, the level of the water charge or tariff)*. (As noted above, the parties are negotiating separately to achieve a rebalancing of investment objectives in order to relieve tariff pressures under the contract.) Rather, the objective is to focus on the efficiency, balance and transparency of arrangements for the implementation and enforcement of the co-operation agreements over time.

In this context, the Consultant shall review the co-operation agreements and associated documents with regard to their compatibility with current good practice. The Consultant shall also meet with the parties to the agreements to hear their views and concerns on the agreements as presently structured, and *understand issues that have been* raised by the parties prior to the commencement of this Consultancy, which are set out in the annexes to this Terms of Reference.

The Consultant shall prepare detailed comments on:

(a) the provisions in the co-operation agreements and associated documents that set out procedures for the monitoring, maintenance and adjustment of the terms of the relationship between the parties to the agreements (including, but not limited to, *processes and mechanisms* for the adjustment of the water charge; *arrangements for adjustments to the tariff*; procedures for the implementation of revenue sharing, *including the Escrow Account mechanism*; procedures for monitoring and the provision of information to the regulatory unit; *procedures for monitoring and evaluating raw water quality and availability; penalty mechanisms*; procedures for the resolution of disputes; *and procedures for responding to extraordinary events*), to assess their compatibility with current good practice in the water sector; and

(b) the allocation of key risks (including, but not limited to, design and development risk, construction risk, *raw and bulk water risk*, operating risk, revenue risk, financial risk, *force majeure* risk, *termination risk*, insurance risk, and environmental risk) under the contracts, to assess its compatibility with good practice in the water sector.

In so doing, the Consultant shall:

- note areas in which the present agreements depart substantially from accepted good practice in the water sector;

- advise on actions that could be taken to bring the agreements in line with accepted good practice;

- comment on the cost, revenue and risk allocation implications of such actions for the affected party or parties.

Outputs

The Consultant shall set out its analysis and recommendations in a draft written report. This report will be subject to review by DKI Jakarta, PAM Jaya, PALYJA, PT TPJ, and representatives of key Sectoral Ministries (the latter to be identified by DKI Jakarta). Each of these parties will have the opportunity to provide the Consultant with written comments on the report. The Consultant will also conduct a workshop for these parties, to discuss its recommendations. Following this workshop, and with regard to the written comments received, the Consultant will prepare a final report, and circulate it to the above parties.

3. Implementation of Work Program

The Consultancy will commence in June 1999. The planned time-line is as follows:

2 weeks from start:	*Delivery of an inception report setting out the Consultant's planned approach and work program.*
5 weeks from start:	*Delivery of Draft Report*
Week 6	*Workshop on the Draft Report*
8 weeks from start:	*DKI Jakarta, PAM Jaya, PALYJA and PT TPJ and other parties deliver comments on the Draft Report*
10 weeks from start:	*Delivery of the Final Report*

4. Support and Funding

DKI Jakarta will identify local counterparts with knowledge of the relevant Indonesian institutional and regulatory arrangements, and of water supply arrangements in Jakarta, to support the Consultant team. Financing for these counterparts will not be the responsibility of the Consultant team.

DKI Jakarta will provide suitable furnished office accommodation including utilities and air-conditioning. The Consultant will be responsible for arranging and bearing the cost of all other support facilities and services required for the satisfactory performance of this technical assistance.

DKI Jakarta will undertake to provide to the Consultant, in a timely fashion and in English, where feasible, all documentation necessary for the successful implementation of

the Consultancy. DKI Jakarta will also *ensure access to the findings and reports of the consultants* appointed separately to assist in (a) the handling of the January 1999 and June 1999 tariff reviews and (b) the review of regulatory arrangements for the two cooperation agreements.

In addition, PALYJA and PT TPJ will make available such data as may reasonably be expected by the Consultant, and will make available staff for consultation with the Consultant, on matters relevant to the fulfilment of this Terms of Reference.

The Consultancy will be financed [...].

5. Consultant Qualifications

The Consultant team will include a senior legal expert and a senior economic expert, who together will bring a strong knowledge of the legal and economic aspects of the design of concessions and other private sector contracts *in the water and sanitation sectors*, based on international experience. The Consultant team should have experience in the design and legal drafting of concession and related contracts, and be familiar with the implementation of such contracts in emerging economies. *The ability to draw on relevant engineering expertise will be an advantage.*

The Consultant will nominate one of the two senior experts to act as Team Leader. In addition to his or her technical expertise, this individual will have strong management and communication skills, and will have acted successfully in a leadership and/or managerial role on previous assignments of a similar kind.

