

Output-Based Aid

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Editor's Message

To the uninitiated, “output-based aid” (OBA) sounds like a simple mechanism with uncomplicated goals: after it can be verified that grantees have achieved a particular output, they will be paid a grant or subsidy. The desired output is typically something tangible: a new water connection in a poor household, a new sewerage connection, or a bus shelter.

This description is true as far as it goes, but as this edition of *Prakarsa* makes clear, that is only the starting point for OBA. Three of our articles discuss particular OBA programs. The “Water Hibah” operated by the Indonesia Infrastructure Initiative (IndII) and the “Expanding Piped Water Supply to Surabaya’s Urban Poor” program by the Global Partnership on Output-Based Aid are both designed to increase water connections. The “Hibah SAUM”, also operated by IndII, incentivises local governments to build bus shelters for their bus rapid transit systems. There is a different story behind each of these three programs, but one characteristic they share is that each program involves much more than just “cash for a connection” or other tangible output.

Even at this simple level, OBA offers advantages: if nothing else, it transfers much of the risk from the grant provider to the grantee, who must expend funds up front to produce the desired results. But the true power of OBA lies in its effectiveness as a tool for institutional transformation.

This transformative potential begins by using OBA as leverage. By offering grants that pay for only part of the total cost of service provision, OBA rewards grant recipients for expending their own funds above the level of the grant provided. This is the important concept of “additionality” – OBA can lead to higher overall expenditures, not simply the use of grant money to replace funds that would have been spent anyway.

Most importantly, OBA can create better governance within the sectors where it is applied. Each of the OBA programs described here has increased its focus on governance as the program has matured. That is especially clear in the Water Hibah, which even in its original design emphasised a governance objective – increased investment by Local Governments directly in their water companies. The expanded resources and timeframe now available to the Water Hibah program mean that OBA can be used to increase capacity at weaker institutions, and specific governance-related outcomes, such as timely audit reports, can be introduced. As this demonstrates, the concept of OBA as cash for a tangible output is a good first step, but only a step. The real potential of OBA can be met when practitioners recognise its power to do much more. • CSW

Infrastructure by the Numbers

>200 kilometres

The total length of the busway routes in Indonesia – the longest in the world. Output-based grants are enhancing the development of supporting infrastructure for busways (see article on page 14).

400,000

The number of people who will be reached over the next three years with off-site sewerage connections under Australia-Indonesia Infrastructure Grants for Sanitation (sAIG).

6

The number of critical requirements that must be assessed to determine whether an output-based aid scheme is suitable and feasible, according to the Global Partnership on Output-Based Aid (GPOBA). Three relate to institutional capacity and assessment (whether the scheme has government ownership and fits government priorities; the quality of the Monitoring & Evaluation that can be done; and whether the implementer has the necessary technical, financial and managerial capability to implement the proposed service). The other three involve the financial mechanisms (can the sector ensure financial sustainability; are the proposed grants acceptable and practical within the sector context; and can the service provider pre-finance through its own resources or commercial/public financing support).

71%

The portion of GPOBA funds devoted to the transport sector; health is next, at 14.2 percent.

1960s

The decade in which output-based aid was first applied to development work, when it was applied to family planning efforts in South Korea and Taiwan.

32; 131

The number of output-based aid projects funded by the World Bank Group in 2002 and 2009, an increase of more than 400 percent in just seven years.

GRANTS AS A TOOL FOR TRANSFORMATION: THE INDII APPROACH TO OUTPUT-BASED AID

Output-based grants can do more than produce desirable short-term results. When properly designed they can be a vehicle for improving governance and strengthening commitment. • By David Ray



The output-based Water Hibah program provided new water connections to 77,000 households during IndII Phase 1.

Courtesy of IndII

Output-based aid (OBA) is an innovative and promising new modality for delivering development assistance. It is a results-based mechanism that links payments to the achievement of clearly defined milestones/deliverables, usually in the form of improved public services. OBA has been widely used in health and education, but is increasingly being applied to improve infrastructure service delivery, particularly in water and sanitation and also in transportation.

One of the earliest uses of OBA using government systems in Indonesia was by the AusAID funded Indonesia Infrastructure Initiative, through the Water and Sanitation Hibah grants program developed in its first phase. As described in greater detail in “Output-Based Aid for Better Water Services” on page 19, this A\$25 million program provided output-based incentive grants to facilitate Local Government (LG) investment in 77,000 new household water connections and 5000 household sewerage connections, with implementation happening in the space of just a year. Key to the success of these grants was the fact that LGs were directly engaged in, and had ownership of, the infrastructure investment process. Moreover, through effective outreach and communications local leaders were able to see and appreciate the relatively high political returns from improved service delivery.

Also in the first phase of IndII, a small grants program was piloted for the support of fledgling busway systems in select cities. This pilot program set new standards for busway infrastructure design and construction, and importantly introduced new incentives for a more robust and disciplined approach to LG contractor management. Lessons learnt from this activity are being applied to a possible expanded program in Phase 2. (See “A Case Study in Output-Based Aid: Improving Indonesia’s Urban Bus Transport” on page 14).

Another grant program from Phase 1 was the A\$ 6 million Infrastructure Enhancement Grants (IEG) for sanitation. The sanitation IEG was a performance-based program that used the proportion of funds budgeted by LGs in 2010 for sanitation as a measure of LG commitment to sanitation improvement. LGs that demonstrated sufficient commitment qualified for IEG support to solid waste and wastewater infrastructure development. (For more details, see “Adapting Output-Based Grants to Sanitation” on page 4 of the July 2011 issue of *Prakarsa*.) This program revealed a number of key problems in sanitation project delivery and in the governing institutional arrangements at the local level. Addressing these issues is at the core of the design of the Phase 2 output-based sanitation grant program (sAIIGs)

described below.

Key Points

Output-based aid (OBA) links payments to grantees to the achievement of clearly defined milestones/deliverables, usually in the form of improved public services. OBA was pioneered in Indonesia by Phase 1 of the Indonesia Infrastructure initiative, through the AusAID funded Water and Sanitation Initiative, which resulted in 77,000 new household water connections and 5000 household sewerage connections. Key to the success of these grants was the fact that Local Governments were directly engaged in, and had ownership of, the infrastructure investment process.

In Phase 2, IndII will build on Phase 1 successes and expand its work in other sectors – notably sanitation and transport – as a means of improving capacity for, and commitment to, infrastructure service delivery at the local level. The Water Hibah will be scaled up. Other programming will assist Community-Based Organisations that operate water systems. A new sanitation grant program (sAIIG) has been designed and is now in the initial stages of implementation. OBA programs in the transport sector will focus on road maintenance and road safety.

OBA is suitable for relatively small, incremental interventions that are easily scalable and replicable and can be pre-financed in a step-by-step manner by governments with limited budgetary resources. Moreover, the outputs need to be easily verifiable. Not all planned IndII OBA grant programs fit these criteria perfectly. For example, the investments planned for the road safety grants (such as pedestrian crosswalks at schools or other improvements) will be standardised to the extent possible, but the outputs in each location will need to be customised to the immediate road environment. Likewise some outputs are more challenging to verify, such as whether a length of road has been maintained to an acceptable standard.

OBA is gaining in popularity because funds are transferred only upon achievement of agreed-to deliverables, which increases certainty and minimises risk. But the most important reason IndII is focusing on OBA is because of its potential to drive reform and transformation. The most valuable impact of IndII grants is not the immediate output, but rather the improved governance and institutional commitment to infrastructure services at the local level. This vision for OBA can only be realised if programs are designed around the principles of conditionality, consolidation, contestability, consistency, and effective communications.

Building on Past Success

Last year IndII was extended into a second phase, which will operate until June 2015. Phase 2 emphasises the “engine room” role for IndII in the design, implementation and management of government-to-government-funded infrastructure grants, for the most part using output-based mechanisms. In its current phase, IndII will build on the success of the Water Hibah, to deepen its engagement in the water sector, and to expand its work in other sectors – notably sanitation and transport – as a means of improving capacity for, and commitment to, infrastructure service delivery at the local level.

In April 2012, a subsidiary agreement between the Governments of Australia and Indonesia was signed, articulating the intentions of both governments to cooperate in the implementation of the Australia-Indonesia Infrastructure Grants (AIIG) program. The AIIG consists of up to A\$250 million in grants financing (including A\$10 million in funding from USAID for the Water Hibah). AIIG programs are to be designed, implemented and managed by IndII.

At this point, IndII is planning to substantially scale up the Water Hibah so that it can deliver 280,000 household connections in during

Phase 2. IndII will also apply the key lessons learnt from the Water Hibah and other Phase 1 programming to assist Community-Based Organisations (CBOs) that operate water systems. IndII will develop a separate grants program that seeks to promote LG investment in and commitment to these CBOs.

The Sanitation Hibah is also being continued, but on a much lower scale than other water and sanitation grant programs, because of the limited capacity of existing sewerage systems to which the Sanitation Hibah can be applied. A new and much larger sanitation OBA grant program (sAIIG) has been designed with the primary objective of building the engagement of LGs in sanitation. This is important, as LGs have tended to be sidelined in recent efforts to promote sanitation service delivery at the local level. The sAIIG program will be implemented through LGs that will provide off-site sewerage infrastructure for 92,000 households, as well as some solid waste facilities.

Also within the sanitation sector, infrastructure grants will be directed at implementing one or possibly two city sewerage systems. This will build upon preparatory work completed by IndII in Phase 1 to develop wastewater master plans for eight cities.

Programs in the Transport Sector

IndII is currently designing two pilot programs in transport. The first is an innovative output-based road maintenance program that will first be implemented for provincial roads in Nusa Tenggara Barat before possibly being expanded to other jurisdictions. This program will explore new modalities such as an enhanced role for the private sector through performance-based contracting, and the engagement of the community through the recently legislated road transport and traffic forums. The primary objective of this program will be to improve LG commit to, and capacity for, effective road maintenance practices.

