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PRIVATE SECTOR PARTICIPATION IN URBAN WATER SUPPLIES

ISSUES FOR INVESTMENT IN INDONESIA

Working Paper B

A REVIEW OF INDONESIAN LAWS AND REGULATIONS CONCERNING PRIVATE SECTOR PARTICIPATION IN URBAN WATER SERVICES

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Prepared for the USAID Mission to Indonesia
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PREFACE

PRIVATE SECTOR PARTICIPATION IN URBAN WATER SUPPLIES: ISSUES FOR INVESTMENT IN INDONESIA

The purpose of this study is to assess the prospects for increasing private sector participation in the Indonesian urban water supply sector. The analysis has concentrated on capital investments and particularly on the "build, operate and transfer" (BOT) model. Issues arising in three policy areas were addressed—financial, legal, and public policy and administration

The report is organized into three volumes. Volume I provides a summary of findings, implications, and recommended next steps; Volume II sets forth proposed administrative guidelines for water authorities in dealing with a private investor; and Volume III comprises a series of Working Papers (A through F) which deal with specific policy areas that need to be addressed if the Government of Indonesia is to successfully involve the private sector

The study was funded by USAID/Jakarta and conducted by the Water and Sanitation for Health (WASH) Project. Field work and preparation of the reports were undertaken in Indonesia from October 1 to December 15, 1990. Consultants involved in the preparation of the report (and their respective specialties) include the following: S. Watt (team leader and engineering). Jane Walker (project manager and finance), S. Biddle (public policy), G Letterman (legal). Lisa Kulp (finance), Tantri Marbun (finance), B. Nainggolan (finance), R Thabrani (legal), D. Soetjipto (legal), R. Roesli (public administration), Harayatiningsih (public policy), and M Maulana (engineering).

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Working Paper B

A REVIEW OF INDONESIAN LAWS AND REGULATIONS CONCERNING PRIVATE SECTOR PARTICIPATION IN URBAN WATER SERVICES

EXECUTIVE SUMMARY

The purpose of this paper is to provide the Government of Indonesia with a comprehensive statement of assumptions and conclusions regarding the laws and regulations of Indonesia which would make the legal and regulatory structure better serve the needs and objectives of the Government regarding water supply activities. The paper includes (a) background information regarding the laws and regulations of Indonesia which are relevant to private sector participation in water supply activities and (b) an analysis of deficiencies in, and recommendations regarding changes to, the legal and regulatory structure. The paper provides information for prospective private sector participants in Indonesia's water supply activities to understand the investment and contracting opportunities permitted and welcomed by the Government as well as the possible legal pitfalls which may be encountered.

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

The paper deals generally with the laws and regulations applicable to private sector commercial activities in Indonesia, e.g., the Commercial Code and the Government of Indonesia's treatment of "facilitated" "domestic" investments. There is also a brief treatment of other laws and regulations that may be of interest to private sector investors, e.g., taxes, customs tariffs, immigration, land ownership and use, and health and environmental matters. More specifically, however, the paper examines the regulation of foreign investments in Indonesia by BKPM and Law No. 1 of 1967.

Private sector participation in other Government and governmentally-promoted activities is examined. In particular, private sector participation in petroleum-related activities is considered in light of the analogous treatment accorded private sector participation in the area of water supply under some Indonesian regulations, i.e., the use of concession A conclusion is drawn that the analogy between petroleum and water supply activities as they relate to private sector participation is flawed because the financial parameters which define

private sector activities in these two fields are so different. The issue of whether the "private sector" should be defined to include governmentally-owned or -related parties is briefly considered. Further, legal authorization for private sector participation in public utilities under Indonesian laws and regulations is identified, including references to any which would seem to exclude or limit that participation.

Consideration is given to the award of service contracts—especially those awarded to the private sector by water utilities. The regulations authorizing the award of such service contracts are examined in detail. The contents of those regulations, including a recitation of critically important elements which they do *not* contain, is given. Particular emphasis is also given to the authorizations for, and restrictions on, the participation of the private sector and PDAMs in joint ventures provided by Law No. 5 of 1962 and No. 1 of 1967 and Regulation of the Minister of Home Affairs No. 3 of 1986 and No. 4 of 1990. Also considered are the means by which water tariffs are approved, with an examination of the specific language of the relevant regulations. Some attention is given to BOTs, but this treatment is cursory since no laws or regulations (except those issued by Pertamina) concerning or authorizing BOTs were found. The study also notes a number of variations which may be made—or which have been made in Indonesia—on the basic BOT format.

The conclusions are based upon two fundamental assumptions. The first is that existing laws and regulations must be adequate to inform prospective private sector participants of investment and contracting opportunities available in Indonesia. The second is that consumers of water and essential public policies of Indonesia must be protected through the regulation of activities if the private sector is to be permitted to participate in the water supply field. The paper concludes that current laws and regulations lack clarity and precision. This is of critical importance in attracting the private sector because a lack of clarity increases the perception of risk. It also concludes that those laws and regulations are inconsistently applied and that rights granted to private parties under them are largely unenforceable through the courts or elsewhere. The result is a perception of unpredictability by the private sector which diminishes its interest in participation in the water supply field. Inadequate measures exist to assure that the private sector is subject to the rigors of competition or to protect the interests of consumers and Government were the private sector to participate in water supply services. Particularly critical deficiencies in current laws and regulations are the conflicts among them which may prohibit or restrict private sector participation in ways which the Government does not intend. Also of importance is the absence of any law or regulation which would authorize or regulate BOTs in the water supply sector and the existence of water tariff rate-making procedures which do not adequately assure the private sector of a reasonable return on investment through the application of fair and detailed standards by independent rate-making bodies.

The paper suggests that Indonesian laws and regulations be made clearer and more precise and detailed. It also recommends that these laws and regulations be consistently applied and that the private sector be assured of its ability to enforce its rights provided under those laws

and regulations. More specifically, it is recommended that the current apparent conflicts among the laws and regulations regarding the ability of the private sector to participate in the water supply field be clarified by new laws and regulations and by authoritative legal interpretations which will eliminate these conflicts. BOTs in the water supply field should be explicitly authorized and regulated. New or amended regulations should be issued that will clarify under what circumstances private sector participation is welcome and unwelcome in the water supply field and that will provide detailed terms for award of service contracts, entering into joint ventures, and administration of water tariffs.

Finally the paper provides a list and short description of all relevant Indonesian laws and regulations, proposed drafts of new laws and regulations, and the full texts of selected relevant laws and regulations.

WORKING PAPER B

A REVIEW OF INDONESIAN LAWS AND REGULATIONS CONCERNING PRIVATE SECTOR PARTICIPATION IN URBAN WATER SERVICES

1. GENERAL BACKGROUND TO THE INDONESIAN LEGAL SYSTEM

The history; the cultural and religious diversity; the governmental organization; and the great size and insular dispersion of Indonesia have all contributed to a very complex legal structure in Indonesia. In some respects, Indonesia has several distinctly different legal systems whose jurisdictions are restricted largely to nonoverlapping sectors. In other respects, several legal and regulatory provisions and schemes will apply to a single sector. These may sometimes be inconsistent or even contradictory. Finally, Indonesia's legal system is in many ways incomplete, and in a current state of formulation and revision.

Within the last half century, Indonesia has been governed under four very different forms of government. The first was the colonial administration of the Dutch East Indies under the control of the Government of the Netherlands. The second was the Japanese military occupation. The third was the "Old Order" rule of President Sukarno who pursued nationalistic and socialistic goals under national policy and law. The fourth was (and is) the current "New Order" government which is pragmatic and generally more receptive to the participation of private and/or foreign capital in the Indonesian economy. Each of these governments issued and implemented laws and regulations. Most of the old laws and regulations have not been rescinded (although new laws and regulations may state that any contrary prior laws and regulations are revoked). All unrevoked earlier laws and regulations continue to be valid. They were issued in support of philosophically disparate policies.

Although there is a national legal system for Indonesia, different ethnic and religious groups are subject to their traditional (*adat*) legal systems which are applicable to most aspects of personal law and—to varying degrees—to the laws of land ownership and custom.

Indonesia is a unitary state. Power is centralized in the national government. The Basic Law of 1945 is the constitution of Indonesia and is the paramount law of the land. The President has the dominant role in practice in establishing and implementing national policies and laws. He may—and often does—achieve this through the issuance of presidential proclamations [*Keputusan Presiden* ("Keppres")], and instructions.

Within the President's Cabinet, individual ministries have been assigned responsibility for prescribed sectors of national interest. Each ministry may itself issue decrees and regulations with regards to its assigned sector, but the application of such decrees and regulations often

infringes on sectors assigned to other ministries. Other governmental agencies and coordinating boards which are not under any ministerial control also issue decisions and policy statements. Ministries may issue regulations in the form of decrees, called *Peraturan Menteri* ("Permen"), and ministerial decisions called *Keputusan Menteri* ("Kepmen"). They may jointly issue decrees called *Surat Keputusan Bersama Menteri*. A decision of the Chairman of the Investment Coordinating Board is called a *Surat Keputusan Ketua BKPM*. Ministries and agencies may also issue circular letters (*Surat Edaran Menteri*), instruction letters (*Instruksi Menteri*), and other guidelines and policy statements.

There is a national legislature which enacts national laws. The national legislature is the *Dewan Perwakilan Rakyat* [People's Representative Council ("DPR")], some of whose members are elected but the majority of whom are appointed. It normally only considers bills submitted to it by the National Government and drafted by the ministries. When enacted by the DPR, bills become laws after being signed by the President, after which they are published in the State Gazette (Lembaran Negara). These are the only formal Indonesian statutes (except for preexisting Dutch East Indies laws with continuing validity).

Below, and theoretically completely subservient to, the national government are provincial and local governments. These regional governments, through their executives and legislatures also issue rules and regulation. The National Government has also promulgated measures for the official decentralization of some power to lower levels of government.

Within the 27 provinces including three special provinces of Jakarta, Aceh and Yogyakarta (referred to as "level one" or *tingkat satu* governments), the chief executive is called a governor (*gubernur*). A governor may issue a decree, called a *Surat Keputusan Gubernur* ("SK Gubernur"). A governor may also issue instructions to a *walikota* or *bupati* (local government executives) and his subordinate *kepala dinas* through a decree called an *Instruksi Gubernur*. In each province, there is a provincial legislature [*Dewan Perwakilan Rakyat Daerah Tingkat I* ("DPRD TK. I")] made up of elected and appointed members. A DPRD enactment—called a *Peraturan Daerah* ("PERDA")—is drafted and submitted by the governor to the DPRD TK. I and is subject in its final form to central government Minister of Home Affairs legalization. When this is accomplished, it becomes part of the law (although it is referred to as a "regulation") of the province. In each province and special province there are organizations—called *dinas*. There are also *Kantor Wilayah* ("KANWIL") which are the provincial offices of some central government's ministries. Their heads report both to the provincial governor and to the appropriate central government minister through its relevant director general.

Within the provinces, local ("level two" or *tingkat dua*) government is exercised in each urban and rural area by a mayor (*walikota*) of the city (*kotamadya*) or (in less urbanized and in rural areas) by the regent (*bupati*) of the regency area (*kabupaten*). At this level, there are also legislatures [*Dewan Perwakilan Rakyat Daerah Tingkat II* ("DPRD TK. II")] made up of appointed and elected members. In each level two government there are *dinas* who act as

technical agencies to the *walikota* or *bupati* and some local offices of national ministries [*Kantor Departemen* ("KANDEP")] which report both to the local government executive and the KANWIL of the relevant ministry. Although they will play little or no role in private sector participation in Indonesian water supply activities, there are lower government units within level two which are called *kecamatan* (whose executive is a *camat*), and generally speaking the lowest level is the *kelurahan* (whose executive in an urban area is a *lurah* and in a rural area is a *kepala desa*).

The implementation and enforcement of these laws, regulations, and rules may also be undertaken at various levels of government by their executives, or agencies.

Indonesia's judicial system is composed, from lowest to highest levels, of Courts of First Instance (*Pengadilan Negeri*) which are located in judicial urban and rural regencies areas within provinces and special provinces, Courts of Appeal (*Pengadilan Tinggi*) which are located in the capital city of each province and special province, and a Court of Cassation or Supreme Court (*Mahkamah Agung*) located in Jakarta. In criminal cases only, further appeals may be made to the President for pardons or reduced sentences. A law to create Courts of Administrative Law (*Pengadilan Tata Usaha Negara*), which will for the first time provide a forum through which private parties have legal recourse against the Government of Indonesia and its agencies, was enacted under Law No. 5 of 1986 and will be effective in 1991.

The laws of Indonesia are now becoming more regularized. An effort has been made to coordinate or harmonize these laws and regulations through the *Badan Pembinaan Hukum Nasional* ("BPHN"), but this process is far from complete and progress has been slow. The Indonesian Government is formulating a broad range of new laws and regulations to cover existing gaps in the laws. The Commercial Code of the Dutch East Indies is now in the process of being modernized and adapted to meet current Indonesian needs and conditions. Within the past decade, great efforts have been made to collect, collate, and index the existing body of Indonesian law and to make that information available to lawyers, judges, and the public. This task has been the special focus of attention of the legal documentation center of the Law Faculty of the University of Indonesia. There are two of its offices in Jakarta which maintain current laws and regulations indexed by subject and relatively current indexed collections of laws and regulations issued by or pertaining to specific central government departments or agencies. New laws and government regulations must be issued in the official State Gazette (*Lembaran Negara*). New laws and regulations are also regularly published by specialized commercial papers which may also publish English-language translations of them. Copies of back issues of these papers are obtainable from their offices for a price that increases with the age of the back issue.

A matrix of the hierarchy of Indonesian laws, regulations, and rules, with the prevailing authority in case of conflicts being that which is found highest and furthest to the left on the matrix, is presented in Figure 1.