6. Preparation of Proposals

Interested parties are invited to submit proposals for the entirety of the terms of reference outlined above. Those making proposals may bring relevant outside expertise into the team, including through short-term assignments or sub-contracting. In submitting the proposal, prospective consultants shall identify which members of the team will be responsible for which tasks, and provide relevant background information on their professional qualifications. They shall also indicate an all-inclusive fee for the above work.

Proposals shall be submitted to [tbd], and shall include the following information:

- qualifications and relevant professional experience of each team member charged with implementing the tasks outlined in Section 2 above;
- a detailed work program and schedule, including a mission schedule and overall time to be spent in Indonesia;
- the fee sought for the above work.

7. Selection Criteria

The technical proposals will be ranked according to the following points system:

Criterion	Points
Expertise and international experience of the team leader in the design of concessions and other private sector contracts in water and sanitation	*35 points*
Expertise and international experience of 2nd senior expert in the design of concessions and other private sector contracts in water and sanitation	*25 points*
Expertise and experience of other team members	*5 points*
Experience of the firm - on related projects - in the region	 15 points 5 points
Quality of technical proposal - quality of methodology - work program	 10 points 5 points

All proposals receiving a score of *75* points or more shall be deemed technically acceptable.

The contract will then be awarded to the technically acceptable proposal with the lowest proposed fee.

Water Utilities Rescue Program

DRAFT PDAM RESCUE PROGRAM

(Amended In Accordance with January 12, 1999 Meeting)

Objectives

1. To assist PDAMs to meet impact of crisis.
2. To take this opportunity to improve operational and financial efficiency consistent with overall direction of water sector reform.

Program Features/Elements

1. Demand-driven, i.e., PDAMs must request support and prepare necessary documentation to be eligible

2. Forms of assistance

   a. Provide cash to meet O&M gap, if any

   b. Funding to meet shortfall in counterpart financing for completing committed investments

   c. Small capital expenditures that will yield quick revenue increases, e.g., meters, pipes to reduce UfW

   d. Rescheduling of existing debt service obligations

3. Assistance to be provided subject to following conditions

   a. Financial Recovery Action Plan (FRAP), to include:
      - Implementation of immediate and steady medium-term tariff increases
      - Accelerated increase in connections, if water capacity exists
      - UfW reduction
      - Efforts at cost reductions for chemicals, power, etc.
      - Control on number of staff
      - Improved collection efficiency and collection period
      - Maintaining positive operating ratio (revenues > expenses)

   b. No grants for either O&M or capital expenditures; loans at SLA rates

   c. No PAD (i.e., dividend) payments until FRAP implemented and 75% service coverage achieved

   d. Supervisory Board to be reformed

4. Penalties/Sanctions for violating FRAP conditions

   a. Assistance stopped

   b. No government funding (grant or loan) for any future capital expenditures until the PDAM is in compliance with FRAP

   c. Dividend payments to PEMDA, if any, to be refunded

5. Technical Assistance Support

   a. TA support to Pusat (DGCK) to:

      i) Explain and guide FRAP preparation to PDAMs
      (WET support will assist partially in this regard.)

      ii) Review PDAM proposals and guide in revision of proposals until FRAP is acceptable

      iii) Monitor PDAM performance in the Rescue Program based on monthly reporting system (to be developed)

   b. TA to support Pusat (PUOD) for developing public relations campaign for implementation by PDAMs

6. Implementation Arrangements

   a. Start date: April 1, 1999; to last for two fiscal years
      - ADB & others to develop similar arrangements