The other pilot program in transport will provide grants that are designed to build commitment and capacity within LGs for the management of road safety. The grants will fund the development of road safety infrastructure that targets vulnerable road users, such as “safe school zones” for school children. They will also be used to build community awareness of the risks faced by pedestrians and motorcyclists from traffic crashes. At the time of writing, consideration was also being given to merging this program

IndII’s Approach to Grant Programming: The five “Cs” of Effective Grant Program Design:

Conditionality: To ensure maximum impact from investment, conditions for participating in grant programs and receiving payments should be aligned with developmental, institutional, and governance policy objectives.

Consolidation: Instead of fragmented efforts, programs should work with a smaller, consistent group of Local Governments (LGs) over time. This can help to enforce longer-run incentives to mainstream policy and governance reforms.

Contestability: LGs should compete to participate in grant programs by demonstrating capacity, commitment and fitness to execute the grants.

Consistency: Grants should be designed and implemented in a manner that is consistent with Government of Indonesia systems for the transfer of funds among national and LGs. This will help to ensure that LGs have ownership over infrastructure development and service delivery.

Communications: A good communications program builds a constituency for improved service delivery at the local level. This demonstrates to LGs the political returns from enhancing infrastructure.

with the urban mobility program to develop busway infrastructure (see above) to improve the amenities, mobility and safety of select urban corridors.

In addition to these programs that are either in concept development, design or implementation stages, IndII is also considering the development of other grant activities targeted to LGs. Among the possibilities under consideration are investments in intermediate treatment facilities for solid waste and the expansion of the Phase 1 bus improvement program to include pedestrian facilities.

Not Always the Answer

OBA lends itself to particular types of grants investments: relatively small, incremental interventions that are easily scalable and replicable and can be pre-financed in a step-by-step manner by governments with limited budgetary resources. Moreover, the outputs need to be relatively standardised in terms of design and unit costs, so that they can be easily verified. OBA is less suited to large, lumpy “one-of-a-kind” investments such as a port terminal, a sewerage treatment plant, or a major bridge. Thus, while most of IndII’s Phase 2 grant programs will be implemented through some kind of output-based modality, there are exceptions, such as investment in one or two city sewerage systems. These large, lumpy investments are beyond the pre-financing capacity of most city governments.

Household water connections, on the other hand, are an ideal OBA investment in infrastructure as they are relatively standardised interventions that can be implemented with uniform standards and design specifications and can be easily verified (in other words, it is easy to check if water is flowing and if invoices are being issued and paid).

Not all planned IndII OBA grant programs fit the above criteria as neatly as the Water Hibah. For example, the investments planned for the road safety grants (such as pedestrian crosswalks at schools or other improvements) will be standardised to the extent possible, but the outputs in each location will need to be customised to the immediate road environment. Likewise some outputs are clearly more challenging to verify than others. For example, it will be more difficult to ensure that a length of road has been maintained to an acceptable standard than it is to confirm that a household has a functioning, billable piped water connection.

Advantages of OBA

Output-based programs are becoming increasingly popular among donors. This is because funds are transferred only upon achievement of agreed-to deliverables or milestones. Programs can be delivered with greater certainty and, importantly, with minimal risk.

These are important advantages, but they are not the primary reason why IndII is placing such an emphasis on output-based grant programming in Phase 2. The key reason to use the OBA modality is that it provides leverage. OBA can drive reform and transformation. It generates “additionality”. Additionality means that there is some kind of catalytic or transformational impact from the program, over and beyond the immediate measureable results. In other words, the most valuable impact of the IndII grants is not the immediate output such as water connections to more households. Rather, it is the improved governance and institutional commitment to infrastructure services at the local level which are generated by the conditions that the LG must meet in order to receive grant payments.

This vision for OBA can only be realised if OBA programs are designed with the five “Cs” in mind: conditionality, consolidation, contestability, consistency, and communications.

Kinds of Conditionality

In broad terms there are two types of conditionality that IndII uses to maximise the additionality of grant investments: matching grants and governance requirements.

Matching grants: Grants are designed and implemented in a manner that, all other things being equal, catalyses progressively larger LG commitment of discretionary funds for investment in hard infrastructure. This helps increase and mainstream greater LG institutional commitment to infrastructure over time.

Governance requirements: Grants are leveraged to ensure that a range of other policy and governance reforms are undertaken. Examples of the requirements that can be imposed are: compliance with national policies and procedures; improvements in procurement systems; implementation of tariff reform; and adherence to audit standards. As with matching grants, governance conditions can be progressively applied to help mainstream and institutionalise reform over time.

Consolidation

An important lesson from Phase 1 programming, particularly from the sanitation IEGs, is that fragmentation is a serious problem that undermines the efficacy of infrastructure delivery. This can be seen in the allocations of national government resources to LGs, and in the allocations by LGs to their agencies and projects. Consolidation is hence an important element of grant design. To the extent possible, IndII seeks to limit the number of LGs participating in any one grant program. This is because spreading finite grant funding across a large number of LGs will lead to an unwieldy program with high unit management costs.

On the other hand, consolidating a program with a select group of participating LGs will enable IndII to provide grants to the same LG for a period of up to three years. Working over a longer timeframe with a consistent set of LGs offers better opportunities to mainstream and institutionalise the key policy and governance changes that are conditions for funding. Setting realistic minimum requirements for the size of projects that LGs undertake will prevent fragmentation of the investment program into too many tiny activities.

Contestability

Ensuring that LGs must compete to participate in grant programs is another key ingredient in the IndII grant program design. When LGs are required to demonstrate that they are the most suitable candidates, there is self-selection of the most committed LG partners. Further, choosing only the “best” LGs helps to keep the number of participating LGs manageable. Various criteria can be used to determine which LGs are selected, most notably commitment to particular governance reforms as well as to counterpart funding.

Consistency

Arguably the most important element of IndII output-based grants is consistency with, and use of, Government of Indonesia fiscal transfer systems. As shown from the Water Hibah, use of these systems allows the roles and incentives of all stakeholders – both national and Local Governments – to be clearly identified and agreed to. Directly engaging LGs in the infrastructure investment process is important so that they can develop a sense of ownership. An important example is in the sanitation sector, where most programs to date have been delivered at the national or community level, and the LG has consequently been marginalised, with little or no ownership over sanitation projects within their jurisdictions. For all IndII programs, on the other hand, the LG plays a pivotal role as both the owner and deliverer of the infrastructure projects.

Communications

A final ingredient to IndII grant programming is communications. Through effective communications and outreach programming using a variety of mechanisms, including launch ceremonies, media reporting, and talkback radio, subnational leaders can see the high political returns from improved service delivery. This generates incentives for them to pursue their own programs to improve local infrastructure delivery. ■

About the author:

As the Director of IndII, **David Ray** is responsible for overall technical and strategic leadership. He is an economist with over 10 years experience working in the development context, mainly in Indonesia and Vietnam. Prior to joining IndII in April 2009, David was the Deputy Director of the USAID-funded SENADA project, focussing on Indonesian manufacturing sector competitiveness. Over the 2003-06 period, he worked for The Asia Foundation in Vietnam managing a USAID economic governance program to improve the investment climate at the local level. Prior to this, he was a USAID-funded advisor at the Indonesian Ministry of Industry and Trade working mainly on trade, investment and regulatory reform issues. David has a number of academic credentials, including a PhD focussing on Indonesia's economic and institutional development.

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USING OUTPUT-BASED AID TO EXPAND PIPED WATER SUPPLY TO SURABAYA'S URBAN POOR

Coordination and socialisation have proved to be key factors in making output-based aid effective. • By Irma Setiono

Surabaya has been successful at bringing piped water to most of its citizens for business and personal use.

Photo by Andre Susanto



Surabaya, the second largest city in Indonesia, has achieved remarkable development success over the past decade. The Surabaya Municipality is considered among the top performers in the nation. This remarkable achievement is echoed by its water utility, PDAM Surya Sembada. Unlike most PDAMs, Surya Sembada has a good reputation in the market and is in a strong financial position with no arrears on its debts. In 2009, the utility's annual operating and maintenance costs were USD 34 million and its total revenue was more than USD 55 million. Its current service coverage is 83 percent. With approximately 450,000 domestic and commercial connections, PDAM Surya Sembada is the biggest water utility in Indonesia.

In keeping with its high levels of coverage, most areas of Surabaya are already served by the piped water system, and many households have individual connections. However, there are still some pockets of unserved areas that belong to the lowest income brackets. Many of these poor households are unable to afford the steep connection fee, which includes the cost of tertiary network expansion. In addition, some segments of the urban poor population are unable to furnish the legal documentation required by the utility for the provision of individual connections. In the absence of piped supply, these households have to rely on a combination of water from neighbours, purchased from vendors or small scale independent providers, and free well water. Much of the water from these sources is expensive or contaminated.

To support PDAM Surya Sembada in expanding their services, the Global Partnership on Output-Based Aid (GPOBA)¹ is providing subsidies for new connections to poor households in Surabaya. The objective is to increase and sustain access to piped water networks for low income households. Three kinds of

connections or “outputs” are the means to deliver water to the urban poor: *in-fill connections* (connections provided to a beneficiary household through a new connection to an existing tertiary pipeline), *expansion connections* (connections provided to a beneficiary household through expansion of the tertiary network to provide access to piped water supply to previously unserved areas), and bulk supply or “*master meter*” connections for particularly poor, dense or informal communities where households are not eligible for individual connections.

Institutional Arrangements

The PDAM is the implementing agency and ultimate recipient of the subsidy. The PDAM pre-finances, procures, and constructs the water delivery systems. However, current regulations do not allow direct reimbursement by GPOBA to be made to the PDAM. The reimbursement has to be channeled through the Government of Indonesia (GoI) and then to the City of Surabaya. The Grant Agreement was signed with the GoI. The Ministry of Public Works (MPW) has been assigned as the Executing Agency. A Governing Committee was established within the Directorate General of Human Settlements (DGHS) within MPW to be responsible for overall project oversight. A Provincial Working Unit (Provincial Satker) was established for procurement of the auditor and overall project monitoring and evaluation.

Key Points

Surabaya’s water company PDAM Surya Sembada has a good reputation in the market and has 83 percent service coverage. However, some low income areas are still unserved. To support PDAM Surya Sembada in expanding their services, the Global Partnership on Output-Based Aid (GPOBA) is providing subsidies for new connections to poor households in Surabaya.