Figure 1

Hierarchy of Sources of Indonesian Laws and Regulations

	NATIONAL	PROVINCIAL (LEVEL 1)	LOCAL (LEVEL 2)
CONSTITUTION	Basic Law of 1945		
STATUTES	1. Dutch colonial laws 2. Laws drafted by ministries, submitted by the President, and enacted by the DPR	PERDA TK. I (Classed as regulations) Drafted by dinas, submitted by a governor and enacted by a DPRD TK. I	PERDA TK. II (Classed as regulations) Drafted by a dinas, submitted by a walikota / bupati and enacted by a DPRD TK. II
GOVERNMENT REGULATIONS AND EXECUTIVE ORDERS	1. Government Regulations 2. Keppres (Decree) 3. Inpres (Instructions)	1. Governor's Regulations 2. Governor's Decrees 3. Governor's Instructions	1. Regulations of a walikota or a bupati 2. Decree of a walikota or or a bupati 3. Instructions of a walikota or a bupati
MINISTERIAL DECREES AND REGULATIONS	1. Joint Ministerial Decree 2. Permen (Regulations) 3. Kepmen (Decision) 4. Guidelines and Policy Statement 5. Circular Letter 6. Instruction Letter		

Note :
Sources are of increasing authority the higher and further to the left that they appear on the chart.

2. THE LEGAL ISSUES CONCERNING BPAMS, PDAMS, AND PDABS

The organization of, and delegation of authority within, the Indonesian Government with regards to water utilities involves many tiers of law- and regulation-making and enforcing bodies.

The principal ministries involved in water utility matters are the Ministry of Public Works [*Departemen Pekerjaan Umum* ("PU")] and the Ministry of Home Affairs [*Departemen Dalam Negeri* ("DEPDAGRI")]. Under PU is the Directorate General of Human Settlement (*Direktorat Jenderal Cipta Karya*), which is over the Directorate for Clean Water [*Direktorat Air Bersih* ("DAB")]. Also under PU but concerned only with irrigation and similar water and water resources issues rather than with BPAMs and drinking water is the Directorate General of Water Resources [*Direktorat Jenderal Pangairan* ("DITJENAIR")]. Under DEPDAGRI is the Directorate General of Regional Development Affairs [*Direktorat Jenderal Pembangunan Daerah* ("BANGDA")] and the Directorate General of General Governmental Affairs and Regional Autonomy [*Direktorat Jenderal Pemerintahan Umum dan Otonomi Daerah* ("PUOD")]—which is in turn over the Directorate for the Development of Regional Enterprises (*Direktorat Bina Perusahaan Daerah*).

Other ministries and agencies which have partial or occasional involvement in water utilities issues or regarding foreign loans to water utilities in Indonesia are the Ministry of Finance [*Departemen Keuangan* ("DEPKEU")] and its Directorate Generals of Budget (*Direktorat Jenderal Anggaran*) and Monetary Fund (*Direktorat Jenderal Moneter*); the Ministry of Health [*Departemen Kesehatan* ("DEPKES")]; the Ministry of Industry [*Departemen Perindustrian* ("DEPERIN")]; the Ministry of Mining and Energy (*Departemen Pertambangan dan Energi*) which is responsible for authorizing the use of groundwater resources; the State Secretariat [*Sekretariat Negara* ("SEKNEG")]; the State Minister for Environmental and Population Affairs [*Menteri Negara Kependudukan dan Lingkungan Hidup* ("KLH")]; the Investment Coordinating Board [*Badan Koordinasi Penanaman Modal* ("BKPM")]; the National Planning and Development Board [*Badan Perencanaan Pembangunan Nasional* ("BAPPENAS")] which is over the Coordination Team for Urban Development [*Tim Koordinasi Pembangunan Perkotaan* ("TKPP")]; and the Indonesian Central Bank (*Bank Indonesia*).

Under Indonesian regulations and practice, municipal water utilities are initially constructed by PU. Each is planned, built, and operated by PU as a *Badan Pengelola Air Minum* ("BPAM"). A BPAM is not a legal entity but is an embryonic project under the national development budget. A BPAM is subject to the administrative overview of a provincial level office of DAB, called *Proyek Peningkatan Sarana Air Bersih* ("PPSAB"). Once a municipal water utility is built, has proven in practice to be running according to design, and is running at "break-even," it is transferred by PU to a level two government. The BPAM's assets will be transferred to an entity in the form of *Perusahaan Daerah Air Minum* ("PDAM")

following DPRD TK. II legal action and approval of the provincial governor (although somewhat different procedures apply where the PDAM is at level one). A PDAM is subject to the administrative overview of its board of directors (whose members are selected by the *walikota* or *bupati* for their technical expertise). Its board of supervisors (*Dewan Pengawas*) which is made up of the *walikota* or *bupati* and appropriate designated level two *dinas* offices, and a provincial *Proyek Monitoring and Development Unit* ("PMDU") which advises the provincial governor and provides technical advice and assistance to the PDAMs at *kotamadya* and *kabupaten* level two. In East Java a new type of level one organization was formed in 1987. It is called a *Perusahaan Daerah Air Bersih* ("PDAB"). Its purpose is to develop multi-use water sources and to resell water from those sources to a number of local PDAMs who, in turn, make distribution to ultimate consumers. The PDAB seems likely to be a form of enterprise which will be adopted for use in other provinces in the near future.

PDAMs, PDABs, and BPAMs are the operational entities used by the Government of Indonesia for water supply services. They are created by the provincial/local government (or the central government for BPAMs) and operate under the guidelines and constraints of the central government. They (excluding BPAMs) are classified as "regional enterprises" (*Perusahaan Daerah*). This category also includes, *inter alia,* agricultural markets, hotels, transportation, banking municipal parking lots, slaughtering houses, etc.

PMDUs have operated under the authority of a joint ministerial decree since 1986. There are now 21 PMDUs scattered throughout Indonesia. The principal objectives of PMDUs are to: (a) assist the management and boards of directors of PDAMs to achieve objectives set for them by national and regional authorities and (b) monitor progress in the Indonesian water supply sector in order to permit the central and provincial governments to determine and implement effective policies for future development and operations. PPSABs may sometimes in practice also advise and assist PDAMs and thereby compete with or duplicate the efforts of PMDUs.

About 140 Indonesian urban water supply programs are operated as BPAMs. Another 151 of them are operated as PDAMs PDAMs are meant to be operated as independent and financially viable companies. Nonetheless, their operations and tariff rate structures are prescribed in general terms by national law and policy and their specific tariff rate schedules are approved by politically-appointed boards and officials. Those tariff rates make inadequate provision for, replacement and future development costs. From its revenues, a PDAM is normally required by law to distribute 55% of its after tax revenues to the level two local or level one provincial government in which the PDAM is located. The Minister of Home Affairs in 1975 left to the discretion of the level one and two executives the decision as to whether to release PDAMs from their obligation to make contributions of 55% of their net earnings to local\provincial governments when such funds are required to be used for later PDAM investments, developments, maintenance, and operations. The legal right of PDAMs to contract for services and otherwise cooperate with third parties has been significantly

augmented in recent years, although the nature and extent of this legal authority remains unclear.

Significant efforts have been made to decentralize water supply and other public sector functions in Indonesia. Decentralization has in practical terms, however, been only incompletely achieved. The relationship between the central government and provincial and local governments is most commonly characterized by centralized regulatory control, institutionally weak local and provincial governments, and intensive involvement by the central government in the implementation of central government water policies through provincial and local governments and institutions. Implementation of urban development through the Integrated Urban Infrastructure Development Program ("IUIDP") is a central government effort to coordinate the programs of a number of central government ministries into a single development program that is responsible to local governments. The IUIDP attempts to prepare the local governments to assume their newly assigned roles in urban development. It also integrates funding sources in order to provide greater latitude in project selection by local governments.

An important issue in this effort to decentralize water supply authority and accountability is the question of the continuing availability to PDAMs of central government funding and financial support. The central government have encouraged PDAMs to become more responsible for their own financing. As PDAMs do so, they will need to adjust their operations and possibly tariff schedules. As this is a new policy, PDAMs appear to continue to rely on central government funding and financial support. This may have ramifications for PDAMs' enthusiasm for private sector participation.

A diagram of the organization and government agencies regulating BPAMs, PDAMs, and PDABs is presented in Figure 2.

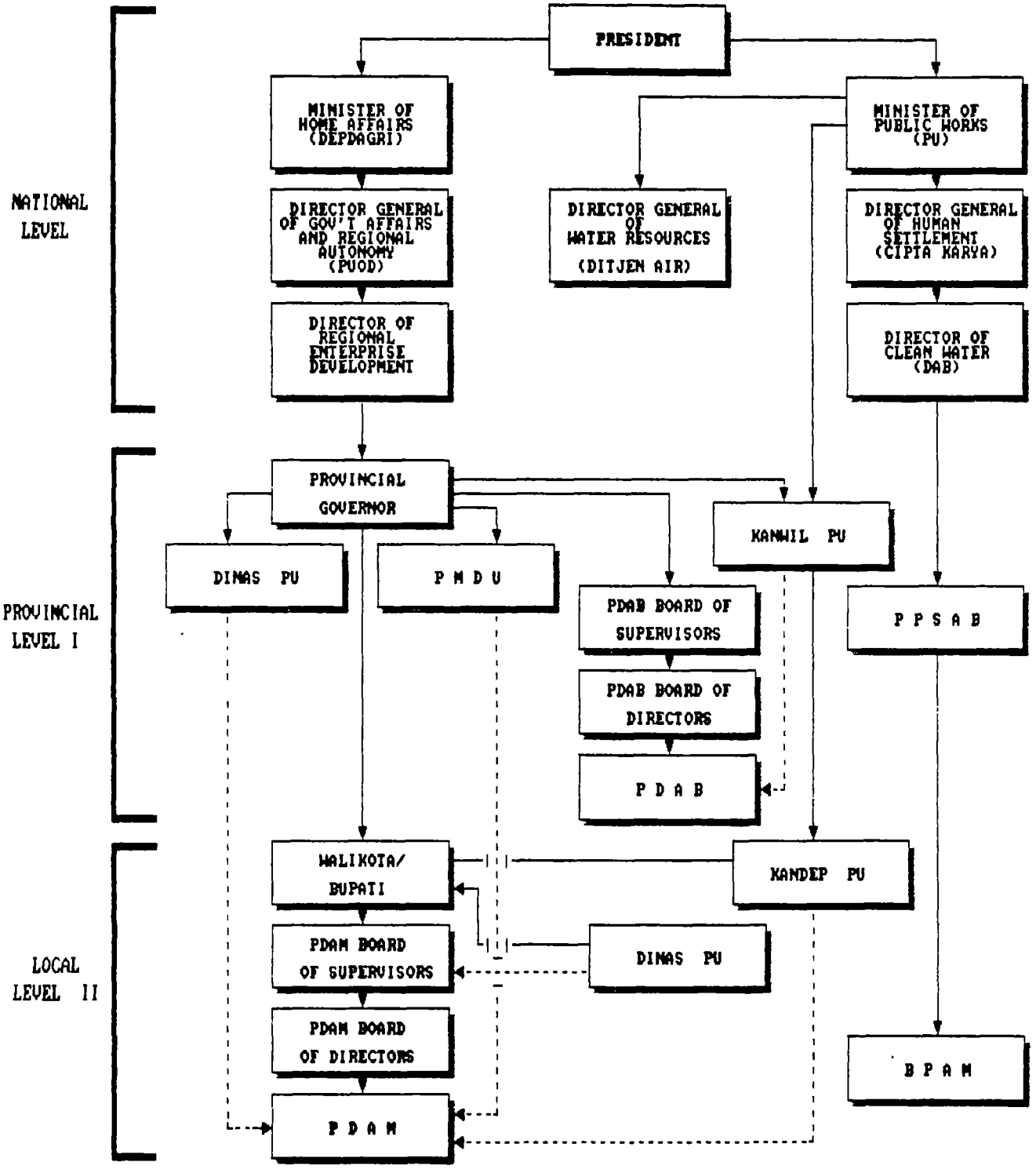
The principal laws and regulations relevant to BPAMs, PDABs, and PDAMs are:

(a) The Basic Law of 1945 (the Indonesian Constitution), particularly Article 33 which provides that "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, *water* and other ground resources have to be managed/utilized by the government for the maximum benefit of the people."

(b) Law No. 5 of 1962 which is concerned with the establishment of government enterprises at provincial/local levels of government It serves as the fundamental legal basis for the establishment of PDAMs and PDABs. The current status of this Law is ambiguous. It was revoked by Law No. 6 of 1969, but revocation was made contingent

Figure 2

Organizational Structure for the Regulation of, and the Provision of Assistance to, BPAMs, PDAMs, and PDABs by the Government of Indonesia



upon the enactment of a new law to replace Law No. 5 of 1962. No such superseding law was ever enacted.

(c) Law No. 11 of 1974 regarding water resources and which has a wide applicability to other public water utility issues.

(d) Government Regulation No. 22 of 1982 regarding water management as it concerns sourcing of water supplies from streams and groundwater.

(e) Presidential Decree No. 21 of 1989 concerning the exhaustive list of 75 economic sectors that are closed for designated forms of new foreign and domestic private investment. "Water supply" or "drinking water" are not listed as closed sectors. This may supersede Article 6 of Law No. 1 of 1967 which designates nine economic sectors—including "drinking water"—as being closed to foreign investment because they are of strategic national importance for which the Government of Indonesia will retain exclusive authority. However (see Figure 1 and later discussion in Sections 8 and 11 of this Paper), a presidential decree may not properly supersede a law because of the relative levels of their legal authority. This Decree supersedes Presidential Decree No. 15 of 1987 which, in turn, superseded Presidential Decree No. 22 of 1986 which both established nonexhaustive lists of economic sectors open to new foreign and domestic private investment and which listed "drinking water" as an open sector.

(f) Joint Ministerial Decree of the Ministers of Home Affairs, Public Works, and Finance Nos. 160 of 1978, 281 of 1978, and 360/KMK.011 of 1978 regarding the execution and development of clean water construction projects with central government aid.

(g) Joint Ministerial Decrees of the Ministers of Home Affairs and Public Works Nos. 3 of 1984 and 26 of 1984 and 4 of 1984 and 27 of 1984 regarding the establishment of local drinking water enterprises and the development of PDAMs. These Decrees assigned the Ministry of Public Works responsibility for initial water supply planning and development and assigned the Ministry of Home Affairs the principal responsibility for developing the nontechnical aspects of water enterprises. Joint responsibility was assigned to the Ministries of Home Affairs and Public Works for formulating guidelines for the organizational structure of PDAMs.