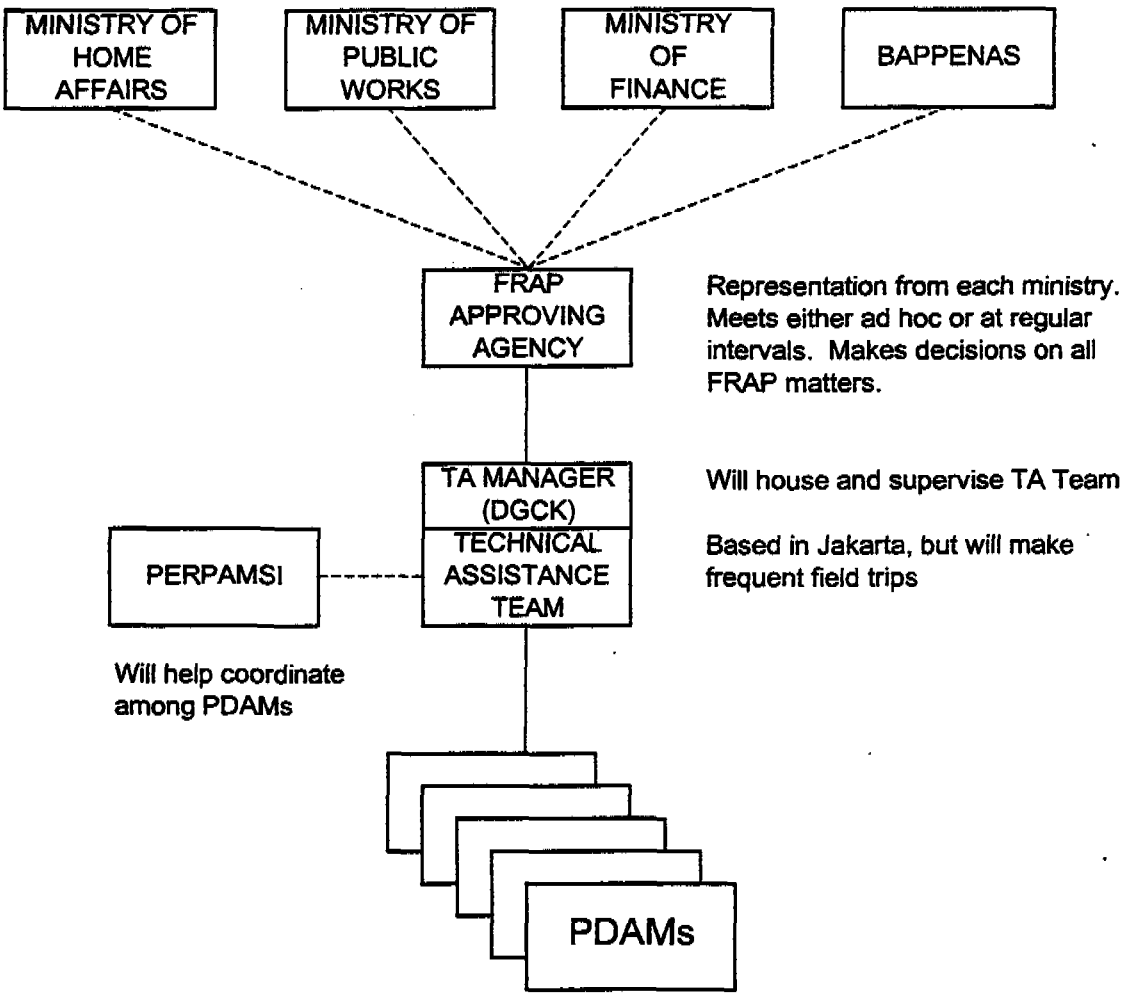
   b. Funding:
      - IBRD (Padat Karya balance)
      - ADB
      - Others

   c. Channeling of funds – IBRD loan funds direct from MoF to PDAM via SLA; ADB & others to develop/confirm similar arrangements. The objective should be funds transfer begins April 1, 1999.

   d. Available also for other PDAMs with no existing SLAs

PDAM RESCUE PROGRAM
PICTORIAL REPRESENTATION

(Amended in Accordance with January 12, 1999 Meeting)



TERMS OF REFERENCE

Bridging Technical Assistance
Under the PDAM Rescue Program

1. Background

The economic crisis that hit Indonesia starting from the middle of 1997 is now felt very much by PDAMs. Operating costs have gone beyond the revenue earning capabilities of PDAMs. Chemical costs have risen to as high as four times in some PDAMs because of their high import charges and the loss in value of the rupiah. Power rates have increased. Maintenance material costs have also gone up, as well as other expenses because of hyper-inflation which reached 78% by the end of 1998. Meanwhile, some PDAMs are saddled with overstaffing. On top of all these, water tariff increases could not just be implemented because of the big drop in the consumers' ability to pay. Many government accounts remain unpaid, and worse, dividends on the PDAMs' income are being paid in to their local governments, even if they do not expect to earn income for the year. On the technical side, the aging water system is producing high leakages which means that these water produced and spent for cannot be converted to revenues. In some areas, PDAMs have been hit by the prolonged drought, worsening their financial condition

PDAMs are almost in the verge of bankruptcy. They see their cash dwindling, current payables remaining unpaid longer, and debt servicing being neglected. Some PDAMs had to reduce chemical dosages in their water production. There was even a reported case where water-borne diseases increased as a result.