The PDAM is the implementing agency and ultimate recipient of the subsidy. The PDAM pre-finances, procures, and constructs the water delivery systems. Reimbursement has to be channeled through the Government of Indonesia (GoI) and then to the City of Surabaya. The project involves coordination among the Ministry of Public Works, the Directorate General of Human Settlements, a Provincial Working Unit (Provincial Satker), a City Satker, an auditing firm, and Community Based Organisations.

The total project size is around USD 3.2 million. It was originally scheduled to operate from 2009 to 2011. It was expected to reach about 16,000 low income households.

Implementation during the first two years was very slow. Challenges that led to the slow start-up included problems in beneficiaries’ identification, coordination between the PDAM and the CBOs, internal PDAM organisational arrangements, and the complicated fund-channeling mechanism. A project restructuring was proposed and approved in 2011 to extend the project through December 2012 and improve performance by removing implementation bottlenecks and streamlining the beneficiary selection criteria.

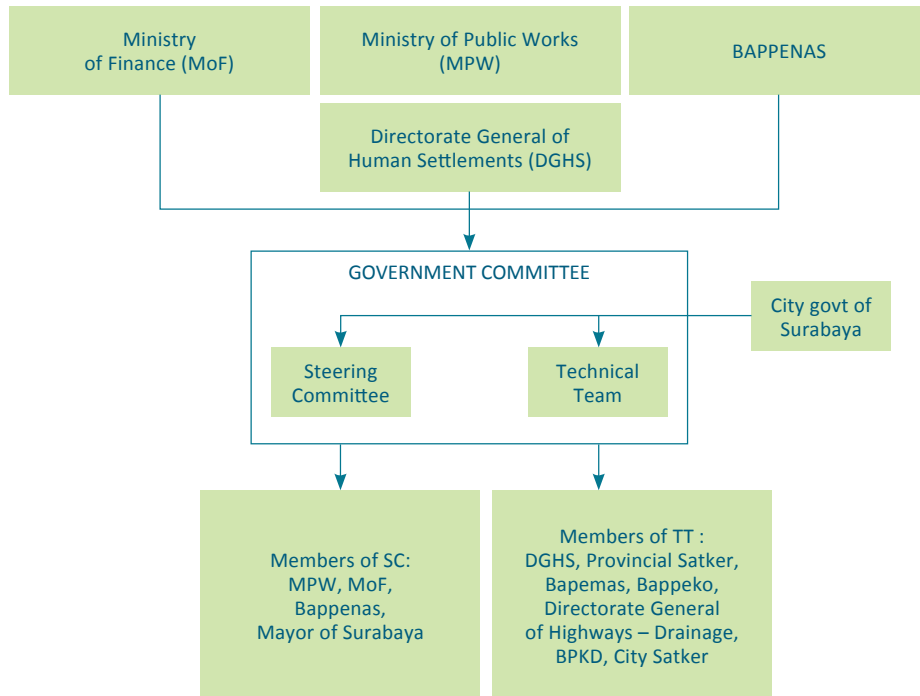
Following the project restructuring, project implementation has improved significantly, as shown by the number of installed connections and disbursements made. Project coordination among the PDAM, Governing Committee, CBOs and different stakeholders has been improved by instituting regular coordination meetings. Community facilitators have been assigned by the Governing Committee to assist CBOs and act as a liaison between the CBOs and the PDAM. The PDAM has also improved its internal arrangements for project implementation and provided a dedicated office space as a hub for the community facilitators, allowing closer coordination and faster responses.

Lessons learned include the need for good communication and close coordination among stakeholders and the importance of managing stakeholder support and commitment throughout project implementation. The PDAM now recognises that community outreach and engagement are critical in providing services to the poor.

At the city level, a City Satker was established to be responsible for confirming eligibility of, and managing, subsidy payments; safeguarding compliance; and reporting. In addition, a firm has been hired as the OBA Auditor to provide an annual assessment of progress and quality of works under the project; to undertake spot checks on connections made; and to certify the subsidies for expansion connections and master meter schemes. The project also involves coordination with Community Based Organisations (CBOs) in the identification of beneficiaries, the administration of connection installations, and the design and implementation of master meter schemes.

The project organisational structure is shown in Figure 1.

Figure 1: Project Organisational Structure



Key:
Bapemas = Badan Pemberdayaan Masyarakat (community empowerment council)
Bappeko = Badan Perencanaan Pembangunan Kota (city development board)
BPKD = Badan Pengelolaan Keuangan Daerah (local financial management board)

Project Targeting and Outputs

The total project size is around USD 3.2 million, of which USD 2.5 million comes from GPOBA for subsidy payments, technical assistance, and World Bank supervision. The remainder is provided by household user contributions, the PDAM, and USAID’s Environmental Services Program (ESP) in the form of supervision and implementation contributions in kind. The project was originally designed to be implemented over three years, from 2009 to 2011, with a phased approach. It was expected to reach about 15,500 households with a mix of in-fill and expansion connections, with a maximum average subsidy of USD 150 per household (around USD 30 per person). Five hundred households were expected to be served through about 10–15 master meter schemes.

Unit costs were developed based on a random sample of the PDAM's previous contracts. They have been carefully verified by an independent consultant and compared with benchmarks. Based on the unit costs, the subsidy payment for eligible in-fill connections is fixed at USD 45 per connection, while the size of subsidy for expansion connections is determined by the cost of the expansion scheme and the subsidy cap, which is USD 500 per household. The average subsidy, across in-fills and expansions combined, cannot exceed USD 150 per connection. For the master meter scheme, the project set a cap of USD 5,000 per scheme for the size of the subsidy for the upstream cost, including any necessary tertiary expansion.

The beneficiaries of the project are low income households that meet eligibility criteria as follows: a residence smaller than 60 square metres; access road to the house shorter than 6 metres or, if facing an open space/dump, the nearest road is fewer than 6 metres away; and the formal installed electricity capacity is less than 1,300 volt-amperes, or there is no formal connection.

Results to Date

The project began in May 2009. Implementation during the first two years was very slow. By October 2011, only 1,500 connections had been installed and only 92 connections were verified and reimbursed. Challenges that led to the slow start-up included problems in beneficiaries' identification, coordination between the PDAM and the CBOs, internal PDAM organisational arrangements, and the complicated fund-channeling mechanism. A project restructuring was proposed and approved in 2011 to improve the performance of the project by removing implementation bottlenecks and streamlining the beneficiary selection criteria, without any changes to the project development objective. The restructuring also resulted in the extension of the project period to December 2012.

Following the project restructuring, project implementation has improved significantly as shown by the number of installed connections and disbursements made. By mid July 2012, more than 5,000 connections had been installed, and reimbursements have been made for around 3,600 of them. Project coordination among the PDAM, Governing Committee, CBOs and different stakeholders has been improved by instituting regular coordination meetings. Community facilitators have been assigned by the Governing Committee to assist CBOs and act as a liaison between the CBOs and the PDAM. The PDAM has also improved its internal arrangements for project implementation and provided a dedicated office space as a hub for the community facilitators, allowing closer coordination and faster responses.

Lessons Learned

The implementation of this project involves many different stakeholders at the local level (the PDAM, City Satker, Provincial Satker, and CBOs), as well as at the GoI level. This requires good communication and close coordination among all these different parties. Regular coordination meetings and provision of dedicated office space as a hub have been proven effective to improve collaboration and accelerate project implementation.

The project also illustrates the importance of managing stakeholder support and commitment throughout project implementation. Managing stakeholders' commitment at all levels, especially when dealing with different and complicated procedures, has proven to be critical. Even though there was strong commitment from the PDAM's top management to achieving project outputs, significant delays

in implementation still occurred. It is important to have intensive internal project socialisation that reaches the PDAM staff responsible for ongoing implementation, and to integrate the project as part of the PDAM's overall program development planning.

Learning from this project implementation, the PDAM now recognises that community outreach and engagement are critical in providing services to the poor. Support from the national community development program (PNPM – Program Nasional Pemberdayaan Masyarakat) through assignment of community facilitators has allowed PDAM to work with CBOs in promoting and socialising the project. These facilitators have also been effective at increasing households' awareness of their rights and obligations as new customers. The PDAM has also learned to work with the CBOs to design and implement the master meter schemes, with the CBOs helping with bill collection and managing the system downstream of the water meter.

The lessons learned through the GPOBA program in Surabaya have value beyond accelerating the implementation of this one program. Thanks to what they have learned, it is expected that the PDAM can continue working with CBOs to design and implement activities to provide services for the poor in the future. In addition, the output-based approach and lessons learned from this project have been incorporated into the design of the Water Hibah Program (see "Output-Based Aid for Better Water Services" on page 19). These are examples of how the GPOBA program can have lasting impact beyond the new water connections it is providing. ■

NOTES

1. GPOBA is a partnership of the IFC/World Bank and bilateral donors from Australia, the UK and The Netherlands, working together to support output-based aid approaches in several sectors including water and sanitation. GPOBA is administered by the World Bank.

About the author:

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A CASE STUDY IN OUTPUT-BASED AID: IMPROVING INDONESIA'S URBAN BUS TRANSPORT

A pilot program to build bus shelters using an output-based grant mechanism offers lessons that apply not only to efforts to improve urban mobility but to other sectors as well. • By Maria Renny and Meilany Fahriantiny



As part of the Bus Improvement Program, representatives from Indonesia travelled to Australia to observe local transit systems and trade insights with their Australian counterparts.

Courtesy of IndII

A well functioning public transport system improves quality of life, reduces pollution and congestion, and supports economic development. But for Indonesian cities, developing good public transport infrastructure that appeals to users is a challenging goal. Many existing public transit facilities are considered unreliable, uncomfortable, and unsafe. At the same time, economic growth and improved access to credit have contributed to higher levels of private transport, as poorer citizens become able to afford motorcycles while wealthier citizens purchase their own cars. (For an overview of urban mobility challenges facing Indonesia, see the April 2011 edition of *Prakarsa*.)