(h) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 5 of 1984 and 28 of 1984 concerning guidance about the calculation of drinking water tariffs and regarding the organization, accounting systems, structure, and cost calculations of water utilities.

(i) Decree of the Minister of Finance No. 540/KMK.011 of 1979 regarding the management of central government funds for the financing of PDAM projects.

(j) Decree of the Minister of Public Works No. 269/KPTS of 1984 regarding BPAMs which provides for a shorter period before they are changed to PDAM status.

(k) Regulation of the Minister of Mining and Energy No. 03/P/M/ Pertamben of 1983 requiring licensing of all private use of ground and spring water and of water drilling by the provincial governor acting upon the binding advice of the Directorate General of Geology within the Ministry of Mining and Energy.

(l) Regulation of the Minister of Home Affairs No. 690-536 of 1988 dealing with guidelines for the pricing of water to consumers by a PDAM. This provides that water prices charged to consumers must be decided by the head of the local government and be subject to gubernatorial approval following a proposal from the management of the water company and the favorable considered judgement of its supervisory board. This eliminated the requirement for ratification by DPRD TK. II provided in Regulation of the Minister of Home Affairs No. 690-1572 of 1985.

(m) Regulation of the Minister of Public Works No. 65/KPTS of 1989 establishing the Joint Technical Team for Water Supply Capital Investment.

(n) Circular Letter of the Minister of Home Affairs No. 690/7072/SJ dated July 10, 1985, to all level one governors, all *bupatis* and *walikotas* of level two, and all directors of PDAMs regarding the possible release by level one and two governments of PDAMs from the duty to provide 55% of their net profits to those governments as provided under Article 25 of Law No. 5 of 1962.

(o) Circular Letter of the Minister of Home Affairs No. 690-1595 of 1985 which authorized the creation of PMDUs.

(p) Instruction Letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of all regional government enterprises to one or the other of two forms of legal entity, i.e., PERUMDA (*Perusahaan Umum Daerah* or Regional Public Company) and PERSERODA (*Perusahaan Perseroan Daerah* or Regional Limited Liability Company), following enactment of a law to replace Law No. 5 of 1962.

(q) Guidelines on the Accounting System of PDAMs of August 1990 issued by the Minister of Home Affairs.

(r) Organizational structure of PDAMs (undated) issued by the Minister of Home Affairs.

(s) Implementing Guidelines for Regulation No. 690-536 of 1988 (Interim Report) (undated) regarding the calculation of drinking water tariffs by PDAMs.

(t) Decree of the Governor of the Special Province of Jakarta No. D.IV-a.12/1/49 of 1974 on the regulation of digging and drilling for groundwater in Jakarta Special Province.

(u) Decision of Jakarta Governor No. 664 of 1980 concerning the organization, structure, and work division of the drinking water company of the Special Municipality of Jakarta ("PAM Jaya").

(v) Provincial Regulation of East Java No. 6 of 1980 amending the provincial water regulation of East Java of 18 November, 1938, on the use of water.

(w) Provincial Regulation of East Java No. 5 of 1985 concerning drilling and the use of underground water in East Java.

(x) Provincial Regulation of East Java No. 2 of 1987 regarding the establishment of PDABs.

3. REVIEW OF INDONESIAN LAWS AND REGULATIONS REGARDING FOREIGN AND DOMESTIC PRIVATE SECTOR INVESTMENTS

The legal structure for private sector commercial activities in Indonesia is based on the Commercial Code of the Dutch East Indies of 1847. This Commercial Code is a civil law code derived from the Dutch Commercial Code. This was in turn derived from the Roman Justinian Code. This Commercial Code continues in full force and effect in Indonesia except where its provisions have been specifically revoked by Indonesian law or are otherwise incompatible with Indonesian independence and public policy. This Commercial Code is currently being revised to accommodate modern and specifically Indonesian conditions, needs, and practices, but no date of completion has been announced and it may not be accomplished in the near future. Corporate practices and procedures are prescribed by the Commercial Code. The most common form of corporate entity for private commercial use in Indonesia is the *Perseroan Terbatas* or "P.T." The P.T. is a limited liability company whose form and legal rights and obligations are similar to, and modeled closely after, those established by most civil code jurisdictions.

Indonesia, under the government which preceded the New Order, adopted an anticapitalistic policy. Even during this period, however, private sector activities continued, e.g., in agriculture and the vending of consumer goods and services. Following the fall of the Old Order government, a change in national economic and social policy was made under the New Order to the *Pancasila* philosophy. *Pancasila* stresses cooperative efforts and a commitment to the amelioration of poverty and social problems through government activities. *Pancasila* continues to be the official Indonesian national ethos and ideology.

This is reflected in some official public policies and enactments of Indonesia. Under these, private sector participation in the economy is frequently only permitted with the special authorization of the government, the private sector's activities are sometimes subject to close regulation and monitoring.

In many instances, the Indonesian laws which refer to "domestic capital" are misleading in their use of this term. In this context, "domestic capital" initially principally referred to flight capital. The "domestic investment" laws were designed to encourage the repatriation and local investment of this flight capital. BKPM licensed "domestic investments" are now those investments of Indonesian capital which seek or require special government incentives—particularly through special customs treatment of some or all of their imported assets

To a great degree, the general Indonesian population is permitted—and even encouraged—to engage in economic activity through the use of private capital To the extent that this is regulated at all, regulation is implemented through general licensing and other laws which will not be considered in this Paper.

The agency of the Indonesian Government most directly involved with specially licensed private sector investments in Indonesia is BKPM. In the two years immediately following the institution of the New Order, foreign and domestic private investments were encouraged and were generally unrestricted. Beginning in 1967, however, the Government of Indonesia—through predecessor institutions of BKPM—initiated a policy of critically reviewing private foreign capital investment proposals. In 1968, that review was extended to "facilitated" "domestic capital" investments, i.e., returning flight capital regarding whose origins the Government of Indonesia tacitly agreed to not examine closely and registered as a Domestic Investment Company [*Penanaman Modal Dalam Negeri* ("PMDN")] which received investment inducements from the government. BKPM was organized in 1973 to formally review and license foreign and domestic investment applications. BKPM does not review investment proposals regarding financial institutions, which are regulated by other ministries and agencies of the Government of Indonesia. It also does not consider private investments related to the petroleum industry or review private sector contractual relationships with the Indonesian national oil company, which is called *Perusahaan Pertambangan Minyak dan Gas Bumi Nasional* ("Pertamina"). All such investments and contracts are handled exclusively by Pertamina itself. BKPM approval is now required for all domestic investments for which special "facilities," e.g., preferential import customs tariffs, are requested. No special tax facilities have been granted to private investors by BKPM since 1983.

Although all foreign investments and all facilitated domestic investments must be reviewed and approved by BKPM, there are a few significant differences in the way foreign and domestic investments may—and must by law—be treated by BKPM. Domestic investments may be licensed upon the approval of the Chairman of BKPM, but all foreign investments also require the formal approval of the President. Domestic, but not foreign, investments may obtain financing through government-owned banks. Domestic investors may engage in the direct distribution of products, but foreign investors may only engage in the distribution within Indonesia of their own products and then only through separately approved Indonesian joint venture companies. Once a foreign investor's equity participation in an Indonesian company is below 50% and Indonesian investors hold the majority of the equity, a company must by law be treated in every respect as the same as a company formed using only domestic private investment.

Initially, private sector investment applications were considered cautiously. Those investments that were approved were approved only with severe limitations and then only as exceptions to the general rule against foreign and "domestic" private sector investments in Indonesia. Over time, BKPM and the Government of Indonesia have grown increasingly receptive to private sector investment applications. Restrictions imposed on investments are now more limited than was previously the case. The annual number of approved investment applications and the speed with which investment applications are dealt with has increased over the period. The likelihood of any investment application being approved has improved over the years.

Since 1977, BKPM has provided a "one stop" review and licensing center for all private sector investment applications over which it has authority (except for forestry, fishing, and mining investments, which require the direct participation of other ministries and agencies). The Chairman of BKPM has been delegated the authority to issue investment approvals (excluding those listed above) without the formal review and approval of those investment applications by other ministries and agencies.

Nonetheless, Indonesian Government investment application review and licensing procedures continue to be officially expressed in negative terms, i.e., they state that all investments are excluded until official approval has been granted. This belies to a degree the current reality that there is a presumption of approval for investment applications barring some special reason for refusal.

The procedure for seeking investment approval by BKPM is to submit an application, complete with detailed plans for the investment, to BKPM. BKPM will then review the application (and may seek extensive clarification of the application from the investor). Following that review, BKPM may choose to approve the application as submitted, reject the application in its entirety, or accept in part the application subject to changes and restrictions imposed by BKPM. Following approval of an investment, any significant changes to that investment are also subject to BKPM notification and approval.

The Government of Indonesia established a policy in the early 1970s of nonexhaustively listing those sectors of the Indonesian economy in which new private sector investment would be permitted. "Drinking water" was added to this list beginning in 1986. In 1989, this policy was changed. In that year, an *exhaustive* list was published of those Indonesian economic sectors from which certain forms of new private sector investment is excluded. Private investment is permitted in all other economic sectors—including "drinking water." Nonetheless, Article 3 states that such investments are only permitted in accordance "with the provisions of prevailing laws and regulations." Consequently, as shall be described in greater detail in a later section of this Paper, those sectors opened for private investment by the Decree may arguably be closed for some such investments through the operation of other laws and regulations. There are now 75 economic sectors in Indonesia which are closed to specified forms of new private sector investment.

The principal relevant Indonesian laws and regulations concerning the participation in the Indonesian economy of the private sector are:

(a) Dutch East Indies Commercial Code of 1847.

(b) Law No. 6 of 1968 concerning domestic investments.

(c) Law No. 12 of 1970 amending and supplementing Law No. 6 of 1968.

(d) Presidential Decree No. 54 of 1977 concerning regional basic provisions on investment procedures.

(e) Presidential Decree No. 26 of 1980 concerning regional investment coordinating boards [*Badan Koordinasi Penanaman Modal Daerah* ("BKPMD")].

(f) Presidential Decree No. 35 of 1985 amending Presidential Decree Nos. 33 of 1981 and 78 of 1982 regarding the status, duties, and organizational structure of BKPM.

(g) Presidential Decree No. 21 of 1989 concerning the exhaustive list of economic sectors that are closed for specified forms of new private investment. It does not include "drinking water." It replaces the earlier nonexhaustive list of economic sectors open to new private sector investment of Presidential Decree No. 15 of 1987 which, in turn, replaced Presidential Decree No. 22 of 1986 which contained a similar list.

(h) Presidential Instruction No. 5 of 1984 concerning guidelines for the simplification and control of business licensing.

(i) Decree of the Minister of Finance No. 862/KMK.01 of 1987 regarding the issuance of securities through a stock exchange.

(j) Decision of the Chairman of the Investment Coordinating Board No. 5/SK of 1987 regarding local equity participation requirements in joint ventures with foreign investors. This Decision followed and implemented the provisions of Article 27 of Law No. 1 of 1967, Circular Letter from the Chairman Nos. 1195/A/BKPM/X of 1974 and B 109/A/BKPM/II of 1975, and BKPM Internal Guidelines of 1981. The Decision was further modified by Decisions of the Chairman Nos. 08/SK and 16/SK of 1989.

4. REVIEW OF INDONESIAN LAWS AND REGULATIONS REGARDING FOREIGN INVESTMENTS

Until the institution of the New Order in 1966, foreign investments in Indonesia were generally discouraged. Between the time of Indonesian national independence and 1966, a number of existing foreign investments—particularly those owned by the Dutch—were nationalized. Foreign investment in Indonesia was largely unrestricted during 1966 and 1967. Indonesia initiated a policy of restricted authorization for foreign investments in 1967.

Since then, local participation with foreign investors has been officially encouraged. In virtually all cases after 1974, foreign investments have been permitted only when made in conjunction with local venture parties. Following the initial foreign investment, the incremental transfer of majority equity ownership to local participants was at first encouraged and later required by the end of a fixed period (initially of ten years, later extended to fifteen years with provision for a discretionary extension of a further five years). Upon the transfer of majority ownership in an enterprise by the foreign investors to local participants, the enterprise will be treated under Indonesian law as a domestic investment.

All foreign investments (except for those concerning financial institutions and petroleum-related sectors) must be authorized by BKPM and be approved by the President. Special customs tariff treatment may be authorized by BKPM, but special tax treatment for foreign investments has not been granted since 1983. Foreign investments may not have access to Indonesian Government bank financing and may only distribute in Indonesia their own products and then only through separately incorporated Indonesian joint venture distribution companies. The procedures for applying to, and receiving authorization from, BKPM for investments which were described in the previous section are generally applicable to foreign investments as well as subject domestic investments. Foreign investments are made in the form of a Foreign Investment Company [*Penanaman Modal Asing* ("PMA")].

It should be noted that foreigners may also invest in Indonesia by buying shares in existing Indonesian companies through purchases on the Indonesian Stock Exchange or through private purchases of equity and shares. They may also list their Indonesian companies on the Indonesian Stock Exchange.

Since 1967, the Government of Indonesia has become increasingly receptive to foreign investment. Foreign investment applications are now routinely processed and approved by BKPM relatively quickly and in large numbers. Nonetheless, foreigners are explicitly excluded from making investments in nine specific Indonesian economic sectors (including drinking water) under the provisions of Article 6 of Law No. 1 of 1967. This is examined in greater detail in Sections 8 and 11 of this Paper. Foreigners may not have proprietary rights in Indonesian real property according to the terms of the Indonesian Agrarian Law. Indonesian laws and regulations by their literal terms treat foreign investment as an activity that is only

permitted selectively and cautiously, although in reality the Government of Indonesia now encourages foreign investment and rejects few legitimate
foreign investment proposals. Government of Indonesia receptiveness to foreign investment may be expected to continue and even increase in the future.

The principal Indonesian laws and regulations of relevance to foreign investments and foreign investors are:

(a) Law No. 1 of 1967 regarding foreign investments.

(b) Law No. 11 of 1970 which amended and supplemented Law No. 1 of 1967.

(c) Government Regulation No. 24 of 1986 concerning the 30 year licensing period for foreign investment companies.