PDAM Rescue Program

Because of all these, the Government formulated the PDAM Rescue Program to help PDAMs survive the crisis, not only in the short-run, but also in a more sustainable manner which will enable it to be self-sufficient in the long-run. This will be achieved by improving the operational and financial efficiency of the PDAM consistent with the overall direction of water sector reform.

Annex A shows the features of this Program – the forms of assistance, its conditions, penalties or sanctions, technical assistance support, and implementation arrangements.

Basically, the assistance is open to all PDAMs, whether they have an existing loan from either the World Bank or the Asia Development Bank or not. Any PDAM is qualified to apply for assistance and submit its proposed Financial Recovery Action Plan (FRAP). The assistance may be in the form of cash to meet its operations and maintenance expenses and/or funding to meet shortfall in counterpart financing to complete committed investments or to finance small capital expenditures that will yield quick increases in revenues. The assistance may also be in the form of rescheduling of its existing debts. All these assistance however have strings attached. The PDAM should prepare its FRAP which should ensure that it will have become financially sound after the assistance. Dividend payments to the local government have to stop, at least during the period of assistance. The Supervisory Board has to be reformed to bring in more transparency and stronger capacity to oversee the management of the PDAM. If these conditions are not reasonably met, assistance will be stopped.

To implement this program, a Technical Assistance Team (TAT) will be provided to process applications before they are submitted to the FRAP Approving Agency (FAA) for approval. The FAA is headed by BAPPENAS, and joined by DGCK of MPW, PUOD of MoHA and DP3 of

MoF as members. BAPPENAS will be the Executing Agency, while DG Cipta Karya will be the Implementing Agency. The TA Team will report directly to the Director for Technical Development of DGCK in the discharge of its duties, as well as for administrative matters. However, it will also serve as the working unit of the FAA. A pictorial representation of these relationships is shown in Annex B.

2. Objectives

Before the TAT can be mobilized, there will be preparatory activities that need to be accomplished. These will be the tasks of the Bridging Consultants (referred to as "Consultant" from hereon).

3. Scope of Work

The Consultant will assist Government in finalizing the preparation of the PDAM Rescue Program. This will entail liaising with BAPPENAS, DGCK, PUOD and DP3 of MoF, as well as with PERPAMSI who represent the interest of PDAMs. Once the Program concept is finalized, the Consultant's activities will include the following:

(a) Assist GoI in drafting the decree and implementing guidelines for the PDAM Rescue Program.

(b) Prepare the procedures to be followed in participating in the Rescue Program, including a sample of a Financial Recovery Action Plan (FRAP), the forms that should be used, as well as the checklist of required supporting documents.

(c) Discuss and agree with DP3 on the financial projections model that will be used to evaluate the loan that will be extended to an applying PDAM and/or evaluate the propriety of the requested rescheduling of debt service payments;

(d) Assist the Implementing Agency in circulating the Decree and Implementing Guidelines for the Program to all PDAMs.

(e) Assist PUOD in preparing a training module for PDAMs on how to prepare their own proposals including the related FRAPs.

(f) Assist PUOD and PERPAMSI in conducting training for a trainor in each regional center of PERPAMSI.

4. Methodology

The Consultant will need to discuss with the concerned agencies (BAPPENAS, Cipta karya, PUOD and DP3 of MoF) regarding the procedures that will be developed and the prescribed forms to be used by applicant PDAMs. The Consultant may also coordinate with PERPAMSI in travelling to its regional centers to meet with PDAMs interested to apply under the Program and to orient them about how to submit their application.

5. Duration

The Bridging Consultancy shall start immediately and shall run for a period of three calendar months.

6. Reports

The Consultant shall be required to submit a Project Report at the end of its term.

7. Support

The Directorate for Technical Development of DGCK will provide suitable office accommodation including utilities and air-conditioning. The Consultant will be responsible for arranging and bearing the cost of all other support facilities and services required for the satisfactory performance of this technical assistance.

DGCK will undertake to provide to the Consultant, in a timely fashion, all documentation necessary for the successful implementation of the Consultancy. DGCK will also act to facilitate interaction between the Consultant and the applying PDAMs and the other government agencies involved (BAPPENAS, PUOD of MoHA, and DP3 of MoF).

8. Staffing

The Consultants shall be composed of two local consultants. The team will be headed by a Team Leader who is an accountant with at least 15 years experience with PDAM operations. The Team Leader will be assisted by a Financial Analyst who should have considerable years of experience on PDAM operations. These consultants should be familiar with running financial projections for a PDAM with the objective of determining the amount of loan that should be approved, and extracting indicators therein that should be included in the FRAP.