To address these challenges, the Government of Indonesia and donor agencies have turned much of their attention to medium-sized cities with populations between 500,000 and 2 million. These cities are not yet hopelessly congested, and they have the space to further develop their facilities and infrastructure. With proper policies in place, these cities can avert the transport crisis that afflicts cities like Jakarta.

This is the rationale behind initiatives such as Law no. 22/2009 on Traffic and Road Transport. Under the terms of this law, medium-sized cities are obligated to provide bus transit using priority bus lanes. After this law was passed, the Directorate General of Land Transport (DGLT) selected 10 Local Governments (LGs) to participate in a pilot program to improve their road-based public transportation facilities. The Directorate of Urban Transportation Facilities Development donated buses, and each LG developed a priority bus system, managed by either a government technical unit (*Unit Pelaksana Teknis* [UPT]) or private operators, using high-platform bus shelters.¹

The AusAID funded Indonesia Infrastructure Initiative (IndII) assisted DGLT efforts by offering technical assistance through its Bus Improvement Project (BIP). Through BIP, LGs serving four of the pilot cities – Palembang, Yogyakarta, Surakarta, and Bogor – learned how to design bus shelters that are suitable for local conditions and that maximise the efficiency of a bus transit system. Representatives participated in training and study tours to several Australian cities, where they observed examples of good and poor provision of bus transportation infrastructure and met with bus operators and staff from local Land Transport Authorities. Participants in BIP developed an understanding of the five primary functions which a bus shelter must fulfil (see Box 1).

An Opportunity for Output-Based Aid

The efforts being made at both the national and local levels gave rise to the idea that an output-based aid program would be suitable for the improvement of bus transport infrastructure. Accordingly, in 2010, IndII began to explore the possibility of using a Hibah mechanism (see Box 2), similar to the one that had proved effective in encouraging LGs to work with their water companies to increase the number of water connections serving low-income families. This led to the creation of the Hibah SAUM (*Sarana Angkutan Umum*, which translates roughly as “financial support for public transport”).

The objective of the Hibah SAUM is to improve the quality and accessibility of bus shelters within currently operational priority bus networks. Two of the four cities taking part in BIP participated in the first round of the Hibah SAUM. Bogor was not yet prepared to successfully implement the program. Yogyakarta submitted a proposal, but then reallocated city infrastructure funds to reconstruction efforts following the devastating eruption of Mount Merapi in 2010.

Key Points

The Government of Indonesia and donor agencies are focusing on improving urban mobility in mid-sized cities that have the potential to avert the transport crisis that afflicts cities like Jakarta. The Directorate General of Land Transport (DGLT) selected ten Local Governments (LGs) to participate in a pilot program to improve their road-based public transportation facilities. The Directorate of Urban Transportation Facilities Development then donated buses, and each LG developed a priority bus system.

The AusAID funded Indonesia Infrastructure Initiative (IndII) assisted DGLT efforts by offering technical assistance through its Bus Improvement Project (BIP). Through BIP, LGs serving four of the pilot cities – Palembang, Yogyakarta, Surakarta, and Bogor – learned how to design bus shelters that are suitable for local conditions and that maximise the efficiency of a bus transit system. In 2010, IndII began to explore the possibility of using an output-based aid mechanism to improve the quality and accessibility of bus shelters. This led to the creation of the Hibah SAUM.

With assistance from IndII consultants, two cities, Palembang and Surakarta, became the pilot locations for the Hibah SAUM. The program is still in progress, but tangible results are occurring, with 10 bus shelters completed in Surakarta and 43 shelters under construction in Palembang.

To date, the implementation of the Hibah SAUM has produced some success but has also encountered some challenges related to both technical and non-technical constraints. Six lessons that have been learned point to the need to: (1) conceptualise the Hibah program as more than just a modality for distributing funds; (2) thoroughly socialise the program with stakeholders; (3) ensure that all participants clearly understand their duties and responsibilities; (4) standardise the mechanism for approvals and channelling of grant funds; (5) consider the larger operating context when selecting and monitoring grantees; and (6) coordinate, communicate, and support.

With assistance from IndII consultants, Palembang and Surakarta submitted proposals and designs for model bus shelters to be financed through Hibah funds. These two cities then became the pilot locations for the Hibah SAUM.

Box 1: The Five Characteristics of an Ideal Bus Shelter

- The area in and around the bus shelter should be comfortable.
- The bus shelter should be accessible to all kinds of passengers, including those with disabilities.
- The design of the bus shelter should be in harmony with the surrounding environment.
- The bus shelter should serve passengers without disrupting the existing traffic flow.
- The bus shelter should offer information about the bus transport services available.

Early Results

The pilot program is still in progress, but tangible results are now becoming evident. Ten bus shelters have been completed in Surakarta, financed by Rp 1.2 billion in Hibah funds. Verification by a technical team from DGLT has been conducted and funds can now be disbursed. Forty-three bus shelters are being constructed in Palembang at a cost of Rp 4.6 billion, with verification and fund disbursement expected in the final quarter of 2012.

To date, the implementation of the Hibah SAUM has produced some success but has also

encountered some challenges related to both technical and non-technical constraints. From a technical perspective, a significant amount of expertise is needed within the Ministry of Transportation to manage the technical aspects of the Hibah program. In addition, LGs have had difficulty ensuring that the bus shelters constructed comply with planning documents and contracts. Just as importantly, non-technical constraints related to bureaucratic procedures and coordination have influenced the timeliness of program delivery. These non-technical issues were not initially viewed as creating major risks for the program, but became important factors in determining success. Such difficulties are to be expected when operating a new program, and future efforts will be able to improve on the pilot program.

Box 2: How the Hibah SAUM Operates

The Hibah SAUM operates under the parameters established by Ministry of Finance (MoF) Regulations no. 168/2008 and no. 169/2008, which set forth the terms for Hibah grants to Local Governments (LGs) and the mechanisms for distributing funds. The AusAID funded Indonesia Infrastructure Initiative collaborates with the Directorate General of Fiscal Balance within MoF, and Bappenas, to channel Hibah funds to LGs.

The cost of developing the infrastructure is initially covered by the LG's budget. The procurement of goods and contractors is done under the authority of the City Government (*Pemkot*) while the head of the LG is fully responsible for project implementation.

After completion of the grant activity, the relevant technical Ministry verifies that the project has achieved the required results within a certain period of time and that the LG has demonstrated commitment to the future sustainability of the project. The funds are then provided by MoF to the LG.

A number of lessons have been learned as a result of experiences with the pilot Hibah SAUM. Program effectiveness will be enhanced when:

The Hibah program is conceptualised as more than just a modality for distributing funds. It must also be viewed as a capacity building effort for LGs related not only to technical issues, but also to non-technical issues, such as management of funds, coordination among stakeholders, etc. A successful Hibah program should be prepared to assist grant recipients to manage all aspects of the program, from procuring goods and services to overseeing technical aspects of building bus shelters.

The program is thoroughly socialised with stakeholders. It is important for participants to clearly understand their duties and responsibilities. They need to be fully aware of both the technical and non-technical goals of the Hibah.

The readiness and commitment of potential participating cities is carefully assessed. The level of commitment by the head of the LG is crucial. A tangible sign of this commitment is the budget allocation spanning several years. Commitment to long term budget support will ensure sustainability of outcomes after the Hibah program ends. Equally important is the technical readiness of the LG agency that has direct responsibility for the infrastructure.

The mechanism for approvals and channelling of grant funds is standardised. This will streamline the efforts needed to explain and expedite administrative processes.

The larger operating context is considered when selecting and monitoring grantees. For example, during the operation of the pilot Hibah, there was also an activity to train bus operators in Palembang, and another to prepare operational guidelines for a Central Control Room in Surakarta. Although these efforts were not directly related to Hibah implementation, they provided added value and may influence the overall quality of each city's bus transportation systems.

The program adopts the principles of coordination, communication, and support. It is important to explain expectations and offer the assistance needed to ensure that all necessary steps are performed adequately, especially when grantees lack prior experience in the steps they will be expected to undertake, such as issuing technical recommendations.

The above lessons are the result of pilot attempts to apply output-based aid mechanisms to the field of urban transport. However, the same lessons will most likely apply to any type of Hibah program, regardless of the sector. ■

NOTES

1. High platforms contribute to faster and more efficient bus systems in several ways. They eliminate the possibility of unplanned stops along the route, as passengers can enter and exit only at the high-platform shelters. Also, because the bus shelter is level with the bus floor, entry and exit are faster – passengers can take their time moving on and off the platform without making the bus wait for them. High platforms also free up space inside the bus for more passengers, because there is no need for a stairwell.

About the authors:

Maria Renny is a Transport Program Officer for IndII, where she manages IndII projects classified under urban mobility and aviation sectors. This includes designing the activity, initiating the procurement process, monitoring the activity progress, and reporting on its completion. She has expertise in planning for urban areas, urban transport and mobility, and metropolitan planning. Prior to working with IndII, she worked with a national NGO on urban transport issues, mainly in Jakarta and Yogyakarta. She assisted in the socialisation of the TransJakarta Busway and media monitoring to assess public perceptions of the TransJakarta system. In cooperation with UN-Habitat, she was a member of a Steering Committee for the Global Energy Network for Urban Settlements (GENUS), a network that promotes better use of energy in electricity, transport, and waste treatment. She is a graduate of the Faculty of Architecture, Design and Planning at the University of Sydney.

Meilany Fahriantiny is a Grant Program Specialist at IndII focusing on transport. She is responsible for the financial aspects of grant programs, including developing strategies and standardised mechanisms for channelling grant funds and liaising with national and subnational government stakeholders. Prior to working with IndII, she worked with an international development consultancy firm in Melbourne, Australia which focused on capacity development and global leadership for local and international development clients such as Australia New Zealand School of Governance, Australia Pacific Islands Disability Supports, UN Agencies, and AusAID. She obtained her expertise on risk management and finance through her work in various Indonesian financial institutions. She is a graduate of Padjadjaran University with a degree in International Relations.