(d) Presidential Decree No. 17 of 1986 requiring that Indonesian investment entities in which a majority equity ownership is held by local participants be treated the same as domestic investments under Indonesian law. This Decree was amended by Presidential Decree No. 50 of 1987.

(e) Decision of the Chairman of the Investment Coordinating Board No. 17/SK of 1986 concerning foreign share participation in business companies already in operation.

(f) Those relevant laws and regulations listed in the preceding section.

5. REVIEW OF INDONESIAN LAWS AND REGULATIONS REGARDING TAXES, CUSTOMS TARIFFS, FISCAL MATTERS, AND OTHER LEGAL ISSUES

A multitude of other Indonesian laws, regulations, and policies will strongly affect private sector investors considering making investments in Indonesia.

The tax laws of Indonesia will affect the net profitability of any private sector investment in Indonesia. There are Indonesian taxes, *inter alia*, on income, real property and the sale of luxury goods. There is a value added tax on the sale of goods and services. There are many licensing fees, document taxes, user fees, and other government exactions which are imposed by the national government and/or its subordinate levels of government. Since 1983, Indonesia has not offered tax holidays or incentives for investors. The assessment of taxes in Indonesia is not made on a clear and accepted accounting basis. Final levels of taxation may, without any suggestion of impropriety, be determined through self-assessment and subsequent negotiations between taxpayers and Indonesian tax officials. This uncertainty and flexibility in Indonesian tax law is often unsettling for foreign investors.

Customs tariffs (except for imported household goods and goods with only a nominal value) are imposed under Indonesian law but are at present administered and collected under contract by a private Swiss company. The result has been a greatly enhanced efficiency and clearer adherence to established procedures. This contract is scheduled to expire soon. For favored investments, BKPM may authorize duty free or reduced duty importation of some or all items. In some cases—i.e. petroleum exploitation imported machinery may immediately become the property of the Indonesian Government or later reexportation of the equipment from Indonesia may be prohibited.

The Government of Indonesia, through its central bank (*Bank of Indonesia*) and BKPM licensing, may impose foreign currency exchange controls (although those controls are now suspended) and restricts the repatriation of investment capital and profits. Special authorization must be obtained through BKPM for the right to make such currency exchanges and capital and profit repatriations on acceptable terms. The national currency, the Indonesian Rupiah, is freely convertible to other currencies.

The Indonesian Agrarian Laws prohibit foreign ownership of, or proprietary rights in, Indonesian land. This may create difficulties for some investors.

Indonesian immigration law and BKPM investment authorizations greatly limit the ability of foreign investors to use expatriate staff resident in Indonesia. Over time, the number of expatriate personnel granted residence and work permits for a particular investment may be reduced. All residents of Indonesia require an official departure authorization (exit permit) each time that they wish to temporarily or permanently leave Indonesia.

Particularly regarding private investments in the water supply sector, laws and regulations regarding pollution controls, environmental matters, and health standards for potable water will be of importance.

The principal relevant laws regarding the above areas include:

(a) The Indies Tariff Law (*Indische Tariefwet*) (Staatsblad 1873 Number 35), as amended and supplemented most recently by Government Regulation No. 6 of 1969.

(b) Law No 4 of 1982 regarding environmental protection.

(c) Law No. 6 of 1983 concerning general tax matters.

(d) Law No. 7 of 1983 concerning income taxation.

(e) Law No. 8 of 1983 concerning value added taxation on goods and services and a sales tax on luxury goods.

(f) Law No. 12 of 1983 regarding customs.

(g) Law No. 13 of 1983 regarding real estate taxation.

(h) Government Regulation No. 20 of 1990 regarding water pollution control.

(i) Presidential Decree No. 23 of 1990 concerning the establishment of a national pollution board.

(j) Presidential Instruction No. 4 of 1985 concerning policies to expedite the flow of goods in support of economic activities.

(k) Decree of the Minister of Health No. 2180/YANKES/INSTAL/XI of 1981 regarding the establishment of water quality standards and an environmental team.

6. DECENTRALIZATION OF, PRIVATIZATION OF, AND GENERAL PRIVATE SECTOR PARTICIPATION IN GOVERNMENTAL AND GOVERNMENTALLY-PROMOTED ACTIVITIES IN INDONESIA

Indonesia was established and has been operated as a unitary state. All power emanates from the central government—to subordinate officials and levels of government. This was true for a number of historical reasons. The Dutch had administered the Dutch East Indies in this fashion. The new Republic of Indonesia was threatened with separatist forces which might fragment the country were not central control maintained. The first government of the Republic of Indonesia perceived its principal tasks as nation building and economic development. The number of competent technicians and administrators in the new government was limited and those persons were concentrated in the central government. The cultural tradition in Indonesia generally favored centralized authority and decision-making.

As Indonesia has developed economically and become more politically sophisticated, the concentration of power at the center has become increasingly inappropriate as a means of successfully and efficiently serving the country's needs. With experience and training, a larger body of qualified persons is now available at lower levels of government which is capable of assuming greater responsibilities.

The implementation of privatization and of a general shift in national economies from the public to the private sector have in many cases proven to have provided significant benefits to countries and their governments. As a consequence, the Indonesian Government has declared in PELITA V (its current five year economic plan) that it favors privatization in some forms and economic sectors. It is now actively exploring the suitability of privatization for Indonesian conditions and needs. Privatization may take many forms.

The purest form of privatization, which has been implemented in Western Europe—particularly in the United Kingdom—is divestiture. Under divestiture, public enterprises which are engaged in commercial activities will have their assets or their equity participation shares sold or transferred in whole or in part to private sector investors.

The leasing of government-owned assets to the private sector which will then operate those assets during the lease period, retain all earnings from the operation of those assets, and return those assets to the government at the end of the lease period in exchange for periodic payments by the private sector to the government is another type of private sector participation. Current Indonesian laws and regulations regarding water utilities do not seem to contemplate such leasing schemes nor does Government of Indonesia policy seem to favor such a form of privatization (unless the term "profit-sharing cooperation" in Regulation of the Minister of Home Affairs No. 4 of 1990 contemplates such leases). In other sectors, the only example of government-owned asset leasing discovered is the leasing of capital assets, e.g , drilling rigs, by the Indonesian national oil company to its private sector contractors.

Other types of privatization (which will be referred to in this Paper as "private sector participation"), i.e., service contracts; joint ventures; and build, operate and transfer investments, are considered in detail in later sections of this Paper.

Private sector participation in governmentally-promoted activities has a long history in Indonesia. The private sector has participated in the operation of plantation agriculture, the exploitation of forestry, the operation of the national customs system, and other areas since, in some cases, the early days of the Republic.

The most noteworthy example of such participation is in the exploitation of petroleum and natural gas. Under certain regulations, private sector participation in the water supply field has been treated in part as though it were directly analogous to the exploitation of Indonesian petroleum and natural gas. Consequently, the practice of private sector participation in the petroleum industry is of particular interest. This analogy has been drawn principally because, under Article 33 of the Basic Law, both petroleum and water are required to be managed exclusively by the government for the use and benefit of the people of Indonesia.

Petroleum exploitation in Indonesia by foreign and domestic private participants is based on the constitutional principle that all resources found beneath the surface of the lands (and seas) of Indonesia are the property of the people. As part of the national patrimony, these natural assets are controlled and exploited exclusively by the national government. Consequently, exploitation of Indonesian petroleum resources is the exclusive right of the Indonesian national oil company, Pertamina. Following the expropriation of foreign interests in the petroleum sector during the first few decades of Indonesian independence, the Government of Indonesia determined that it required the technology and worldwide marketing capabilities of foreign participants. Pertamina awards contracts to private foreign participants to explore for, develop, and extract Indonesian petroleum. Foreign parties are required to provide all technology, capital investments, and other facilities for their activities in the petroleum sector. All capital equipment which is entered into Indonesia for this purpose becomes immediately the property of the Republic of Indonesia and is leased to the foreign participants which originally purchased and imported the capital equipment. All risks and costs of exploration are for the account of the foreign participant. All extracted petroleum is the property of Pertamina. The foreign participant, through production or profit sharing contracts, is permitted to take a part of the extracted petroleum as its payment for its participation and to compensate it for its costs of exploration and exploitation. In many instances, the foreign participant is also permitted to market abroad additional portions of its petroleum production on behalf of Pertamina.

The analogy between petroleum production and water supply activities is flawed. It fails to take into account the social policy concerns of governments which are applicable to water supply and the essential differences in the economic dynamics of petroleum production and water supply activities. Foreign participants are willing to participate in the Indonesian

petroleum industry under the terms established by the Indonesian Government because of the international dollar-denominated market for petroleum, the high per unit price which petroleum brings on those markets, and the needs of the foreign participants for secure supplies of petroleum to serve their international refining and marketing requirements.

In the case of water, all water produced from Indonesian sources (with the possible exception of some proposed sales of water to Singapore) will be consumed in Indonesia and will be sold at prices denominated in Indonesian rupiahs. Consequently, if private sector participants incur non-rupiah expenses and financing costs they will be reluctant to accept currency exchange rate risks in meeting those costs and expenses through rupiah sales. Further, they will be dependent for profits from their exploitation of Indonesian water resources on the strength of the Indonesian demand for the water and on the ability of Indonesian consumers to purchase the water. In addition, the prices charged for the water they sell may in some cases be established by Indonesian Government institutions under regulatory structures which may not assure a recovery of their investment and a reasonable profit on that investment.

A confusing factor in any evaluation of private sector participation in government-related activities in Indonesia is the fact that many so-called "private sector" participants are in fact not purely "private." They may be quasi-government institutions or may have other close ties to the government. For example, the letting of a service contract by the PDAM of Surabaya for bill collection has been frequently cited as an example of "private sector participation." In fact, the "private" party that was awarded the contract was a provincial government-owned bank which, in turn, admittedly subcontracted collection work to genuinely "private" sector bill collectors. Similarly, foreign government and multilateral noncommercial institutional financial participation is often considered to be "private sector participation" as long as such financing moves the investment out of the Government of Indonesia's budget, even though foreign governments and multilateral noncommercial institutions are hardly private sector investors in any other sense.

The principal Indonesian laws and regulations which are relevant
to decentralization, privatization, and private sector participation in governmental and governmentally-promoted activities in Indonesia are:

(a) Basic Law of 1945, particularly Article 33 which states "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people."

(b) Law No. 8 of 1971 regarding Pertamina's right to license private sector participants in the Indonesian petroleum-related economic activities.

(c) Law No. 5 of 1974 which is concerned with decentralization and the establishment of autonomous authority in the provincial and local governments regarding administrative matters.

(d) Government Regulation No. 14 of 1987 regarding the delegation of part of the central government's authority in the field of public works to the provincial Level I and Local Level II Governments.

(e) Presidential Decree No. 21 of 1989 concerning the list of economic sectors that are closed for prescribed forms of new private investment and revoking Presidential Decree No. 15 of 1987 which, in turn, revoked Presidential Decree No. 22 of 1986.

(f) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation by a regional enterprise with a third party. This made possible the establishment of joint cooperation undertakings between a regional enterprise and a private sector investor.

(g) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

(h) PELITA V, the current Indonesian five year economic plan which refers to the Government of Indonesia's plans for private sector participation in its public sector activities.

7. GENERAL REVIEW OF INDONESIAN REGULATION OF PRIVATE SECTOR PARTICIPATION IN PUBLIC UTILITIES

Public utilities are commercial (but not necessarily profit-making or even fully self-supporting) operations which provide essential services and products to consumers and which are, by the very nature of their means of production and distribution, compelled to operate as monopolies within their geographical marketing areas if they are to achieve maximum—or even reasonable—efficiencies and economies of scale. Examples of public utilities are water, telephone, and electric companies. The essential nature of the services and products they provide make public policy considerations of great importance in assuring that the public is adequately served with those services and products at prices that are reasonable and—in some cases—that are at subsidized prices for more remote or for poorer consumers of those services and products.

The existence of natural monopolies in the provision of public utility services and products necessarily creates a conflict between any private sector participation in those utilities and public policy considerations. Private capital seeks to maximize its profits. Where free market competition exists, it assures that private capital will so function as to maximize efficiencies and provide the consumers the best service or product at the lowest competitive price. Where there is no competition or where competition is imperfect—which must necessarily be the case for public utilities, private capital will be driven by its own internal dynamics to maximize its profits, which may be to the detriment of consumers and public policy if there are no ameliorating limits imposed by competitors or the free market.

This is true for public utilities in all countries. Consequently, in countries where private capital has been permitted to participate in public utilities, governments have established independent utility rate-making regulatory bodies which operate under clear and consistently applied rules. These permit the private sector to realize the recovery of its investment and a reasonable rate of return on that investment and to conduct its activities on a business-like basis without the imposition of unnecessary and disruptive government interference while assuring that the consuming public receives adequate service at reasonable prices and that public policies are protected and implemented.

Indonesia has no history of private sector participation in public utilities. It has not established any independent utility rate-making regulatory bodies (or rules to govern the operations and activities of those bodies) which would permit private sector investors to operate efficiently and realize reasonable profits while protecting the public and promoting public policies. The existence of such independent regulatory bodies—and the rules under which they operate—are not only important from the standpoint of the government because they protect consumers and assure the proper implementation of public policy. They are also important to private sector investors because they will make investing in public utilities less speculative—and therefore more attractive—and will provide private investors with an assured forum through which to pursue and enforce their legal rights.

The Government of Indonesia has permitted private sector participation in water utilities since 1986. This was originally authorized through the publication of nonexhaustive lists of economic sectors open to private investment. In 1989, an *exhaustive* negative list was issued which recited all those economic sectors in Indonesia in which specified forms of new private investments would not be permitted. Water supply/drinking water and a number of other public utility operational areas were not on this negative list. Nonetheless, Article 3 of the relevant Decree states: "(1) The licensing of investment within the framework of the Domestic Investment Law shall be implemented by the Chairman of the BKPM on behalf of the minister responsible for the investment concerned *in accordance with* his authority and *the provisions of prevailing laws and regulations*; (2) The licensing of investment outside the Foreign Investment Law and the Domestic Investment Law shall be handled by the minister responsible for the investment concerned *in accordance with* his authority and with *the provisions of prevailing laws and regulations*; ..." Consequently, these sectors opened to private investment by the Decree may still be closed through the operation of other laws and regulations. Law No. 15 of 1985 explicitly permitted private sector investment in electric utilities. Law No. 3 of 1989 gave a similar formal authorization for private sector participation in telecommunications.