TERMS OF REFERENCE

Technical Assistance for Processing Assistance to PDAMs
Under the PDAM Rescue Program

1. Background

The economic crisis that hit Indonesia starting from the middle of 1997 is now felt very much by PDAMs. Operating costs have gone beyond the revenue earning capabilities of PDAMs. Chemical costs have risen to as high as four times in some PDAMs because of their high import charges and the loss in value of the rupiah. Power rates have increased. Maintenance material costs have also gone up, as well as other expenses because of hyper-inflation which reached 78% by the end of 1998. Meanwhile, some PDAMs are saddled with overstaffing. On top of all these, water tariff increases could not just be implemented because of the big drop in the consumers' ability to pay. Many government accounts remain unpaid, and worse, dividends on the PDAMs' income are being paid in to their local governments, even if they do not expect to earn income for the year. On the technical side, the aging water system is producing high leakages which means that these water produced and spent for cannot be converted to revenues. In some areas, PDAMs have been hit by the prolonged drought, worsening their financial condition

PDAMs are almost in the verge of bankruptcy. They see their cash dwindling, current payables remaining unpaid longer, and debt servicing being neglected. Some PDAMs had to reduce chemical dosages in their water production. There was even a reported case where water-borne diseases increased as a result.

PDAM Rescue Program

Because of all these, the Government formulated the PDAM Rescue Program to help PDAMs survive the crisis, not only in the short-run, but also in a more sustainable manner which will enable it to be self-sufficient in the long-run. This will be achieved by improving the operational and financial efficiency of the PDAM consistent with the overall direction of water sector reform.

Annex A shows the features of this Program – the forms of assistance, its conditions, penalties or sanctions, technical assistance support, and implementation arrangements.

Basically, the assistance is open to all PDAMs, whether they have an existing loan from either the World Bank or the Asia Development Bank or not. Any PDAM is qualified to apply for assistance and submit its proposed Financial Recovery Action Plan (FRAP). The assistance may be in the form of cash to meet its operations and maintenance expenses and/or funding to meet shortfall in counterpart financing to complete committed investments or to finance small capital expenditures that will yield quick increases in revenues. The assistance may also be in the form of rescheduling of its existing debts. All these assistance however have strings attached. The PDAM should prepare its FRAP which should ensure that it will have become financially sound after the assistance. Dividend payments to the local government have to stop, at least during the period of assistance. The Supervisory Board has to be reformed to bring in more transparency and stronger capacity to oversee the management of the PDAM. If these conditions are not reasonably met, assistance will be stopped.

To implement this program, a Technical Assistance Team (TAT) will be provided to process applications before they are submitted to the FRAP Approving Agency (FAA) for approval. The FAA is headed by BAPPENAS, and joined by DGCK of MPW, PUOD of MoHA and DP3 of MoF as members. BAPPENAS will be the Executing Agency, while DG Cipta Karya will be the

Implementing Agency. The TA Team will report directly to the Director for Technical Development of DGCK in the discharge of its duties, as well as for administrative matters. However, it will also serve as the working unit of the FAA. A pictorial representation of these relationships is shown in Annex B.

2. Objectives

The Consultants will primarily assist the FAA in approving applications for assistance by screening them and seeing to it that all applications comply with agreed conditions. And once a PDAM is given assistance, the Consultants will monitor compliance with the agreed FRAP.

3. Scope of Work

Basically, the Technical Assistance Team will be the conduit between the PDAMs who would like to avail of the rescue assistance and the government agencies responsible for providing the assistance. Its scope of work can be broken down into two phases. Phase One is that stage where PDAMs are still applying for assistance. The Team will process these applications. Phase Two is the stage where PDAMs have already received assistance and have their respective FRAPs. The Team will now monitor compliance with this FRAP, give recommendations on how PDAMs can stay within the FRAP, and recommend suspension of assistance if the PDAM willfully does not abide by its FRAP. Details of work under each of these phases are as follows:

Phase One: Processing of requests for assistance

- To guide PDAMs in preparing their requests for assistance.
- To process requests for rescue assistance from all PDAMs that may apply
- To endorse processed applications for rescue assistance that pass the criteria to the FRAP Approving Agency

Phase Two: Monitoring of FRAP compliance

- To monitor implementation of agreed financial recovery action programs (FRAPs) that were developed as conditions for the rescue assistance
- To give recommendations to PDAMs on how to remain within their FRAPs
- To liaise between and coordinate with PDAMs and government agencies who are key players in the Rescue Program
- To recommend to the Ministry of Finance the suspension of disbursements for a PDAM who willfully does not follow its agreed FRAP

4. Methodology

The PDAMs should prepare their own financial projections and formulate their own FRAPs. The Team will just guide them to ensure that they comply with the conditions of the assistance. However, once the requests have been submitted, the Team will scrutinize them until they are ready for approval by the FAA.