OUTPUT-BASED AID FOR BETTER WATER SERVICES

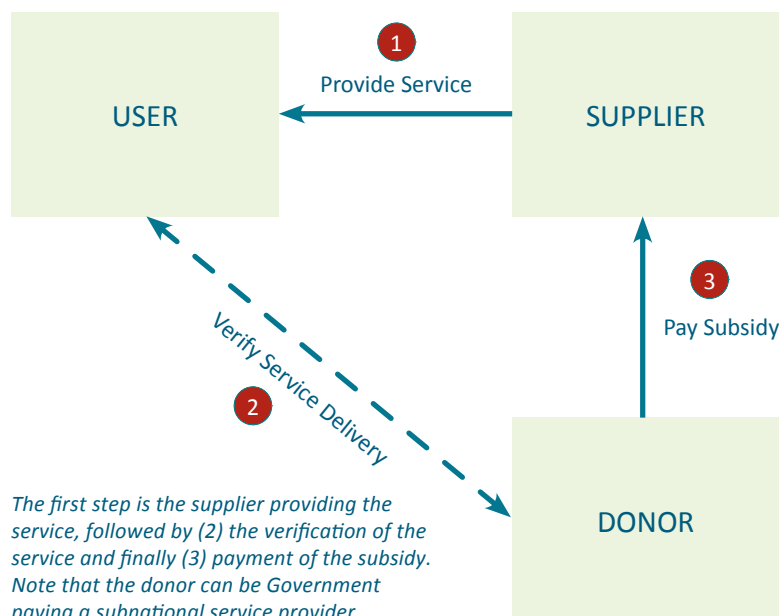
Output-based aid is especially well suited to Indonesia’s water sector. Opportunities exist not merely to increase the number of connections to poor households, but to make lasting improvements to governance in the sector. • By Jim Coucouvinis

The PDAM in Banjarmasin was one of the few that made spectacular improvements to service provision during a period when overall investment in water services was lagging.
Courtesy of IndII



Output-based aid (OBA) is the payment of a subsidy when an agreed output is achieved. Behind this simple concept (shown in Figure 1) lies a powerful modality that can be adapted to achieve more complex development outcomes. There are many ways to design and deliver OBA. Some are more effective than others; some are suited to one sector and not another; and some have multiple objectives, as programs implemented by the AusAID funded Indonesia Infrastructure Initiative (IndII) demonstrate.

Figure 1: The Basis of OBA



OBA is effective at targeting beneficiaries and removing the barriers that prevent people from accessing services. OBA is also an effective method to leverage investment; when the subsidy paid is a fraction of the total cost of providing the output, the institution receiving the aid is motivated to spend its own funds over and above the amount of the subsidy. These advantages are especially apparent when OBA is used to increase access to piped water. In this article, we examine how IndII designed the AusAID funded Water Hibah using OBA, and why we chose the design features that have made the program so successful.

The Hibah program is based on a simple principle: when localities invest in their water and sanitation systems, they are rewarded with funds based on the number of new connections put into operation. The focus is on increasing services to poor households. A fixed grant is given for each new connection, after it is verified that billable services have been supplied for a set period of time.

The Water Hibah is an extremely large project. To put it in context, the Global Partnership on Output-Based Aid (GPOBA) portfolio for OBA in water and sanitation in East Asia and the Pacific is USD 21.5 million, and GPOBA's global spending for all water and sanitation programs stands at USD 169 million.¹ The IndII Water and Sanitation Hibah and Sanitation Infrastructure Enhancement Grant programs in Phase 1 totalled A\$ 31 million, while the planned IndII Phase 2 water and sanitation grant program is A\$ 190 million.²

The Poor Are Good Customers

Households that are not connected to piped water and do not have access to private wells must obtain water from vendors or from public taps. The quality may be unreliable, supplies are limited, and hauling

Key Points

Output-based aid (OBA) is a powerful modality that can be adapted to achieve complex development outcomes. OBA is effective at targeting beneficiaries, removing the barriers that prevent people from accessing services, and leveraging investment. These advantages are especially apparent when OBA is used to increase access to piped water, as in the Water Hibah program operated by the AusAID funded Indonesia Infrastructure Initiative (IndII).

The Hibah program rewards localities for investing in their water systems by paying a fixed grant for each new connection. The focus is on increasing services to poor households. Poor households tend to be good customers for piped water, as purchasing from vendors can cost 20–40 times more. But local water companies (PDAMs) have been reluctant to connect them, partly because these households are generally out of reach of the existing water network, and the PDAM will not extend the network for just a few new customers. The Water Hibah overcomes this problem by rewarding PDAMs for extending the pipe network into poor areas and connecting the majority of households.

When IndII started to design the Water Hibah in 2009, investment in the water sector had been stagnant for 10 years. IndII focused on the obligation of Local Governments (LGs) to fund water supply, which was occurring through central government Ministry budgets and specific purpose grants. The overall effect of funding from these sources was to reduce LG spending of their own resources.

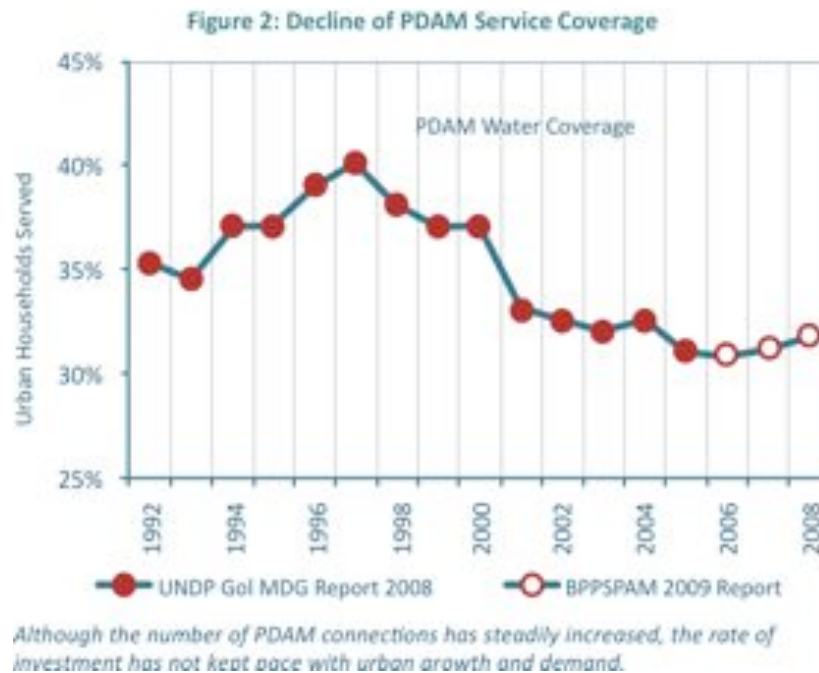
LGs and PDAMs that improved service coverage, such as Palembang, Banjarmasin, Bogor, and Malang, shared a common factor: LG investment of equity in the PDAM rather than through its own Public Works department. This is a political decision that shows trust in the capacity of the PDAM to improve water services – an understanding that underpins the Water Hibah design: The grant goes to LG only after it makes an equal or greater investment in equity to the PDAM.

This design assigns risks and rewards primarily to the LG and PDAM, as well as to the local house of representatives that approves the investment.

The original Water Hibah, implemented over one year, exceeded expectations and leveraged an estimated additional expenditure of \$ 500,000 in each of the 36 participating PDAMs. The program is being scaled up to \$ 90 million in IndII Phase 2. The Phase 2 program is about more than simply increasing water connections; it is about using the Water Hibah to leverage greater governance outcomes. Implementation over multiple years means that weaker PDAMs can gradually participate and that governance requirements can be established for retaining grants.

water is time-consuming (burdens that may disproportionately affect women). Moreover, the cost of buying water from vendors is typically 20–40 times higher than the cost of piped water.

Once they are connected to piped water, poor households can increase their water usage and still save money. For poor households, a piped water connection is one of the most valuable assets they have. It is therefore not surprising that when poor households are connected to piped water they become good customers.



But generally, local water companies (PDAMs) have been reluctant to connect poor households. Anecdotal arguments pointed to the risks of non-payment of bills by poor households. PDAMs also feared that serving poor households would result in overall lower revenue because of the lower tariff charged to low-income households³ and the expected lower volumes of water consumed. The first concern has proved to be unfounded, while the second has a very minor impact on PDAM profitability.

A more compelling explanation of why PDAMs are reluctant to serve poor households is that these households are generally out of reach of the existing water network. A few poor households in these areas may be willing to pay for a connection, but the PDAM will not extend the network for just a few new customers. The Water Hibah overcomes this problem by rewarding PDAMs for extending the pipe network into poor areas and connecting the majority of households.

Underinvestment in Water

When IndII started to design the Water Hibah in 2009, investment in the water sector had been stagnant for 10 years. Figure 2 illustrates graphically the situation for service coverage by PDAMs. While there is more than one explanation for this decline, the evidence points to two main causes: (1) a reduction in availability of investment funds and the means of channelling them to the sector, and (2) lack of commitment by Local Governments (LGs) to fulfil their obligation to invest in the sector. Repercussions of the 1997 financial crisis were primarily responsible for reduced availability of investment, but that phenomenon is beyond the scope of the Water Hibah. Instead, IndII focused on the obligation of LGs to fund water supply.

Output-Based Grants and Sanitation

Sanitation shares some of the problems of development with the water sector but with a number of important differences. First, the sanitation sector is far less developed than the water sector. In fact when we try to define what sanitation services local governments provide we have difficulty in doing so. Second, sanitation benefits go less to individuals but more to the community as a whole through environmental improvements. Finally, paying for sanitation requires a higher level of community awareness about the benefits of sanitation as a whole, a much more difficult task than convincing people to connect to piped water. (For more information on the challenges of applying OBA to the sanitation sector, see “Adapting Output-Based Grants to Sanitation” on page 4 of the July 2011 edition of *Prakarsa*.)

The AusAID funded Indonesia Infra-structure Initiative (IndII) program for sanitation is also output based, but it addresses different objectives. It focuses on the provision of small scale sewerage schemes of about 1,500–2,000 households for each local government. Poverty targeting is not a specific objective of the program although by its design it will be implemented in high density, lower income areas. Equity investment is also not required. What is required is that the works are implemented by local government, and operated by local government through establishment of a sewerage operating unit which is authorised to set tariffs and collect income. Readers may learn more about the program rationale and design by consulting *Australia-Indonesia Infrastructure Grants for Sanitation, sAIG, Project Design Document, December 2011*, available on the IndII website [http://indii.co.id/publications-detail.php?id_news=283].