Little interest has been shown by the private sector in participating in water supply during this period, but greater interest has been expressed in investing or obtaining service contracts in other public utility sectors, e.g., waste removal and disposal, electric power generation, and telecommunications. In at least one area, i.e., the construction and operation of toll roads, the private sector has not only displayed an interest in making investments but has completed a number of major investments in projects which are now operational. Nonetheless, the legal procedures for seeking and obtaining authorization to make such private investments in public utilities and the terms and conditions under which such investments will be permitted are unclear. The charges or tariff rates which private investors in public utilities may demand of the public are often established or approved by appointed bodies.

With particular reference to private sector participation in public water utilities, the legal status of that participation is especially unclear. Article 33 of the Basic Law states that the State must control the "production branches" which provide for the "needs of the people" and that water may only be managed and utilized by the government for the maximum benefit of the people. If these are not absolute prohibitions regarding private sector investments in water supply activities, they minimally establish a requirement for a high standard of government regulation of any private sector activities in this area. Of greater concern is Law No. 1 of 1967 which states in Article 6 that nine economic sectors are closed to foreign investment which is "exercising full control." These include telecommunications, electricity, and *drinking water*. Paragraph 2 excludes *absolutely* foreign investment in other economic sectors. Although foreign investment in electricity and telecommunications has been explicitly permitted by later laws, foreign participation in the drinking water sector has been authorized only through presidential decrees and ministerial

regulations (see the list of relevant laws and regulations at the end of this Section). If a law prevails over any conflicting language of presidential decrees and ministerial regulations—as seemingly it must (see Figure 1), the definition of what constitutes "exercising full control" is of critical importance. This term is as yet undefined.

The principal laws and regulations relevant to private sector participation in Indonesian public utilities are:

(a) Basic Law of 1945 (Indonesian Constitution), particularly Article 33 which states "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people."

(b) Law No. 1 of 1967 regarding foreign investments.

(c) Law No. 15 of 1985 regarding private sector participation in electricity.

(d) Law No. 3 of 1989 regarding private sector participation in telecommunications.

(e) Presidential Decree No. 21 of 1989 concerning the list of sectors that are closed for specified forms of new private sector investment, superseding Presidential Decree No. 15 of 1987 which, in turn, superseded Presidential Decree No. 22 of 1986.

(f) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation by a regional enterprise with a third party. This made possible the establishment of joint cooperation undertakings between a regional enterprise and a private sector investor.

(g) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

8. INDONESIAN LAW REGARDING PRIVATE SECTOR SERVICE CONTRACTS AWARDED BY UTILITIES AND GOVERNMENTAL ENTITIES

Indonesian public utilities and governmental entities have for a long time awarded service contracts to private sector participants. Private sector participants perform under service contracts in petroleum-related activities which are worth millions of dollars annually. Garuda Airlines has in the past privately contracted out some of its aircraft maintenance. A private Swiss company has contracted with the Indonesian Government to collect and administer customs tariff operations for goods entering Indonesia.

In the field of water supply public utilities, private sector service contracts have been awarded under more limited circumstances and less frequently. In two cases, i.e., Medan and Surabaya, the collection of the payment from at least some water consumers has been contracted out to other parties. At least in the case of Surabaya, the contract was awarded to a bank owned by the provincial government and not to a genuine private sector bidder (although private sector bill collectors were subcontracted to actually perform the service).

In the water utility sector, authorization for the award of service contracts is principally provided by Regulation of the Minister of Home Affairs No. 4 of 1990. That Regulation states that service contracts may be awarded by regional enterprises to the private sector through "management cooperation," "operational cooperation," "management contract," "agency, usage and distribution," or "technical assistance cooperation." Regulation of the Minister of Home Affairs No. 3 of 1986 also permits, *inter alia,* regional enterprises to enter into service contracts with third parties regarding "management and operation assistance." These terms are not defined in the regulations. No clear procedures are established for evaluating bidders or for awarding contracts. No standard contract terms or formats were prescribed.

To assure that private sector performance of services under contract to government entities is provided at the lowest possible cost and with the greatest efficiency, there must be competitive bidding by qualified bidders for such contracts, such service contracts must be regularly rewarded through competitive bidding, and the performance of private sector service contracts must be subject to continuous monitoring and evaluation. Of course, the benefits to be derived from awarding water supply service contracts to the private sector may only be achieved if the private sector itself has the competence and resources to fulfill such contracts. This must be determined prior to initiating a program of awarding such contracts. There are currently no rules in the water utility sector for the publication of announcements of a request for bids, the preparation of the terms of service contracts for which bids will be accepted, the formal qualification of competent bidders, the submission of sealed bids, the selection of the most competitive bidder, public disclosure of the winning bid, the right of losing bidders to challenge the bid award through the courts, a requirement that service contracts be for only limited periods and that they be rewarded competitively, or the

mechanics for monitoring and evaluating the performance under service contracts of winning private sector bidders.

Those principal laws and regulations which are relevant to the award by public utilities and government entities to private sector participants of service contracts are:

(a) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation of a regional enterprise with a third party.

(b) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party which revoked the Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

(c) Surabaya PDAM President Director's Decree No. KPTS/29/411.61 of 1985 regarding private sector service contracts for bill collection.

9. INDONESIAN LAW REGARDING PRIVATE/PUBLIC SECTOR JOINT VENTURES

The answer to the question of whether a public sector regional enterprise may legally enter into a joint venture with a private sector investor, particularly in the area of water supply, remains unclear. Regulation of the Minister of Home Affairs No. 4 of 1990 and Regulation of the Minister of Home Affairs No. 3 of 1986 explicitly authorize such joint ventures. Instruction letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of regional government enterprises into one or the other of two types of legal entity, i.e., PERUMDA (Regional Public Company) and PERSERODA (Regional Limited Liability Company), following enactment of a law to replace Law No. 5 of 1962 would make such joint ventures more easily accomplished. Because of the peculiarly ambivalent status of Law No. 5 of 1962, which is neither quite revoked nor quite inoperative, the ability of PDAMs or PDABs to enter into joint venture agreements with private sector investors remains in doubt. In Law No. 5 of 1962, Article 5(4), provides that: "The important/main branches of the region which affect the well-being of the region must be *managed* by the regional enterprise ..." Article 7(2) states: "The capital of a regional enterprise may not consist of shares." The continuing overhang of the limitations imposed by Law No. 5 of 1962 (as well as the previously quoted Article 33 of the Basic Law) may be argued by some to make some or all such joint ventures illegal. These Articles require that control and/or management of essential services (including water supply) be the exclusive right of the State which is exercised for the benefit of the people. For foreign investors, the restrictions of Article 6 of Law No. 1 of 1967 would seemingly limit the participation of foreigners to a noncontrolling minority without management rights in any such joint venture and prevent the foreign investor from exercising control over the investment.

The clearest authorization for public/private sector joint ventures in the water supply area is found in Regulation of the Minister of Home Affairs No. 4 of 1990. It explicitly permits regional enterprises to participate with the private sector in joint ventures (as well as quasi-joint ventures, i.e. "profit-sharing cooperation," "financing cooperation," "production-sharing cooperation" and "facilities-sharing contracts." Regional enterprises may also purchase equity in existing private sector enterprises or sell stocks and bonds (seemingly contrary to the provisions of Law No. 5 of 1962) under this Regulation. The other provisions of the Regulation clearly have joint ventures as their principal focus and deal with a number of their aspects, e.g., the joint venture agreement under Article 6. Nonetheless, the provisions of the Regulation as it concerns joint ventures are neither clear nor detailed.

Under Regulation of the Minister of Home Affairs No. 4 of 1990, regional enterprises are permitted to cooperate, *inter alia*, with a foreign country government, a foreign private enterprise, a cooperative, a national private enterprise, and/or a national and/or foreign financial institution. "Cooperation" means any activities resulting from a formal binding contract between a regional enterprise and a third party to jointly execute any business activity to accomplish a specified objective. Cooperation is permitted to increase the

efficiency, productivity, and effectiveness of a regional enterprise, to make a regional enterprise more financially viable, and to "accelerate the mobilization of business." Those terms are undefined. This may be accomplished by (a) developing an existing business or (b) establishing new enterprises based on anticipated mutual benefits. The role and responsibility of each party is to be linked to their relative risks. The "cooperation" with a third party *may not,* under Article 6, *change the legal entity status of the regional enterprise.* Article 8 specifies the qualifications of an eligible third party. The level of final Government of Indonesia approval required for any "cooperation" is based on the size of the investment (which clearly contemplates only joint ventures) as prescribed in Article 9.

Regulation of the Minister of Home Affairs No. 3 of 1986 permits the purchase of shares in an existing corporation by a regional enterprise, the establishment of a new corporation by a regional enterprise, and the award of contracts by a regional enterprise for, *inter alia,* profit-sharing, production-sharing, and shared facility arrangements.

Under Law No. 5 of 1962 and Regulation of the Minister of Home Affairs No. 3 of 1986, DPRD TK. II approval is required for joint ventures between regional enterprises and third parties. This requirement does not exist under Regulation of the Minister of Home Affairs No. 4 of 1990.

Regulation of the Minister of Home Affairs No. 690-536 of 1988 states in Chapter II, Article 2, that revenue projections from water sales must be clearly calculated based on the establishment of tariffs for water which will recover personnel costs, electricity costs, costs for chemicals, operation and maintenance costs, general administration costs, depreciation of assets, and any interest payments. No provision is made for set-aside funds for planned new infrastructure developments. Infrastructure replacement funding is only provided to the extent that is covered by depreciation of assets. The tariff schedules must: permit any member of the community to afford to pay for water; provide for higher tariffs for wealthier consumers to subsidize below cost of water sales to poorer consumers; and encourage the efficient use of water. There are drafts of accountancy rules for PDAMs and a detailed methodology for the determination of tariffs which are only available in Indonesian-language versions. They were not examined in detail for the preparation of this Paper. Different tariff rates will be established for the following categories customers in accordance with Chapter III, Article 4: (a) nonprofit public institutions, e.g., hospitals and mosques, (b) noncommercial customers, e.g., residential customers, (c) industrial customers, and (d) special commercial customers, e.g., hotels and restaurants. There is no provision for regularly scheduled periodic or specially requested reviews or revisions of the tariff schedules. Proposed tariff schedules are prepared and submitted by the board of directors to the board of supervisors of a PDAM/PDAB. The board of supervisors may modify the proposed tariff schedule. It submits its proposed tariff schedule to the head of the level of government under which the PDAM/PDAB operates. The government executive may modify the proposed tariff schedule and will formally issue the tariff schedule through a *Surat Keputusan.* No provision is made

for public hearings on the tariff schedule or for legal challenge to any tariff schedule which is formally issued.

The principal relevant laws and regulations regarding joint ventures between private sector participants and public sector enterprises are:

(a) Basic Law of 1945, particularly Article 33 which states "Production branches which are important to the State and provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people.

(b) Law No. 5 of 1962, particularly Article 5(4) which states, "The important main production branches of the region which affect the well-being of the region must be managed by the regional enterprise ..." and Article 7(2) which states, "The capital of a regional enterprise may not consist of shares."

(c) Law No 1 of 1967 on foreign investment, particularly Article 6 which prohibits foreign investors from "exercising full control" over any activities regarding "drinking water."

(d) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning the cooperation of a regional enterprise with a third party.

(e) Regulation of the Minister of Home Affairs No. 690-536 of 1988 dealing with guidelines for the pricing of water to consumers by a PDAM. This provides that water prices charged to consumers must be decided by the head of the local government and be subject to gubernatorial approval following a proposal from the management of the water company and the favorable considered judgement of its supervisory board. This eliminated the requirement for ratification by DPRD TK. II provided in Regulation of the Minister of Home Affairs No. 690-1572 of 1985.

(f) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This Regulation revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject

(g) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 5 of 1984 and 28 of 1984 concerning guidance about the calculation of drinking water tariffs and regarding the

organization, accounting systems, structure, and cost calculations of water utilities.

(h) Instruction letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of regional government enterprise into one or the other of two types of legal entity, i.e., PERUMDA (Regional Public Company) and PERSERODA (Regional Limited Liability Company), upon enactment of a law to replace Law No. 5 of 1962.

(i) Guidelines on the Accounting System of PDAMs of August 1990 issued by the Minister of Home Affairs.

(j) Implementing Guidelines for Regulation No. 690-536 of 1988 (Interim Report) (undated) regarding the calculation of drinking water tariffs by PDAMs.

10. INDONESIAN LAW REGARDING BUILD, OPERATE AND TRANSFER INVESTMENTS

Build, Operate and Transfer (BOT) private sector investments have been made in Indonesia in hotels, commercial buildings, toll roads, petroleum-related supporting institutions and elsewhere.

In a BOT, the private sector investor first plans and constructs ("BUILD") the investment capital project using its own capital and resources. It then operates the project on a commercial basis ("OPERATE") for a fixed term or until it has recovered its investment costs and a reasonable rate of return. At the end of the period of operation by the private investor, the assets of the investment capital project will be transferred ("TRANSFER") to the government or one of its entities.

It is the preference of the private sector, and occasionally it has been proposed, that private investors *not* ultimately transfer the assets but retain them indefinitely as their own private property. This has been characterized as a Build, Operate, and Own/Operate ("BOO") investment.

Of critical importance from the standpoint of the Government of Indonesia in evaluating the beneficial nature of BOTs is a determination of: (a) whether a BOT constitutes a cheaper form of financing for projects which serve public policy goals; (b) whether a shortage of available funds to the Government of Indonesia would prevent construction of the project without the participation of private BOT capital; (c) whether a BOT would provide urgently needed water supply services more expeditiously or more thoroughly or reliably than would or could the public sector; (d) whether the operation of the BOT would be contrary to essential Government of Indonesia public policies or whether the BOT could be so regulated as to operate in accordance with those essential public policies; and/or (e) whether the BOT capital investment project infrastructure will be so maintained during the period of private sector operation that the infrastructure will have some intrinsic value to the Government of Indonesia upon its transfer.