To make it easier for PDAMs to file their requests, the Team may organize its activities in such a manner that it may periodically go to the field and accept applications on site and guide the PDAMs in preparing proper, correct and complete applications.

During the monitoring phase, the Team may also conduct field visits in monitoring compliance with the FRAP. To simplify monitoring, the Team should design a form which should capture all the FRAP conditions and how far the PDAM is performing. PDAMs should use this form and submit it monthly to the Team, subject to random checking in the field.

5. Duration

The Application Phase should last for six months, while the Monitoring Phase should last at eighteen months to start after the Application Phase. In all, the project shall have a duration of 24 calendar months.

6. Reports

a. General Reports

- Quarterly Report on status of activities
- Annual Report
- Final Report

b. Processing of requests for assistance

- Monthly Status of Requests for Assistance from PDAMs –
  - Those who applied
  - Those who are still being processed
  - Those who were not approved, and reasons why
  - Those who need to modify their submittals
  - Those who were approved, and endorsed to the FAA

  Showing the amount of assistance applied/approved, kind of assistance required (O&M subsidy, counterpart funds, mini-investments, debt rescheduling)

b. Monitoring of FRAP compliance

- Monthly status of compliance by PDAMs –
  - Summary
  - Details by PDAM

7. Support

DirTek/DGCK will provide suitable office accommodation including utilities and air-conditioning. The Consultant will be responsible for arranging and bearing the cost of all other support facilities and services required for the satisfactory performance of this technical assistance.

DGCK will undertake to provide to the Consultant, in a timely fashion, all documentation necessary for the successful implementation of the Consultancy. DGCK will also act to facilitate interaction between the Consultant and the applying PDAMs and the other government agencies involved (BAPPENAS, PUOD of MoHA, and DP3 of MoF).

8. Staffing

The Team shall be composed of a foreign expert and local consultants. It will be headed by a Team Leader (expatriate), preferably an accountant, with at least 15 years experience in managing a water supply enterprise. The Team Leader will be assisted by Technical Advisors, Financial Advisors and an Institutional Development Advisor who will evaluate the technical, financial and institutional aspects of the rescue assistance applications, respectively.

The Technical Advisor should be a water and sanitation engineer with at least 10 years of experience in the water supply industry. He will review the propriety of the request for counterpart topping off and/or minor investments to improve revenues, reduction of unaccounted for water, rate of increase of connections, adequacy of water to service the increasing number of consumers, and other technical assumptions to be used in the financial projections.

The Financial Advisor should be an accounting/economics graduate with at least 10 years familiarity with the operations of a PDAM. He/she should be familiar with running financial projections for a PDAM with the objective of determining the amount of loan that should be approved, and extracting indicators therein that should be included in the FRAP. He/she will check the adequacy of the FRAP presented by a PDAM to ensure its financial recovery within a period of time and the loan repayment. He/she will also monitor compliance of the agreed FRAPs.

The Institutional Development Advisor should have at least 10 years of experience on the operations of a PDAM and should preferably be an accounting/economics graduate, although he/she may also be a water and sanitation engineer. He/she will review the proposals for improvement of the PDAM's management and operations and monitor compliance of the agreed FRAPs.

The Application Phase, which should last about six months, will need about 40 person months to process all the expected applications for assistance represented by the three fields of expertise.

The Monitoring Phase, which is between the seventh and the last month, will need about 36 person months composed of the Team Leader and the Institutional Development Advisor.

The Team Leader may determine the timing of when to mobilize the appropriate number of consultants. But during the Application Phase, it is expected that the peak number of applications will be evaluated during the initial two months.