To support LGs to meet their obligations, the Government of Indonesia (GoI) provides *Dana Alokasi Khusus* (DAK). These are grants earmarked for specific purposes, including water provision. DAK are small relative to needs, and also require only a 10 percent contribution from LGs. In 2010, GoI distributed a total of about \$45 million in DAK funds for water, distributed amongst 470 LGs. This amounts to less than \$100,000 for each LG. By comparison, in 2011 the Water Hibah provided an average of \$750,000 to each of the 36 participating LGs. We estimate that the IndII grants leveraged a further \$500,000 from each PDAM, compared to about \$10,000 leveraged from each LG by the DAK.

Besides the DAK, the Government also provides investment for water supply through Ministry budgets.

This support is nearly 10 times the value of the DAK, totalling \$350 million per year. Unfortunately, the large investment from the central government does not stimulate LG investment, rather it substitutes for LG investment. For every one dollar the GoI spends on water, the LGs reduce their spending by approximately 56 cents.⁴ This top-down approach is doubly detrimental. Not only is LG investment reduced, but investment from central government does not have the same impact as investment from LGs, as discussed below.

LG Investment in Water

Despite the general decline in PDAM service coverage over the last decade, it is striking to note that a number of LGs and their PDAMs confounded this trend and made spectacular improvements in service coverage. Two notable examples are Palembang and Banjarmasin. Other examples are the Bogor and Malang PDAMs. There are others as well, but these stand out as exceptional. The common factor in our view was LG investment of equity in the PDAM. While other LGs were also spending money on water supply, they did so through their local Public Works department (*Dinas*) and not by investing in the PDAM. These two types of expenditure are not equivalent. Broadly speaking, when the LG invests equity in the PDAM, it is saying that it trusts the PDAM to use the funds in the best way for the expansion of the water service.

Investment of equity in the PDAM appears to be the best indicator that the LG has taken the decision to improve water services. It is a decision with political ramifications, because the LG must secure the approval of its local house of representatives (DPRD) to make the investment in the PDAM. Conversely, when LG spends money through the Dinas it is saying that it has not made a commitment with its PDAM to seriously address the sector.

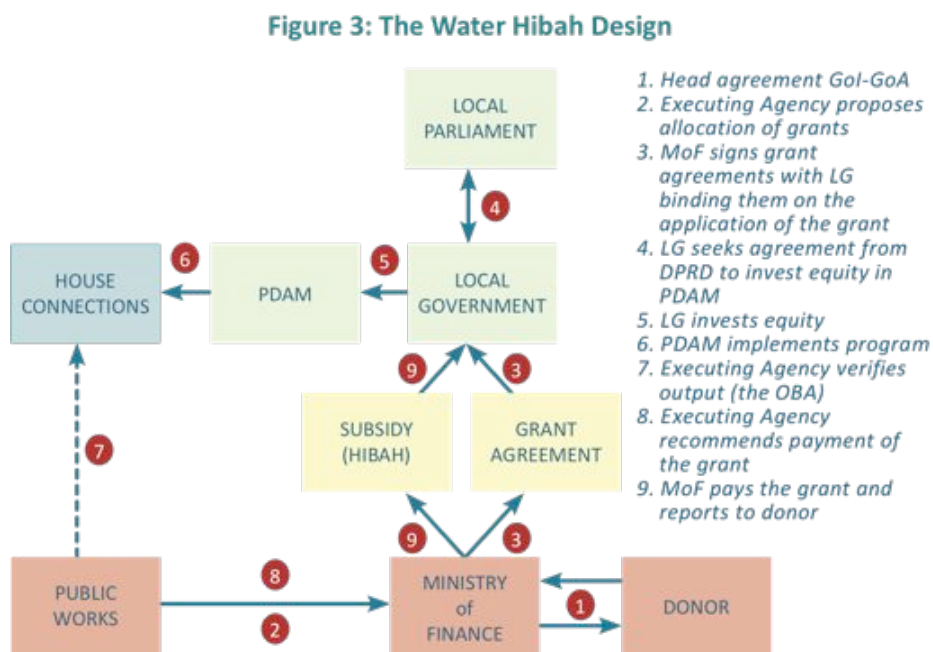
By the same argument, works constructed through Ministry budgets for PDAM services are even further removed from the direct involvement of the PDAM, and by substituting for funds that should come from LG call into question whether the LG is meeting its legal responsibility to finance and provide water services.

Key Design Elements

Armed with this understanding, IndII was able to identify the key elements of the Water Hibah design: The grant goes to LG only after it makes an equal or greater investment in equity to the PDAM. The PDAM in turn uses the equity investment and its own additional funds to implement the expansion of the water network and make the new connections to poor households. How much to charge for each connection was left to individual PDAMs to decide.

This design assigns risk for the project primarily to the LG, which has to make the first investment of funds, and also to the DPRD which approves the investment. The PDAM bears the next level of risk. It has to expand the network and trust that poor households will connect. The donor has the lowest level of risk. The grant pays for a fraction of the cost of the works, and the grant is only paid after the output has been verified. This balancing of the risk amongst the stakeholders – the DPRD, LG, and PDAM – promotes improved governance in the sector. It also assigns rewards: by providing water to poor households, the LG and the DPRD generate tangible benefits for their constituency and they can reap the political returns.

The design of the Water Hibah conforms to the Jakarta Commitment⁵ and relies on GoI agencies for implementation. The AusAID grant funds are part of the GoI budget, and GoI regulations and procedures are used in the implementation. These regulations for on-granting of funds were first used to finance the implementation of the JICA-funded Mass Rapid Transit project for the city of Jakarta. When we



applied the regulations to the Water Hibah, it was the first time these regulations were used in an output-based form. We did this through the on-granting agreement between the Ministry of Finance (MoF) and the LGs. It is now possible to see how the OBA principle has transformed into a robust project design as depicted in Figure 3. Compare this with Figure 1. The principle is the same – but the ability of the OBA mechanism to develop a program that engages with multiple stakeholders and objectives is clearly evident.

Program Performance

The original Water Hibah was meant to be a \$ 10 million grant program implemented over two years. It turned out to be a \$ 20 million program implemented in one year. It demonstrated the effectiveness of using government systems, and the benefits of obtaining “buy-in” from partner agencies. The success of the program has been acknowledged by GoI leaders, who frequently refer to it in presentations. The Government compares it to the existing DAK grants, which delivered 110,000 connections for \$ 45 million at the same time the Water Hibah delivered 77,000 connections for \$ 20 million; these numbers suggest that connections resulting from Water Hibah cost GoI about 37 percent less. Furthermore, the Government likes to add that the connections achieved by the IndII Hibah are verified as working, whereas those from the DAK program are simply LG-reported data which is unverifiable. It is no surprise that the Government is seeking to adapt the OBA features of the Water Hibah design into future DAK programming for water supply.

Where Do We Go From Here?

In its Phase 2 programming from 2011 to 2015, IndII has planned a scaling up of the Water Hibah to \$ 90 million. This includes a \$ 10 million contribution from USAID to implement a Water Hibah program on USAID’s behalf. Altogether this programming will provide water to approximately 300,000 low-income households.

But the next program is not just about scaling up. It is about using the Water Hibah to leverage greater governance outcomes. Unlike the first program which was implemented in one year, this program will be implemented over multiple years, which will allow weaker LGs to invest equity in tranches. LGs that have been awarded the Water Hibah must comply with defined governance targets to retain the grants. These targets include timely reporting of financial audits to MoF, progressive increases in tariffs to reach full cost recovery, and quarterly meetings by the PDAM oversight board accompanied by publicly reported findings.

The Executing Agency, the Directorate General of Human Settlements, is also using the Water Hibah to leverage commercial borrowing through the Perpres 29 program.⁶ Those PDAM that are not participating in the Perpres 29 program will have to secure a higher equity investment from the LG to qualify for the Hibah.

Parallel Developments

The output-based approach is relatively new to development institutions. Apart from a few isolated applications in previous decades, OBA made its institutional debut in 2003 with the formation of GPOBA by the World Bank. Since then, OBA has gathered support amongst the development agencies for its simplicity, lower risk profile, and ease of targeting beneficiaries.

While IndII was developing the Water Hibah, the World Bank implemented an output-based grant for water supply to potential customers of PDAM Surabaya and Jakarta (see “Using Output-Based Aid to Expand Piped Water Supply to Surabaya’s Urban Poor” on page 9 for more about this program). At approximately the same time, the World Bank was also developing the Local Government and Decentralisation project in which the Bank disburses loan proceeds to GoI for achieving specific targets related to implementing DAK grants. That project commenced implementation in 2011 and its first year performance is now being assessed.

The World Bank has further embraced the OBA concept by developing a new lending instrument – Program for Results Lending.⁷ Disbursements using this lending modality are made upon achievement of results and performance indicators, and not inputs.

Lessons Learned

What we learned from implementing the program was both expected and surprising. We expected that giving LGs responsibility for implementation would result in good performance. What we weren’t ready for was the extent of this effectiveness. We ended up implementing twice the size of the original program in half the allocated time. The program also showed that supplying poor households with water provides a significant economic benefit. It demonstrated to the Mayor and Bupati that there are real political benefits, because constituents value the improvements and recognise who had a role in creating them. The program showed the PDAM that poor households can be good customers. Finally, the use of equity as a prerequisite for payment of the grant demonstrated that it is possible to forge alliances among the DPRD, LG, and PDAM – parties that usually don’t agree on common objectives – for the purpose of providing water to poor communities. Meanwhile at the central government level, the channelling of the grant to LGs demonstrated that the Water Hibah is a fiscal transfer mechanism with better governance outcomes and 60 percent more efficient use of funds.