No examined BOTs in Indonesia seem to fit the classical BOT format. Under some BOT investments, the transfer of the assets may not take place completely on some fixed date but the title to the assets may be transferred to the government incrementally and over time. In some cases the project assets are transferred immediately upon completion of the infrastructure construction and the operations themselves are handled by the public sector with the investor retaining nothing but a right to a portion of the revenue stream from the investment. In the petroleum sector in Indonesia, such immediate transfers of investor assets are the norm. It is noted that in case of the proposed Umbulan Spring project in East Java, the drafted legal agreement characterized the cooperation as a "production sharing cooperation"—a term derived exclusively from Government of Indonesia-private sector dealings in petroleum-related activities.

There are no laws in Indonesia which are specifically applicable to BOTs in the area of water supply. Regulation of the Minister of Home Affairs No. 4 of 1990 makes no reference to BOTs among those enumerated acceptable means by which the private sector may cooperate with regional enterprises in the public sector in water supply activities. The law of Indonesia regarding BOTs in the water supply area must therefore be determined by an extrapolation from current practice. The only laws or regulations of Indonesia dealing with BOTs which were discovered are Presidential Decree No. 42 of 1989 and Regulation of the Ministry of Mining and Energy No. 03P/39/M.PE of 1989 which deal with BOTs in the supporting sector, e.g., refineries, of the petroleum industry. On the basis of current practice, nonetheless, it is clear that BOTs have an accepted and legitimate legal basis under Indonesian law for private sector investments because so many of them are in operation and because BOTs in Indonesia have been built and operated for so long. What is less clear is on what basis and through what administrative procedures the Government of Indonesia will receive, approve and deny applications for BOTs and how such applications will be evaluated by the Indonesian Government. Because all examined Indonesian BOTs differ from the standard definition and perception of what constitutes a BOT, it is uncertain whether classic BOTs as such are permitted by Indonesian law generally or in the water supply sector.

The only relevant Indonesian laws and regulations discovered regarding BOTs are the following.

(a) Presidential Decree No. 42 of 1989 regarding BOTs in the petroleum-related support sector.

(b) Regulation of the Minister of Mining and Energy No. 03/39/M.PE of 1989 regarding BOTs in the petroleum-related support sector.

11. ANALYSIS OF THE ADEQUACY OF EXISTING INDONESIAN LAWS AND REGULATIONS

Some laws and regulations of Indonesia regarding private sector participation in water supply activities are clear in their statement of policy that such participation is encouraged, but these may conflict with Article 33 of the Basic Law, Law No. 5 of 1962 may restrict PDAMS'/PDABS' cooperation with the private sector, and Law No. 1 of 1967 would seem to prohibit at least a controlling interest or management by foreign participants in Indonesian water supply activities. They are far less clear in stating on what basis the private sector may so participate, what standards the Government of Indonesia will apply in evaluating any application by the private sector to participate, and how the Government of Indonesia will assure that its public policy aims in the water supply area will not be unacceptably frustrated as a result of any private sector participation.

Current Indonesian law regarding private sector participation in water supply activities creates perceived risks in the minds of private sector participants because of its lack of clarity and uncertain application. Where financing or capital costs are incurred in currencies other than rupiah, the lack of guaranteed currency conversion from rupiah to other currencies at assured rates adds to this perceived risk.

From the standpoint of the Indonesian Government, private sector participation in a natural or *de facto* monopoly—such as water supply—poses great risks unless that participation is clearly defined and limited by law and unless provision is made for continuous oversight of such private sector participation under clear and consistently applied standards by Indonesian regulatory bodies. Where there are few competing investors or enterprises which wish to participate in water utility activities; where those investors have a limited competence to undertake roles in the water supply area; or where some investors or enterprises are inappropriately supervised and obtain an unevaluated role in water supply activities, private sector participation provides uncertain benefits. Effective and beneficial private sector participation demands competent and competing private sector parties and prudent government regulation.

Figure 3 lists the respective needs of the private and public sectors if private sector participation in Indonesian water supply activities is to prove mutually beneficial to both parties. Applicable laws and regulations must be formulated to meet the needs of both parties and to provide assurances that fulfillment of those needs is based on enforceable rights at law. If the private sector's needs are not satisfied, it will not participate. If the public sector's needs are not satisfied, it may be displeased with the participation of the private sector. If standards and procedures are not clearly articulated under laws and regulations, both the private and public sectors may lose time and money and incur lost opportunity costs by pursuing possible projects under terms that one or the other party will ultimately find unacceptable. Current Indonesian laws and regulations regarding private sector participation

Figure 3

Private and Public Sector Needs

PRIVATE SECTOR NEEDS

A. PREDICTABILITY

(1) CLARITY
(2) CONSISTENCY
(3) ENFORCEABILITY

B. PROFITABILITY

(1) CALCULABLE RISKS
(2) CALCULABLE COSTS
(3) A REASONABLE EXPECTATION OF A COMMERCIAL RATE OF RETURN ON THE INVESTMENT

PUBLIC SECTOR NEEDS

A. BENEFITS

(1) EFFICIENCIES
(2) FINANCIAL ASSISTANCE
(3) A DESIRED SHIFT IN PRIVATE / PUBLIC SECTOR BALANCE

B. PUBLIC POLICY IMPLEMENTATION

(1) INCREASED SERVICES/CHEAPER SERVICES
(2) ASSURED / SUBSIDIZED SERVICES TO MORE REMOTE OR TO POORER CONSUMERS
(3) RESPONSIVENESS TO NEW OR CHANGED PUBLIC POLICIES

in water supply activities do not provide clear and detailed standards and procedures nor do they satisfy the real needs of either the private or the public sector.

Generally, relevant Indonesian laws and regulations are unclear and are not detailed. Terms used in them are undefined and are not self-defining. No procedures are clearly provided through which private parties may enforce their legal rights through courts or independent bodies. Standards for decision-making are expressed only in vague terms. Administrative procedures are not stated in sufficient detail to serve as guidance for implementing agencies of the Government of Indonesia or to advise the private sector of exactly what opportunities are offered to it and how it should proceed to explore those opportunities. The laws and regulations should do all these things. To the degree that this lack of clarity and precision reflects the fact that the Government of Indonesia has not yet thoroughly determined its public policies in this area, implementation should not be attempted until such public policy decisions are made and are reflected in Indonesian laws and regulations.

Current Indonesian laws and regulations establish no clear standards for evaluating the desirability of specific private sector participation proposals in the water supply area or for evaluating their compatibility with essential public policy aims. There are also no legal standards for evaluating the awards of water supply service contracts, the competence of bidders to adequately perform those contracts, the assurance that contracts are awarded on a competitive basis to the bidder who best meets the articulated standards of the Government of Indonesia for a particular contract, or for the form of contract to be used in making such awards No legal authority for, or laws and regulations concerning, BOTs in Indonesia's water supply sector exist. In particular, there is uncertainty about the time at which a transfer of BOT assets will be made. Although PDAMs and other agencies of the Government of Indonesia will *implement* the laws and regulations of Indonesia concerning private sector participation in water supply activities by proposing, evaluating, and authorizing such participation in *specific projects*, the laws and regulations themselves must give detailed guidance in terms of general policy, standards, and procedures to those implementing agencies if they are to be able to implement them in specific cases. Those laws and regulations must also be sufficiently explicit, detailed, and clear to reassure and give guidance to prospective private sector participants. The current laws and regulations do not satisfy these requirements.

There is not any independent regulatory body now established by the Indonesian Government or its subordinate levels of government which operates under clear and consistently applied rules and whose function is to provide a mechanism for permitting private sector investors in monopoly public utilities the opportunity to obtain a reasonable return on their investments while assuring that essential public policy goals of Indonesia are pursued and attained. Members of such independent rate-making bodies should be impartially selected and should sit for limited terms of office. The procedural methodologies of such bodies should operate through explicit and detailed rules which are transparent to the public The procedures should permit private parties to submit information and arguments and might

allow private parties to personally appear before the regulatory body. The standards they apply in setting rates should also be clear and expressed with sufficient precision to assure the public, the private investors, and the Government of Indonesia of a predictable outcome. The decisions of the regulatory body must be subject to the review of the courts upon the request of private parties.

In summary—

- Indonesian laws and regulations authorizing private sector participation in water supply activities are in apparent conflict.
- Current laws and regulations satisfy neither private sector nor public sector needs although they must satisfy both if they are to be at all effective.
- Applicable Indonesian laws and regulations are not clear and are undetailed and may reflect the fact that the Government of Indonesia has not yet formulated specific relevant public policies.
- In some cases, particularly with regards to BOTs, there is a complete absence of applicable laws and regulations.

12. RECOMMENDED CHANGES TO, AND ADDITIONAL, INDONESIAN LAWS AND REGULATIONS

The private sector requires clarity in any legal description of its legal rights and the standards under which its activities will be regulated by the Indonesian Government. It also requires the consistent and predictable administration by the Government of Indonesia of the existing laws and regulations applicable to its investments. Finally, the private sector must feel assured that its rights are legally recognized and enforceable at law through the courts against the Indonesian Government and its agencies. There are some historical reasons why the private sector may have legitimate concerns that those requirements are not now met regarding its present and prospective investments in Indonesia. It is recommended that the Government of Indonesia continue its current program of providing greater assurances to the private sector that these requirements are, and will continue to be, met. Specifically, applicable laws and regulations should be made clearer and more detailed, with essential terms used in them defined to a thorough and practical degree.

Specifically, Law No. 5 of 1962 should be replaced as proposed by Law No. 6 of 1969 by a new law that will clarify the legal ability of PDAMs and PDABs to contract with private parties or to enter into joint ventures, BOTs, and service contracts with private parties for water supply activities. If such a replacing law cannot be issued, a new law clarifying private sector participation authorization in water supply activities and eliminating the requirement for DPRD approval of each such private sector participation should be promulgated.

The restrictions imposed on foreign investments in the water supply sector by Article 6 of Law No. 1 of 1967 should be clarified. If they are significant, they should be eliminated through new legislation.

A new law should be promulgated or the legal opinion of the Minister of Justice should be sought regarding the significance of Article 33 of the Basic Law on private sector activities in the water supply field.

Ministry of Home Affairs Regulation Nos. 3 of 1986 and 4 of 1990 should be amended to specifically provide legal authorization for BOTs, to clarify the nature of production and profit sharing contracts in the water supply sector and to distinguish the nature of such contracts from those which are used in the petroleum sector to eliminate the requirement for DPRD approval of each private sector participation, and to clarify and provide details of the nature of other permitted forms of private sector participation in the water supply area.

The possible conflicts of law regarding the legal authority of, and restrictions on, private sector participants to engage in water supply activities in Indonesia are listed and juxtaposed in Figure 4.

Figure 4

Possibly Conflicting Authorities—
Private Sector Participation in Indonesian Water Supply Activities

PROHIBITED OR RESTRICTED	PERMITTED
Basic Law of 1945, Article 33 Production branches which are important to the State and provide for the needs of the people must be under the control of the State and water is to be managed and utilized by the government for the maximum benefit of the people.	
Law No. 5 of 1962 PDAMs (see Article 5) have no authority to cooperate with the private sector if this would relinquish "management" by the PDAM.	
Law No. 1 of 1967 Foreign investment may not (see Article 6) "exercise full control" in activities in the drinking water sector, although [see para. (2)] foreign investment in this sector is not absolutely prohibited.	
	Presidential Decree No. 21 of 1989 The private sector is permitted to participate in the water supply sector because "water supply" or "drinking water" is not listed as an area from which any form of new private sector investment is excluded.
	Regulation of Minister of Home Affairs Nos. 4 of 1990 and 3 of 1986 Permits, inter alia, cooperation of prescribed types between regional enterprises and the private sector.

The legally mandated methodology for rate-making and the setting of tariffs for the sale of water should be based on clear and readily calculable determinations of the cost of delivered water. Such tariff schedules should be legally defined. Tariffs should preferably be established by independent bodies which are free from political influences which must act in accordance with precise and clearly articulated standards. Tariff rate schedules must be reviewed and adjusted on a regularly scheduled and/or specially requested basis in order for the tariffs to reflect changed circumstances. The tariff rate determinations of those independent bodies must be subject to judicial scrutiny and judicial modification based on their inconsistency with the legally established standards by which those independent bodies are required to conduct their proceedings.

Laws, policies, and guidelines should clearly state where and how private sector participation in the water supply sector will be welcome, where it will be unwelcome, and on what terms it will be judged. This will permit private sector investors/contractors to realistically evaluate investment opportunities and only pursue those where they and the Government of Indonesia are likely to find mutually acceptable accommodation.

For any government, the participation by the private sector in economic activities where the private sector will attain complete or localized officially-recognized or *de facto* monopoly powers poses a serious threat to its ability to effectively pursue its public policy objectives. Further, such monopolies in private sector hands also pose a potential threat of exploitation by the private sector of consumers through the private sector's monopolistic control of the provision of services and goods. Water utilities are classic cases of such monopolies. Any possible adverse effects of private sector participation in monopolies may generally be avoided through carefully administered government regulation.

The Government of Indonesia has an essential interest, which must be protected by law and through established administrative
procedures, to assure that its fundamental public policy goals are not frustrated by the participation of private sector parties in the water supply sector. This must be accomplished by the clear articulation of the administrative methods—including which ministries and agencies of the Indonesian Government have review and approval authority—through which applications by the private sector to participate in water supply activities will be considered and the standards under which any such applications will be evaluated. It must include continuing oversight of the activities of private sector investors/contractors to assure that they do not improperly exploit their monopoly economic position.

Evaluation of private sector activities in the water supply area must also be the subject of continuous monitoring to assure that private sector participation generates those benefits which originally justified the authorization for its participation and to assure that competing private sector participants are provided regular and fair competitive opportunities to participate in permitted water supply activities. This may only be accomplished through the

creation of a new agency or the delegation of power to an existing governmental body to perform such a role in accordance with clearly established administrative procedures and the consistent application of explicit standards.

Standard contractual forms should be created to be used for the award of service contracts by public water utilities. Standards should be established to evaluate the competence of prospective bidders on such contracts and to assure that the bidder which most completely satisfies those standards is ultimately awarded the contract. Bidders who have not been awarded a contract but who think they should have been awarded the contract under the applicable standards should have the right of recourse to the courts for a reevaluation of the contract award process. The courts should have the power to overturn the award where it has been improperly made.