WET Projec
Statistics for PDAM Visited

Statistic	PDAM Kabupaten Dati II										Total for Project
	Majalengka	Serang	Pandeglang	Tegal	Batang	Jepara	Blora	Jember	Garut	Kln Progo	
	1	2	3	4	5	6	7	8	9	10	
Month	Sept. 98	Sept. 98	Sep. 98	Sep. 98	Oct.98	Nov.98	Sep.98	Des. 98	Nov.98	Nov.98	
Population	209,645	NA	194,198	1,281,000	116,850	NA	154,812	276,012	232,000	175,848	
Technical Information											
Water Source	Deep Well	Deep Well	River	Spring	Spring	Deep Well	River	Deep Well	Spring	Spring	
Flow System	Pumping	Pumping	Pumping	Gravity	Gravity	Pumping	Pumping	Pumping	Gravity	Gravity/Pump	
Coverage	14%	34%	34%	8%	13%	11%	18%	8%	9%	31%	
Connection	6,227	15,207	5,558	5,810	7,466	7,327	7,331	18,632	10,022	7,344	
Capacity (LPS)	117	291	82	90	174	122	153	226	183	149	
Idle Capacity (%)	25%	0%	19%	20%	50%	0%	28%	0%	NA	51%	
NRW	25%	30%	43%	32%	50%	24%	35%	20%	50%	29%	
Income Statement											
Operating Ratio	95%	114%	124%	111%	85%	79%	79%	74%	125%	97%	
Staff/Connec. (1.000)	20	14	18	13	12	9	12	7	13	10	
Average Tariff	645	602	780	686	323	592	586	444	605	410	
Average Cost/m3	894	595	755	293	378	728	740	670	602	423	
Oper cost/Total cost	42%	15%	48%	50%	59%	39%	62%	63%	41%	59%	
Admin cost/Total Cost	58%	85%	52%	50%	41%	61%	38%	37%	59%	41%	
Non-Sales/Total Rev.	2%	34%	15%	18%	41%	42%	22%	11%	4%	8%	
Balance Sheet											
Acc. Receivable/Days	43	NA	61	67	58	63	61	64	82	52	
Current Ratio	1.21	NA	3.01	7.36	19.00	NA	1.10	0.27	2.29	3.24	
Debt to Equity	4%	NA	1%	3%	58%	NA	20%	85%	2.29%	0%	
Debt Coverage	0.00	NA	0	0	0	NA	1.01	0.94	0	0	
Project Information											
Project Cost	Rp. 2.25 Bn	NA	NA	Rp. 2.76 Bn	Rp. 1.75 Bn	NA	Rp. 4.92 Bn	Rp. 2.41 Bn	NA	RP. 0.405 Bn	Rp. 14.495 Bn
Man-days work	24,340	NA	NA	20,117	14,587	NA	15,061	22,283	NA	4443	100,831
New Connections	4,710	NA	NA	3,560	1,500	NA	2,916	4,400	NA	864	17,950
Coverage Increase	11%	NA	NA	6%	6%	NA	NA	NA	NA		

Notes :

NA = Not Available
NYA = Not Yet Available
NRW = Non Revenue Water

* = Urban

WET P... ...ct
Statistics for PDAM Visited

Statistic	PDAM Kabupaten Dati II						Total for Project
	Lamongan	Gresik	Pasuruan	Pacitan	Tuban	Nganjuk	
	11	12	13	14	15	16	
Month	Decem. 98	Decem. 98	Decem. 98	Decem. 98	Decem. 98	Decem. 98	
Population	160854	919515	412813	531991	1003289	999726	
Technical Information							
Water Source	River	River	spring	Spring, River	spring/deep well	River	
Flow System	Pumping	Pumping	pumping	Gravity , Pumping	grav./pumping	Gravity	
Coverage	49%	13%	10%	26%	50 % *	34 % *	
Connection	9,542	16,453	10,289	5,853	15,500	11,000	
Capacity [LPS]	78	310	422	165	260	100	
Idle Capacity [%]	0%	24%	71%	42%	23%	47%	
NRW	28%	34%	18%	41%	43%	20%	
Income Statement							
Operating Ratio	57%	61%	63%	42%	83%	47%	
Staff/Connec. (1.000)	10	9	14	15	7	7	
Average Tariff	1,047	1,526	626	569	579	552	
Average Cost/m3	1,850	2,488	986	1,340	697	1,164	
Oper cost/Total cost	66.38%	57.57%	43.00%	73.24%	66%	45%	
Admin cost/Total Cost	33.62%	42.43%	57.00%	26.76%	34%	55%	
Non-Sales/Total Rev.	24.00%	23%	19%	8.47%	19%	20%	
Balance Sheet							
Acc. Receivable/Days	173	34	52	90	45	57	
Current Ratio	405%	88%	80.80%	32%	713%	7%	
Debt to Equity	167%	87.68%	117.00%	27%	7%	77%	
Debt Coverage	0	1	0	0	0	0	
Project Information							
Project Cost							
Man-days work							
New Connections							
Coverage Increase							