As Water Hibah matures in IndII Phase 2, and as OBA programs become the mechanism of choice for more and more donors, more lessons will be learned and OBA designs can be further refined. OBA promises to be an effective tool for achieving even more ambitious objectives with respect to service delivery and improved governance. ■

NOTES

1. Output-Based Aid – Lessons Learned and Best Practices, GPOBA, 2010 citing 2007 data.
2. The Australian and US dollars are roughly at parity, so these figures can be broadly compared. In the remainder of the article, all dollars are Australian.
3. Indonesia mandates a “lifeline tariff” that is designed to enable a poor family to obtain its basic water needs for 4 percent of the provincial minimum wage.
4. Blane Lewis and Daan Pattinasarany. World Bank, Jakarta. *A new intergovernmental capital grant for Indonesia: a polemic in support of economic growth*. Presented at the International Conference – Alternative Visions for Decentralisation in Indonesia. 12–13 March, 2012. Jakarta.
5. The Jakarta Commitment is an agreement signed by GoI and 22 countries and multilateral donor

agencies. It states that signatories will follow the Paris Declaration on Aid Effectiveness, which is intended to improve the effectiveness of foreign grants and loans. The central tenet of the Commitment is the affirmation of Indonesian ownership of all aid initiatives.

6. Under Presidential Regulation no. 29/2009 (Perpres 29), GoI subsidises bank lending rates by up to 500 basis points and provides guarantees for non-performing loans, making it easier for PDAMs to obtain commercial credit.
7. See *Program for Results Lending, Revised Concept Note WB Operations Policy and Country Services*. 23 February, 2011.

About the author:

Jim Coucouvinis is IndII's Technical Director for Water and Sanitation. Prior to his affiliation with IndII, Jim was an independent consultant working with the World Bank and AusAID on water and wastewater sector programs. Previously, he was Vice President, Louis Berger Group for water and environmental services in SE Asia and the People's Republic of China. Before that he was Resident Manager of Montgomery Watson, Indonesia. In Australia, Jim worked for the Canberra Water and Power Authority on the design and construction of major sewerage works, and with the Australian Murray-Darling Basin Authority on the management of water quality in the Murray-Darling system and reservoirs. Jim holds a Master's of Engineering degree from the University of New South Wales, and Bachelor's degrees in Science and Civil Engineering from the University of Queensland.

A VIEW FROM THE MINISTRY OF FINANCE: THE ROLE OF ON-GRANTING

Output-based aid is possible in Indonesia thanks to the on-granting mechanisms that in the past few years have begun to transform how the Government of Indonesia works with Local Governments and international donors to fund improved services for the nation. Adriansyah, the Director of Financing and Capacity Development at the Directorate General of Fiscal Balance—Ministry of Finance, recently spoke with *Prakarsa* to discuss the role of on-granting, output-based aid, and the potential that these approaches offer.



Adriansyah

Courtesy of Eleonora Bergita

Can you tell us about current on granting programs in Indonesia?

This is something new that began with the issuance of Ministry of Finance (MoF) Regulation (PMK) no. 168/169 in 2008. For years, people have been enthusiastic about the possibility of on-granting, and we are now trying to harness some of that enthusiasm. There are actually many active programs. The first one was the Local Basic Education Capacity program that reached 50 kabupaten and cities throughout Indonesia. The second one was Mass Rapid Transit [MRT]. The bidding process for that has already taken place and it will go ahead next year. We also have a number of programs from Australia – wastewater, the bus improvement project, and so on. The last one is for alternative energy, Seulawah geothermal.

Before Seulawah, there was an irrigation project that reached 115 kabupaten and kota. For a new initiative, 115 is not bad, considering that the on-granting mechanism just became effective in 2009 or 2010. I think what we have achieved in the last two years is really something.

How do you categorise these on-granting programs? Are they considered part of the Anggaran Pendapatan Belanja Negara [APBN, the national government's budget], or as foreign grants, or as foreign loans?

No matter what, the resources have to be considered part of APBN. We have to go through the APBN, that's just the way it is. We used to see a lot of [foreign aid] grants going directly to Local Governments, but this is not how it's supposed to be. The national government has to be responsible. In the international arena, I don't think we use the term "G to LG" [Government to Local Government]. It's always "G to G", right? For accountability reasons, we have to return the responsibility to central government.

So channeling APBN funds to Local Governments is one of the long term objectives of the on-granting mechanism?

I believe it has to be. The regulations say so, but when it comes down to implementation, this is where the problem starts. For example, yesterday I attended a meeting of government organisations. Can you imagine, there was a request by a ministerial agency to do on-granting [outside the APBN]? I firmly said no. I'll give you another example, about education. The central government has given authority to Local Governments to operate school systems, but the responsibility [to ensure a quality education system] still rests with the national government. So, if it is under central government, everything has to be channeled through the APBN mechanism, and at the regional level through the APBD (Anggaran Pendapatan Belanja Daerah, the regional government budget). It is an absolute rule.

What are the steps being taken by the Ministry of Finance to ensure that methods for approval and distributing funds are standardised?

What we need to do is to socialise the mechanism and create a higher level of understanding among government officials. I have high hopes that the MRT, Seulawah, and Water Hibah programs will become references for all stakeholders. So, if anyone asks for an example of how on-granting works, we have the facts and the evidence. We can say to look at Water Hibah, for example. If you are looking for large scale projects, look at MRT. MRT is a Rp 15 billion project. It's not child's play.

We need to sit down and straighten this out. There are many regulations that have existed for a long time, but none are implemented correctly. For example, bringing grants to the region. Grant money doesn't automatically refer to on-granting; there are grants that come purely from APBN [such as the DAU or Dana Alokasi Umum, the unrestricted funds provided by the Government of Indonesia to Local Governments]. But the question is, has anything [similar to what's been done with on-granting mechanisms using donor funds] been implemented [using DAU]? The answer is no.

Prior to the on-granting mechanism, did the Government of Indonesia have a verification process for grants disbursement?

A verification process exists in APBN's structure, but it has never been implemented. It is not a simple task to convince a lot of different stakeholders to do this, for example inside the Ministry of Finance itself there is the Director General of Budgeting, plus you have Bappenas, Ministries and Agencies, all acting as regulators. It is not easy.

How does the on granting mechanism compare to other means of grant implementation, for example with regard to accountability?

What we implement [through on-granting] is supposed to be purely performance-based. We are now applying performance-based budgeting techniques [to the national budget], so this means that using the on-granting mechanism should be our priority. We shouldn't simply disburse funds, as has been done previously. I said to all stakeholders that whatever the mechanisms – grant, non grant, non agreement – we have to be oriented toward performance. This is in line with our budgeting rules. The approach is based on performance – not money, but performance.

Is on-granting included in the fiscal policy apart from PMK 168?

Yes. There are laws and regulations; the PMK is just for operational matters. However, apart from all these regulations, the problem is that each grant [is for a specific jurisdiction]. What's important is not the law and regulations, but the detailed agreement. Different regions can be treated differently, depending on their situations and conditions. This is why I have advocated for the careful selection of regions receiving grants made through on-granting. Let's take for example Serang and Banten. Even though they are part of the same province, and even if they are located right next to each other, they might have different circumstances. Therefore, the difference must be reflected in the PPH [Perjanjian Penerimaan Hibah, the agreement made by the two levels of government between which funds are being transferred]. Government regulations are just a reference; the most important thing is what the agreement says.

So everything depends on the PPH?

Indeed. "Perjanjian Penerimaan Hibah" is the key term. To have a clear agreement [between central and local government] that can specifically identify who is responsible for each task. A clear functional arrangement and clarity on how the funding is disbursed is very crucial to ensure that each program can be implemented by the funding recipient.

One of the advantages of output-based aid (OBA) is that it creates transparency among the Government of Indonesia, the Local Government, and the donor agency. What is your view about this? What are the difficulties in implementing OBA?

Well, that's the way it should be. If someone gives you money to buy a car, you should buy a car. If they give you money for a house, you should get a house. You shouldn't get money for a car and just use it on a bemo, right? The idle money in Local Government accounts is no small amount. It's plenty. The local governments are given authority [to make expenditures] on education, health – this includes clean water, and infrastructure. Now, you see in the regions, heads of regional authorities being driven around in cars that costs billions [of Rupiah], while public health clinics are lacking medicines and schools collapse. This is the result of not implementing output-based aid. We aim for a school, we get a Mitsubishi Pajero.

As we know, billions have been allocated for some programs in the regions, but the result was not clear. But with Rp 200 billion from [the output-based Water Hibah program funded by AusAID], we can see that 77,000 houses have been connected to piped water. Everybody can see the evidence. This is what we hope for. If performance-based approaches are not applied, who knows where the money will go. I know it's hard. I've said so many times that all money transferred (not just through on-granting) from APBN has to be performance-based. It is our imperative; why can't we implement and monitor it?

For Local Governments, what are the advantages of performance-based mechanisms?

The advantage is obvious. I'll give you an example in one region in Kalimantan. I said, when water enters houses, especially houses of the less fortunate, as soon as that water is poured into a bucket, what people see is not a reflection of their faces, but a reflection of the mayor. In some regions, the heads of government authorities are worshiped by the community. Imagine a woman who has never seen clean water in her life, and now she has clean water in her house. This means that whatever the Local Government is trying to do, the community will support them. We don't have to make a campaign out of it. What we have to do is not campaign but to just do it. Don't do the NATO (No Action Talk Only). Water is really important in people's lives. It is a basic need.

We don't have to write it anywhere to say that clean water has been installed. We can see clean water has been installed. But if we decide to put it in writing, this will add to the credibility of the Local Government.

In Kalimantan, I remember saying to the Bupati, first you have to install clean water, borrow some money if you have to. If the effort is successful, you don't even have to campaign for a second term. What for – you would just be wasting money. You can just sleep peacefully in your bed. It's true, when he was up for re-election he didn't campaign but he won 82 percent of the vote. What does this say? The people respond [to services provided through output-based aid]. Technically and politically, it's an advantage. It's performance, not just talk. This is what we need to strive for.