In summary, it is recommended that—

- Applicable Indonesian laws should be written clearly and in a detailed fashion and that they should be implemented and enforced consistently and rigorously.

- A new law or laws should be promulgated to replace Law No. 5 of 1962 and/or to clearly authorize private sector participation in Indonesian water supply activities; to clarify/eliminate conflicts of law regarding that participation and Article 33 of the Basic Law, Law No. 5 of 1962, and Law No. 1 of 1967; and to eliminate any requirement for DPRD TK. I approval of each such participation.

- Regulation of the Minister of Home Affairs Nos. 3 of 1986 and 4 of 1990 should be amended or a new regulation issued to authorize BOTs and to provide needed details, definitions, and clarifications regarding other permitted forms of, and procedures for, private sector participation in Indonesia's water supply activities.

- Where a private sector investor is dependent on revenues based on a tariff schedule for water to cover its costs and realize a reasonable rate of return on its investment, tariff rate-making methods must be clearer, more detailed, reflective of the needs of the private sector investor, frequently subject to review and revision, and subject to enforcement by the private sector investor through the courts.

- In general, Indonesia must establish a regulatory system for its water utilities which satisfies the needs of both the private and public

sectors; provides for continuous monitoring and evaluation of private sector performance; and the continuous reformulation of government objectives and public policies based on recent and continuing empirical experience.

13. DRAFT LAW

Regarding: A law to clarify the permitted activities of the private sector in Indonesian water supply activities.

In Consideration of: A. basic law of 1945, particularly Article 33; B. Law No. 5 of 1962, particularly Article 5; and C. Law No. 1 of 1967, particularly Article 6.

Chapter I—Article 1—The provisions of the basic law of 1945, Article 33, state that "Production branches which are important to the state and provide for the needs of the people must be under the control of the State" and "Water is to be managed and utilized for the needs of the people by the government."

Article 2—These restrictions are unchanged by this law, but—in clarification—it is sufficient to satisfy the above requirements if the private sector engages in activities in Indonesia's water supply functions which are explicitly authorized by the State and remain under the control of the State.

Chapter II—Article 1—Law No. 5 of 1962, Article 5, prohibits regional enterprises from cooperating with third parties in any way which would relinquish "management" over those activities for which it is responsible.

Article 2—This prohibition is unchanged by this law, but—in clarification—it is sufficient to satisfy the above requirement if any transfer of a PDAM's/PDAB's assets to third parties is made with the explicit authorization of the Ministry of Home Affairs or a person to whom he has delegated this function and if any cooperation with a third party by a PDAB/PDAB is made under a written contract entered into in accordance with the relevant rule and regulations of the Minister of Home Affairs.

Chapter III—Article 1—Law No. 1 of 1967, Article 6, prevents foreign investment in the drinking water sector where the foreign investor would "exercise full control."

Article 2—This prohibition is unchanged by this law, but—in clarification—it is sufficient to satisfy the above requirement if any foreign investment in the drinking water sector is authorized by BKPM and if it remains under the continuing regulation of the Minister of Home Affairs.

Chapter IV—Article 1—Domestic and foreign private sector investments in build, operate and transfer ("BOT") infrastructure in the drinking water sector are hereby authorized when such investments are made in compliance with the rules and regulations and under the continuing regulation of the Minister of Home Affairs and/or if each such investment is explicitly authorized by the _____.

Article 2—No formal approval or ratification shall be required of any private sector participation in drinking water activities, to include cooperation with PDAMs/PDABs or related tariff rate-making, by any DPRD TK. I or II.

Minister of Home Affairs Regulation No. ____ of 199__.

Regarding: The award of service/management contracts by PDAMs/PDABs to third parties.

Chapter I—PDAMs/PDABs are hereby authorized to make awards of service/management contracts to third parties where to do so would result in cost savings, greater efficiency, improved service to customers, or similar benefits.

Chapter II—No such contracts will be awarded unless they are: (a) awarded competitively as provided below; (b) concluded through a written contract which is approved by the _____ or some delegated authority; (c) for a limited term; and provide compensation to the third party commensurate with the benefits to be realized; and (d) subject to continuing monitoring and control by the PDAM/PDAB to assure compliance by the third party with any contractual terms and conditions.

Chapter III—Article 1—Any service/management contract which is proposed to be awarded by a PDAM/PDAB must be drafted by the PDAM/PDAB regarding its specific terms and conditions before it is announced for bids.

Article 2—The proposed award of such contract and requests for tender bids by third parties for the contract must be advertised conspicuously in at least two regularly published general circulation newspapers and provided to commercial attaches or all major foreign embassies at least _____ days prior to any award.

Article 3—A copy of the proposed contract draft must be provided by any party which requests it.

Article 4—Third parties wishing to compete for the contract must submit sealed bids for the context on or before a data specified by the above advertisements and no bids may be accepted after that date. Sealed bids must be accompanied by sufficient information to demonstrate that the third party has the competence and the resources to perform under the contract. All sealed bids must remain sealed and in a secure place under the constant control of the PDAM's/PDAB's officer responsible for the contract.

Article 5—The qualifications of bidders will be reviewed by the PDAM/PDAB and those bidders found to be unqualified will be so notified promptly and in writing, to include the reasons for disqualification, by the PDAM/PDAB officer responsible for the contract

Article 6—In a public place with third parties permitted to be present and at an announced place and time, the PDAM's/PDAB's officer responsible for the contract will open all the sealed bids of qualified bidders in the sequence in which they were received, and shall read each of them aloud. At that time, the contract will be provisionally awarded to the maker of the lowest qualified bid, contingent upon finalization of a formal written contract.

Article 7—Where there is only one qualified bidder, no award of a contract will be made until the bidder's tender has been specially reviewed and approved by the _____ or his delegated official.

Article 8—Any bidder which has been disqualified or which was not awarded the contract may have recourse to an appropriate court of law for judicial review of the contract award with these and other relevant regulations, rules and procedures.

Minister of Home Affairs Regulation No. _____ of 199__.

Regarding: The water tariff rate-making where a private sector party is dependent on such tariffs for its revenues from its legally authorized activities.

Chapter I—All water tariff rate-makings where a private sector party is dependent on such tariffs for its revenues from its legally authorized activities shall be conducted in accordance with these regulations and with other rules formally promulgated for such rate-makings where not inconsistent with this regulation.

Chapter II—All such rate-makings shall be based on calculations and revenue projections derived from full, sufficient and reliable information and using the formal accounting rules specially promulgated for PDAMs/PDABs or generally accepted accounting rules where other rules are unclear, imprecise, or silent on a point or do not exist.

Chapter III—Revenue projections and tariff rate-making shall result in the full recovery by the private party of all its legitimate costs plus a reasonable rate of return on its investments. A reasonable rate of return will be commensurate with prevailing commercial rates of return on investments of similar risk and will exceed current rates on commercial depository instruments

Chapter IV—The private party may attend and participate in any rate-making bodies' proceedings.

Chapter V—Tariff rates shall be reviewed and revised annually and will be reviewed and revised specially upon the private party's request where justified by significant and unanticipated changes in circumstances.

Chapter VI—All decisions of water tariff rate-making bodies shall be subject to challenge by the private party in a court of law and will be subject to judicial review for compliance with applicable rules and regulations.

14. LISTING WITH BRIEF DESCRIPTIONS AND SELECTED TRANSLATIONS INTO ENGLISH OF PRINCIPAL RELEVANT INDONESIAN LAWS, REGULATIONS, AND OTHER OFFICIAL DOCUMENTS

(a) Basic Law of 1945, particularly Article 33 which states "Production branches which are important to the country and which provide for the needs of the people must be under the control of the State" and "Earth, water and other ground resources have to be managed/utilized by the government for the maximum benefit of the people." The Basic Law is the Indonesian constitution. It is superior to all other Indonesian laws and legal authorities.

(b) Dutch East Indies Commercial Code of 1847. This is the essential law regulating commercial and corporate legal activities and transactions. It is now being revised. It is invalid to the extent it is incompatible with Indonesian independence or conditions or is revoked by subsequent Indonesian law. It is based on the Roman Code of Justinian and is similar to continental European civil codes.

(c) The Indies Tariff Law (*Indische Tariefwet*) (Staatsblad 1873 Number 35), as amended and supplemented most recently by Government Regulation No. 6 of 1969. It is the basic law regulating customs tariffs and administration.

(d) Law No. 5 of 1962 which is concerned with the establishment of regional government enterprises at provincial/local levels of government. It serves as the fundamental legal basis for the establishment of PDAMs and PDABs. The current status of this Law is ambiguous. It was revoked by Law No. 6 of 1969, but revocation was made contingent upon the enactment of a new law to replace Law No. 5 of 1962. No such superseding law was ever enacted.

CHAPTER II: CHARACTERISTIC, OBJECTIVE AND FIELD OF ACTIVITY

Article 4:

(1) A Regional Government Enterprise (of Level I or II Governments) is established under a Regional Government Regulation (*Peraturan Daerah* = PERDA), based on this Law.

(2) The Regional Government Enterprise as meant in paragraph (1) is a Legal Entity, the status of which is obtained with the existence of this Law.

(3) The Regional Government Regulation as meant in paragraph (1) will come into force upon legalization by the appropriate government executive (For Special Regions of Level I Government, the President; For Provincial Level I Government, the Minister of Home Affairs; For Local Level II Government, a governor of Level I).

Article 5:

(1) The Regional Government Enterprise is a production unit with the characteristic of:
   a. providing service
   b. serving public needs
   c. gaining revenue

(2) —

(3) —

(4) The important/main production branches for the Region which effect the well-being of the community of the Region concerned are to be managed by Regional Government Enterprises whose capital wholly or partly must be part of the separated assets of the Regional Government.

CHAPTER III: CAPITAL

Article 7:

(1) The capital of a Regional Government Enterprise consists of assets wholly or partly belonging to a Regional Government, which forms a separated asset.

(2) The capital of a Regional Government Enterprise may not consist of shares.

(3) —

(4) —

CHAPTER V: THE MANAGEMENT

Article 11:

(1) A Regional Government Enterprise will be managed by a Board of Directors, whose number and composition is stipulated in its Establishment Deed (Articles of Association).

(2) Members of a Board of Directors must be Indonesian nationals appointed and dismissed by the appropriate government executive.

(3) Appointment as meant in paragraph (2) is for a period of 4 (four) years at the most. After the said period ends, a member may be reappointed.

Article 15:

(1) The Board of Directors shall make decisions on the management policy of the Regional Government Enterprise.

(2) The Board acts as the executive and manages the assets of the Regional Enterprise.

Article 16·

limited power (authority) of the Board are prescribed in the Regional Enterprise's Articles of Association.

Article 17:

Each Regional Enterprise will have a Supervisory Board which is further subject to regulation by the PERDA (the Regional Government Regulation on the establishment of the Regional Enterprise).

CHAPTER VII: CONTROL

Article 19:

The Board is under the control of the appropriate government executive or the head of an agency appointed by him

CHAPTER VIII: STIPULATION ON THE USE OF PROFIT AND THE CONTRIBUTION OF PRODUCTION SERVICE

Article 25:

(1) —

(2) The use of the net profit after deduction of depreciation, reserve and other real deductions within the Enterprise, is determined as follows:

a. for the Regional Development Fund—30%
b. for the Regional Expenditure Budget—25%
c. for General Reserve Fund, social and education fund, production service, and Retirement Fund and Donation, the amount of each is stipulated in the Articles of Association of the Enterprise totalling 45%.

CHAPTER XIV: PERSONNEL

Article 26:

(1) The status, salary, retirement fund and donation and other income of the Board members and personnel/employees of a Regional Government Enterprise is regulated in the PERDA (Regional Government Regulation) and is effective after getting legalization from the Governor for a Level II Government Enterprise and the Minister of Home Affairs for a Level I Government Enterprise, taking into account the stipulations of the prevailing Regional Government Salary Regulation.

(e) Law No. 1 of 1967 regarding foreign investments. It is the basic laws under which all foreign investments in Indonesia are regulated and authorized by BKPM. In Article 6, it list nine economic sectors closed to foreign investors "exercising full control," a term which is not defined. "Drinking water" is one of those listed economic sectors.

Article 2:

Foreign Investment in this Law means:

a. foreign exchange which does not form a part of the foreign exchange resources of Indonesia, and which

with the approval of the Government is utilized for financing an enterprise in Indonesia.

b. equipment for an enterprise, including rights to technological developments and materials imported into Indonesia, provided the said equipment is not financed from Indonesian foreign exchange resources.

c. that part of the profits which in accordance with this Law is permitted to be transferred, but instead is utilized to finance an enterprise in Indonesia.

Article 3:

(1) An enterprise as intended by Article 2, which is operated wholly or for the greater part in Indonesia as a separate business unit, must be a legal entity organized under Indonesian Law and have its domicile in Indonesia.

(2) The Government shall determine whether an enterprise is operated entirely or for the greater part in Indonesia as a separate business unit.

Article 5:

(1) The Government shall determine the fields of activity open to foreign investment, according to an order of priority, and shall decide upon the conditions to be met by the investor of foreign capital in each such field.

(2) The order of priority shall be determined whenever the Government prepares medium and long-term development plans, taking into consideration developments in the economy and technology.

Article 6.

(1) Fields of activity which are closed to foreign investment exercising full control are those of importance to the country and in which the lives of a great deal of people are involved, such as the following:

a. harbors;

b. production, transmission and distribution of electric power for the public;

c. shipping;
d. telecommunications;
e. aviation;
f. drinking water;
g. public railways;
h. development of atomic energy;
i. mass media.

(2) Industries performing a vital function in national defence, among others, the production of arms, ammunition, explosives, and war equipment, are absolutely prohibited to foreign investment.

Article 18:

Every permit for investment of foreign capital shall specify the duration of its validity, which shall not exceed 30 (thirty) years.

Article 23:

(1) In the fields of activity open to foreign capital, cooperation may be effected between foreign and national capital, with due consideration given to the provisions of Article 3.

(2) The government shall further determine the fields of activity and the forms and methods of cooperation between foreign and national capital utilizing foreign capital and expertise in the fields of export and the production of goods and services.