Notes :
NA = Not Available
NYA = Not Yet Available
NRW = Non Revenue Water
*** = Urban**

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PDAM Surakarta's Response to Crisis

World Bank Support for PDAM Surakarta

1. Surakarta is a medium-sized city in the province of Central Java. The Surakarta water utility (PDAM Surakarta) is one of the implementing agencies in the Bank's Semarang Surakarta Urban Development Project (SSUDP, Loan 3749 – IND) in Indonesia. Under SSUDP (which became effective in late 1994, and is scheduled to close in September 2000, after a one year extension), PDAM Surakarta is expected to raise its service level from 30% to 58% through supply augmentation, improvements to the distribution system, and reduction in unaccounted for water. PDAM Surakarta is to receive $9.5 million from loan funds under a sub-loan agreement from the central government, and is required to meet financial covenants on cost recovery.

2. PDAM Surakarta has made good progress in project implementation, even though a change had to be made in the water source (from deep wells to a spring source). Targets on population served and number of house connections are expected to be achieved without difficulty. The utility has also been complying with loan covenants on cost recovery. (A copy of PDAM Surakarta's financial indicators is attached.) Further, as envisaged in the project, it has also taken over the operations of the sewerage system in the city.

3. In order to further increase its operational efficiency and to cope with the current crisis, the PDAM is currently working on a number of initiatives, with the support of the Bank. These include:

(a) *An Operational and Management Audit* – The Bank is financing an Operational and Management Audit of the utility's operations to identify areas for improvement and to develop an agreed Action Plan. Following a competitive selection procedure, the Indonesian arm of Arthur Anderson is being appointed to carry out the audit. EASUR will finance the audit as part of an informal sector work piece entitled "Water Supply Innovations".

(b) *A Communication Program* – In 1998 PDAM Surakarta initiated a communication program, including a customer survey, to obtain feedback from its customers and also to inform them on the benefits of piped water supply and the costs of providing the service. At the Bank's suggestion, PDAM Surakarta has since developed a comprehensive communication plan for the medium term. EASUR will finance some aspects of this program under "Water Supply Innovations".

(c) *Extended overseas internship* – At the Bank's suggestion, government has agreed to support PDAM Surakarta's own efforts towards staff development by financing (out of the proceeds of SSUDP) the costs of an extended overseas internship for two middle level managers (one from operations and the other from the commercial side) who have a high potential for growth. EASUR has obtained trust funds for an expert from Brisbane Water Authority to visit Surakarta (and also Semarang) to meet with the short listed candidates, to understand the level of sophistication of PDAM Surakarta, and to develop an appropriate internship program at Brisbane. The internship program will start later this year, after the selected candidates undergo an intensive English language training program.

PDAM SURAKARTA
Financial Indicators

	1997 Actual	1998 Estimated	1999 Projected	2000 Projected	2001 Projected	2002 Projected
DEMAND						
Population Served (%)	50%	54%	59%	63%	66%	67%
Number of Connections	41,247	43,568	46,063	50,066	52,744	54,922
Increase in Connections	6,046	2,321	2,495	4,003	2,678	2,178
Consumption m3/Month/Connection	26.8	26.2	26.6	26.8	26.8	26.8
Forecast Volume Sold – 000 m3	13,270	13,683	14,710	16,104	16,965	17,683
% Unaccounted-for Water	33.2%	33.1%	31.1%	29.1%	27.1%	25.1%
Water Production – 000 m3	19,872	20,458	21,355	22,719	23,278	23,615
MANAGEMENT						
# Days Accounts Receivable	46	46	50	49	50	50
Number of Employees	306	296	313	340	359	373
Additional Employees	8	(10)	17	27	19	14
Employees per 1000 Connections	7	7	7	7	7	7
% Increase in # of Employees	2.7%	-3.3%	5.7%	8.6%	5.6%	3.9%
FINANCIAL						
Cash / Mo. Operating Expenses	0.65	1.05	4.40	1.82	2.10	3.44
Current Ratio	1.08	1.26	1.90	0.80	0.93	1.22
Tariff in current prices (Rp/m3)	567	608	715	843	1,006	1,169
Average Tariff Increase	4.2%	7.1%	17.7%	17.9%	19.3%	16.2%
Contribution to Investment – 3 yrs ave.	32.1%	32.1%	32.1%	32.1%	32.1%	32.1%
Debt on Debt plus Equity	73.2%	73.2%	80.1%	79.8%	76.2%	70.3%