Potentially, the number of output-based grants that will need to be administered is quite high. For example, consider the water and sanitation programming that IndII is administering: we will have 130 Water Hibah projects, 50 sAIG [Australia Indonesia Infrastructure grants for sanitation], and 25 projects with Community Based Organisations. And that doesn't even include the Bus Improvement Project. So, how can output-based aid be implemented if the volume of grants increases? For example, will MoF look at implementation through state banks? Separate organisational bodies? Something else?

For now, the law and regulations say it is the responsibility of MoF. The agreements with donors can't be done by any other institution. But in my view, [the law and regulations are not the only thing we need to think about]. For example, in Australia, the Minister of Finance's role is no more and no less than a treasury, or to put it in simple terms, a cashier. However, who is responsible for substantive matters? It is the technical ministries. If you ask me about water pipes, I would not understand. If you ask me about medical equipment, I also don't know. The responsibilities [between MoF and the technical ministries] need to be made clear.

I said in a meeting recently, government duties are not only the concern of entities that are government-owned, such as national and regional state-owned enterprises. Other parties that carry out government's duties have to be supported. It is a part of decentralisation. For example, hospitals. Do you think all hospitals in Jakarta belong to the government? No. I don't think there are more than 10 hospitals in Jakarta that are state-owned. The rest are owned privately. As for elementary school, education is clearly a government responsibility and the government is obliged to fund it. Now, are all existing elementary schools belonging to government? No. For these non-government elementary schools, can government ignore them? Of course not. This is where intervention is needed. One of the ways is through this grant mechanism for the private sector. Sometimes a school is left in disrepair, it is insufficiently equipped and it is neglected. Those non-government schools are helping to fulfill government duties, but they are left unsupported. This is what we need to change. It's not easy, as I have said so many times. If we can see results within five years, we will be lucky.

With the on-granting mechanism, we can be a bit proud. From 2010 until now, we can see a lot of results, which is why Pak Nugroho and Pak Dedy S. Priatna from Bappenas have strongly encouraged everything to be shifted into this mechanism.

Is MoF looking at applying output-based modality to DAK? If so, how will it be done?

I don't know. The key lies with Bappenas. Once again, do not ask MoF to be involved with the substance. Here we act like a cashier, you give us the bill, we pay. You provide goods, we pay. We don't know how you made those goods. Therefore, we need to sit down and come to a mutual understanding. For example, if we talk about clean water, then the Directorate General of Human Settlements absolutely must be involved. Previously, MoF had to think about irrigation and independent water resources, and it took us years. I say, MoF does not have the capability to talk about water. We have to speak as one government, the whole government. MoF deals with money, the Ministry of Public Works deals with irrigation, the Ministry of Health deals with health issues. It's everybody's responsibility.

We would like to encourage other stakeholders to use OBA. If later on OBA is adopted for DAK, DAU or anything, we will welcome the effort. What we would like to see is the output. Nowadays, it has become a national issue. The House of Representatives has asked: billions of Rupiah have been spent, and what are the results?

A simple example with respect to DAK: the initial objectives are for education, health and infrastructure. Now, you ask the Ministry of Education, what has become of the money allocated for DAK? Officials of the Ministry of Education wouldn't have an answer. But all of the issues connected with education in this country should be their responsibility. How can they say they don't know? It is really not easy [to shift to performance-based approaches], but I hope that gradually this will change. ■

— *This interview was conducted by IndII Communications Officer Annetly Ngabito.*

IN MEMORIAM: DAVID RAMSAY



It is with great sorrow that we announce the loss of David Ramsay, who passed away in Jakarta on 4 September, 2012. David was the Project Manager of the Government of Australia funded Indonesia Transport Safety Assistance Package. He worked tirelessly to promote improvements in the safety of Indonesia's Air Transport Management Systems. David was not only dedicated to improving aviation safety in Indonesia but was also dedicated to Indonesia – in his speech, his actions, and his vision.

He was always willing to extend a helping hand, and will be especially remembered by IndII for his energy and assistance in helping us establish and develop our air transport program and for the way he generously shared his time and expertise for the *Prakarsa* issue on aviation. Perhaps more importantly, he will be remembered in the donor community in Jakarta for his innovative and energetic approach to local partnership and engagement. We will always fondly remember him in his crisply ironed blue Ministry of Transport uniform that he proudly wore. We will also remember the incredible rapport he shared with his colleagues from that ministry.

IndII and many others have lost a charming colleague, a close friend and a mentor. We wish to express to his family and his team our heartfelt condolences. We will miss his humour, his presence and his leadership. —*David Ray, IndII Facility Director*

THE EXPERT VIEW

Question:

Should output-based mechanisms be mainstreamed into Government of Indonesia fiscal policies?

▶ **Ir. Antonius Budiono, MCM**
Director of Program Development
Directorate General of Human Settlement
Ministry of Public Works

The framework for fiscal policies issued by the Government of Indonesia includes implementation of an output-based mechanism, specifically by providing grants to Local Governments (LGs) for the development of water and sanitation infrastructure. Provision of these grants is based on the performance of LGs that have successfully implemented properly functioning infrastructure that can be enjoyed by beneficiaries. The Directorate General of Human Settlement (DGHS) will provide the grant according to the volume and allocation of funds for building infrastructure. Obviously, the output-based mechanism is becoming a very important component of the support for the successful implementation of fiscal policies. Through this mechanism we can ensure both the optimal achievement of objectives and the effectiveness of Government expenditures in funding infrastructure activities. In addition, through this mechanism, DGHS has been capable of developing a larger amount of infrastructure through more efficient funding.

▶ **Ir. Nugroho Tri Utomo, MURP**
Director of Settlement and Housing
Bappenas

In my opinion, there are two keys to the success of the output-based grant mechanism that we implemented through the Water and Sanitation Hibah program. First is the good and revolutionary design. Second is the high quality of the implementation – the manner in which advocacy has been conducted, the way the participants have been selected, and the approach to providing assistance. In my opinion, this mechanism perfectly matches the conditions we face: when decentralisation becomes stronger, an output-based mechanism is a positive response.

In other programs, we provide funding, but we have no direct control over the output. There is no direct link between what is given out and the results seen. If the results are poor, not as much money will be given in the following year. But there are no direct consequences in the same year. Since we know that LGs budget yearly, we should explicitly link performance in one year to payments in the same year.

One constraint of output-based aid is the capability of the Local Governments (LGs) to self-fund activities in advance of grant payments. Some LGs are not strong enough financially to do this. On the other hand, relevant ministries such as DGHS in the Ministry of Public Works have experience in implementing output-based aid, and I observe a great deal of support for internalising the performance-based approach in our regular funding.

▶ **Dr. Ir. Djoko Sasono M.Sc.**

Director of Urban Transportation System Development, Ministry of Transportation

Law no. 17/2003 on State Finances, and Government Regulation no. 21/2004 on Preparing a Work Plan and a Budget for the Ministries and Institutions, provide an output based mechanism for the Indonesian budget system, known as Performance-Based Budgeting (PBB). In this case, performance not only reflects *output* (measurable goods or services resulting from activities implemented to support the successful achievement of program and policy goals and objectives), but also encompasses the *outcome* (everything that reflects the functioning of the program output).

According to PBB, a budget is prepared which pays attention to the relationship between funding and the expected output and outcome, including efficiency in achieving the output and outcome. Therefore, performance indicators, standard expenses, and performance evaluation are necessary for each program and type of activity.

A Performance-Based Budget is designed to obtain maximum benefit from limited resources (*input*), and establishes the following expectations:

1. Improvements in the effectiveness of budget allocations through program/activity designs that are directed toward the successful achievement of determined output and outcome
2. Improvements in cost efficiency through determining the cost of each unit of output
3. Improvements in credibility and accountability.

When budgeting activities that are funded by third party assistance, a policy should also be established requiring that the said assistance must be performance-based, identifying not only outputs but also outcomes. Hence, the objectives and conditions expected in the performance based budget may be realised not only for activities that are funded by the State Budget, but also for activities that are funded through overseas assistance/grants.

Outcomes:

ACCESS TO CREDIT HELPS COMMUNITY ORGANISATION PROVIDE WATER SERVICES



In areas that are beyond the reach of water companies, Community Based Organisations (CBOs) can assume responsibility for managing piped water provision. But to successfully operate a piped water system, they often need help to access capital and financing, as well as to build their understanding of management, engineering, operations, and maintenance. During its first phase of operations, the AusAID funded Indonesia Infrastructure Initiative (IndII) operated a pilot program to help 25 CBOs address these needs. The program was coordinated with Bappenas and DGHS and conducted together with the World Bank's Water and Sanitation Program (WSP). CBO Sumber Maron in Malang Regency made especially good use of IndII's technical assistance. The high cost of electricity was a major burden for this CBO. With assistance from IndII, they drew up a plan to generate alternative power by financing and building a 35-kilowatt-capacity micro hydro power generator. The Rp 408-million system was 70 percent funded by a loan provided through a syndication of two local private banks (BPR Sadhya Muktiparama and Pujon Jayamakmur, Malang), 10 percent through an equity grant from IndII, and 20 percent through self-financing. If the CBO reaches targeted performance criteria, IndII will provide an additional grant valued at 50 percent of the bank loan. The micro hydro power generator is now functioning well, and has reduced the CBO's electricity costs by approximately 90 percent. (To read more about this and other positive outcomes from IndII activities, see Success Stories on the IndII website at http://www.indii.co.id/publications.php?id_cat=58).

IN OUR NEXT ISSUE:

INFRASTRUCTURE GOVERNANCE

Good governance and accountability are essential when public sector institutions expend and manage funds. Nowhere is this more true than in the infrastructure sector, where the scale and impact of projects tends to be particularly large. With assistance from the AusAID funded Indonesia Infrastructure Initiative, Indonesia's Ministry of Public Works (MPW) is implementing a Reform Agenda designed to improve the governance environment. This Reform Agenda is preparing the Inspectorate General of the MPW to maximise the value of their services by strengthening staff capabilities, introducing Results-Based Internal Auditing methodologies, and improving internal controls. Three pillars for governance reform – institutional strengthening, better procurement practices, and an enhanced anti-corruption environment – support these efforts. The January 2013 edition of *Prakarsa* will explore these reform activities in detail, looking at the progress that has been made as well as challenges that remain and how those challenges can be met.