Article 27:

(1) Enterprises mentioned in Article 3 of which the capital is entirely foreign, are obligated to provide opportunities for participation by national capital, following a specified period and in a proportion to be determined by the Government.

(2) When participation as intended by Section (1) of this Article is effected by selling existing shares, the proceeds of such sales can be transferred in the original currency of the foreign capital concerned.

Article 28:

(1) Provisions of this Law shall be implemented by coordination among the Government agencies concerned in order to ensure harmonization of Government policies regarding foreign capital.

(2) Procedures for such coordination shall be subsequently determined by the Government.

(f) Law No. 6 of 1968 concerning domestic investments. This law was originally designed to attract back to Indonesia flight capital and is the authority under which BKPM now licenses "facilitated" domestic investments.

Article 1:

(1) That which is intended by "Domestic Investment" in this Law is a portion of the property of Indonesian society, including rights and goods, owned either by the State or by National Private or Foreign Private Entities domiciled in Indonesia which has been reserved/made available for the operation of an enterprise insofar as such capital is not governed by the provisions of Article 2 of Law No. 1 of 1967 concerning Foreign Capital Investment.

Article 2:

That which is intended by "Domestic Investment" in this Law is the use of property as referred to in Article 1, either directly or indirectly for the operation of a business in accordance with or based upon the provisions of this Law.

Article 3:

(1) A national enterprise is an enterprise of which at least 51% of the domestic investment therein is owned by the State and/or a National Private Enterprise. This percentage shall be increased so that on January 1, 1974, it will amount to not less than 75%.

(2) A foreign enterprise is an enterprise which does not satisfy the conditions of Section (1) of this Article.

(3) Should an enterprise intended by Section (1) of this Article be a limited liability company, then at least the percentage of the total shares as referred to in Section (1) of this Article must be identified by a holder.

Article 4:

(1) All fields of activity are in principle open to private enterprise. State activities in connection with the development of fields of private activity include fields to be initiated or pioneered by the Government.

(2) Fields of State activity include especially those fields of undertaking which the government is obligated to conduct.

(g) Law No. 11 of 1970 which amended and supplemented Law No. 1 of 1967.

(h) Law No. 12 of 1970 which amended and supplemented Law No. 6 of 1968.

(i) Law No. 8 of 1971 regarding Pertamina's right to exclusively license private sector participants in the Indonesian petroleum-related economic sector.

(j) Law No. 5 of 1974 which is concerned with decentralization and the establishment of autonomous authority in the provincial and local governments regarding administrative matters.

Article 2

To organize and establish an Administration, the territory of the Republic of Indonesia shall be divided into Autonomous Regions and Administrative territories.

Article 3:

(1) In the framework of the implementation of the decentralization principle, there shall be organized and established Regions of the First Level and Regions of the Second Level.

Article 7:

A Region has the right, is authorized and is obliged to organize and manage its own services in accordance with the prevailing laws and regulations.

Article 8:

The additional transfer of governmental affairs to the Region will be stipulated by Government Regulation.

Article 13:

(1) The Regional Government will consist of the Head of the Region and the Regional Legislature.

Article 38:

The Head of Region with the approval of the Regional Legislature shall have the authority to issue Regional Regulations (Perda).

Article 39:

(1) Regional Regulations (Perda) and/or Decisions of the Head of Region may not be in contravention of the general interests and statutes of Regional Regulations of the higher level.

(2) A Regional Regulation shall be signed by the Head of Region and be countersigned by the Chairman of the Regional Legislature.

Article 55:

Sources of Regional Revenue are:

(1) Original revenue of the Regional Government consisting of:
   a. revenue from regional taxes
   b. revenue from regional fees
   c. revenue from Regional Enterprises
   d. other legal regional revenues

(2) Revenue originating as subsidies from the (central) Government consist of:

   a. subsidy from the (central) Government
   b. other contributions regulated by statutes.

(3) other legal revenue.

Article 59:

(1) The Regional Government may set up a Regional Enterprise of which the execution and maintenance shall be carried out based upon the principle of cost accounting.

(2) Basic stipulations on Regional Enterprises shall be determined by Law (Statute). (Note: See Law No. 5/1962)

(k) Law No. 11 of 1974 regarding water resources and which has a wide applicability to other public water utility issues.

Article 2:

Water and its resources, including the natural wealth contained therein, has a social function and must be used for the maximum welfare of the people.

Article 3:

(1) Water and its resources must be managed/controlled by the State.

(2) The State therefor gives the authority to the Government:

a. to manage and develop the use of water and/or water resources.
b. to formulate, legalize and/or issue licenses according to planning and technical planning of water/water resource management.
c. to organize, legalize and/or issue licenses for the purpose, the use and the supply of water and/or water resources.
d. to organize, legalize and/or issue licenses for the exploitation of water and/or water resources.
e. to determine and arrange legal deeds and legal relations between persons and/or corporate bodies in water and/or water resources matters.

Article 4:

The authority of the Government as meant in Article 3 can be delegated to Government agencies/units, at Central as well as at Provincial and Regional

Level and/or to certain legal entities based upon the requirements and procedures to be determined by Government Regulation.

Article 5:

(1) The Minister, who is given the task of water resources affairs (Ministry of Public Works, Directorate General of Water Resources), is authorized and responsible to coordinate all regulations concerning planning, technical planning, control, exploitation, maintenance, protection and the use of water and/or water resources; with due consideration of the interests of other related Ministries and/or Institutions.

Article 11:

(1) The exploitation of water and/or water resources, aimed to enhance its benefit for the welfare of the people, is basically carried out by central as well as Regional Government.

(2) A corporation, social organization, or person exploiting water and or water resources must obtain a license from the Government.

(l) Law No. 4 of 1982 regarding environmental protection.

(m) Law No. 6 of 1983 concerning general tax matters.

(n) Law No. 7 of 1983 concerning income taxation.

(o) Law No. 8 of 1983 concerning value added taxation on goods and services and a sales tax on luxury goods.

(p) Law No. 12 of 1983 regarding customs.

(q) Law No. 13 of 1983 regarding taxation of real property.

(r) Law No. 15 of 1985 regarding private sector participation in electricity.

(s) Law No. 3 of 1989 regarding private sector participation in telecommunications

(t) Government Regulation No. 22 of 1982 regarding water management as it concerns sourcing of water supplies from streams and groundwater.

Article 2:

(1) The system of water management should be based on the principles of public benefits, balancing of competing interests, and preservation of a natural resource.

(2) A water right is the right of water-use only.

Article 5:

(2) The Regional Government is responsible for the implementation of authority within the framework of its duty to assist the Central Government with regards to water and/or water resources within its regional boundary.

(3) The authority regarding water and/or water resources crossing more than one regional boundary is still in the hands of the Minister of Public Works.

Article 11:

(1) The exploitation of water and/or water resources with the purpose of improving its benefit for the people's welfare is basically carried out by the Central as well as Provincial/Local Governments.

(2) Legal entities, social organizations, and/or persons exploiting water and/or water resources should obtain licenses from the Government based on the principle of joint and mutual cooperation.

(3) The implementation of this Article will be further stipulated by Government Regulation.

Article 13:

(1) Water used for drinking holds the top priority above all other needs.

Article 16:

(1) Any person has the right to use water for the needs of his daily life and/or the animals under his care.

(2) Use can be made of water derived from water sources as meant in paragraph (1) of this Article as long as it does not resulting in damage to the water source and its environment or projects constructed for the benefit of the public.

Article 19:

(1) The use of water and/or water sources other than for the needs as stated in Article 16 may only be made under a license.

(2) The use of water and/or water sources as meant in paragraph (1) of this Article covers use for the needs of urban activity, agriculture, power, industry, mining, water traffic, recreation, health and other necessities in accordance with development needs.

(u) Government Regulation No. 24 of 1986 concerning the 30 year licensing period for foreign investment companies.

(v) Government Regulation No. 14 of 1987 regarding the transfer of entities and assets, and the delegation of part of the government's authority in the field of public works, to the provincial and local governments.

Article 2:

Without decreasing the duties and responsibilities of the Minister of Public Works, part of Public Works affairs are transferred to Heads of Level I and Level II Governments based upon the stipulations provided in the Government Regulation.

Article 3:

Part of Public Works affairs as meant in Article 2 which are transferred to Provincial/Level I Governments are:

c: in the field of Human Settlement (Cipta Karya):

6: the development of planning, construction, maintenance and management of clean water in the rural areas, piping systems and artesian wells.

Article 4:

Part of Public Works affairs as meant in Article 2 which are transferred to Local/Level II Governments are:

c: in the field of Human Settlement (Cipta Karya):

10: The construction, maintenance and management of infrastructure and facilities for clean water supply.

Article 8:

(1) The Minister of Public Works organizes technical guidance and controls on the execution/implementation of Public Works affairs which have been transferred to and carried out by Level I Government and Level II Government.

(2) Technical guidance as meant in paragraph (1) shall further be regulated by the Minister of Public Works after obtaining advice and consideration from the Minister of Home Affairs.

(3) Technical control as meant in paragraph (1) shall further be regulated by the Minister of Public Works.

Article 10:

(2) All charges (taxes) in the field of Public Works which have been transferred to Level I and Level II Governments become Level I and Level II Government income and shall further be determined in the Regional Government Regulation (Perda).

(w) Government Regulation No. 20 of 1990 regarding water pollution control.

(x) Presidential Decree No. 54 of 1977 concerning regional basic provisions on investment procedures.

(y) Presidential Decree No. 26 of 1980 concerning regional investment coordinating boards [*Badan Koordinasi Pananaman Modal Daerah* ("BKPMD")]

(z) Presidential Decree No. 35 of 1985 amending Presidential Decree Nos. 33 of 1981 and 78 of 1982 regarding the status, duties, and organizational structure of BKPM.

(aa) Presidential Decree No. 17 of 1986 requiring that Indonesian investment entities in which a majority equity ownership is held by local participants be treated the same as domestic investments under Indonesian law. This Decree was amended by Presidential Decree No. 50 of 1987.

(bb) Presidential Decree No. 21 of 1989 concerning the exhaustive list of 75 economic sectors that are closed for designated forms of new private investment. "Water supply" and "drinking water" are not listed as closed sectors. This seemingly does—but may not—supersede Article 6 of Law No. 1 of 1967 which designates nine economic sectors—including "drinking water"—as being closed to foreign investment because they are of strategic national importance for which the Government of Indonesia will retain exclusive authority. This Decree also supersedes Presidential Decree 15 of 1987 (which superseded Presidential Decree No. 22 of 1986) which established nonexhaustive lists of economic sectors open to new private investment and which listed "drinking water" as an open sector. Economic sectors open to new private sector investment by the Decree may still be closed or restricted by "prevailing laws and regulations" as stated in the Decree.

(cc) Presidential Decree No. 23 of 1990 concerning the establishment of a national pollution board.

(dd) Presidential Instruction No. 5 of 1984 concerning guidelines for the simplification and control of business licensing.

(ee) Presidential Instruction No. 4 of 1985 concerning policies to expedite the flow of goods in support of economic activities.

(ff) Regulation of the Minister of Mining and Energy No. 03/P/M/Pertamber of 1983 requiring licensing of all private use of ground and spring water and water drilling by the provincial governor acting upon the binding advice of the Directorate General of Geology within the Ministry of Mining and Energy.

(gg) Regulation of the Minister of Home Affairs No. 3 of 1986 concerning cooperation by a regional enterprise with a third party. This made possible the establishment of joint cooperation undertakings between a regional enterprise and a private investor.

(hh) Regulation of the Minister of Home Affairs No. 690-536 of 1988 dealing with guidelines for the pricing of water supplies by a PDAM This provides that water supply prices must be decided by the head of the local government and be subject to gubernatorial approval following a proposal from the management of the water company and the favorable considered judgement of the supervisory board This eliminated the requirement for ratification by DPRD TK. II provided in Regulation No. 690-1572 of 1985.

Article 2:

The drinking water tariff will be based upon:

(1) The ability to cover the following expenses:

a. Personnel
b. Electricity
c. Chemicals
d. Organization and Maintenance
e. General Administration
f. Depreciation
g. Rate of interest.

(2) Clear calculations of revenue must be made or the rate of return must be based on a prior calculation.

(3) The price of drinking water must be affordable by all members of the community.

(4) Wealthier consumers must bear part of the cost of providing drinking water to poorer consumers.

(5) The efficient use of water must be promoted.

Article 3:

The system applied for determining a drinking water tariff is the progressive tariff system.

Article 4:

(1) Customer categories are divided into:

Category	I:	Social
	II:	Non-Commercial
	III:	Industry
	IV:	Special—Commercial

(2) The Categories mentioned in paragraph (1) above may also be modified according to the situation and need.

Article 5:

The tariff of drinking water is determined by the Head of Region with his Decision Letter (Decree = *Surat Keputusan*) upon the proposal of the Board of Directors through the Board of Supervisors.

Article 6:

(1) Prior to submission to the Head of the Region, the proposed tariff should first be discussed and considered by the Board of Supervisors.

(2) The consideration by the Board of Supervisors covers political, social, economic and cultural aspects.

(3) If it is considered necessary, the Board of Supervisors may alter the said proposal with or without the approval of the Board of Directors.

(4) The decision of the Head of the Region regarding the tariff determination becomes effective after it is legalized by:

— the Governor (for PDAM Level II Government)
— the Minister of Home Affairs (for PDAM Level I Government).

Article 7:

(1) The Board of Directors in submitting its proposal for determination of a tariff for drinking water to the Head of the Region, should base the proposal upon full consideration of subjects such as:

a. The objective of tariff determination
b. [AVAILABLE COPY UNREADABLE]
c. Price Calculation of water sale
d. Analysis of water price
e. The method of tariff investigation
f. Final Determination of the Tariff Structure.

(2) —

(3) The Head of the Region is not bound by the tariff proposal of the Board of Directors.

(ii) Regulation of the Minister of Public Works No. 65/KPTS of 1989 establishing the Joint Technical Team for Water Supply Capital Investment.

(jj) Regulation of the Minister of Home Affairs No. 4 of 1990 concerning the guidelines for cooperation between a regional enterprise and a third party. This revoked Regulation of the Minister of Home Affairs No. 1 of 1983 concerning the same subject.

Article 2:

The basis for the cooperation between a regional enterprise and a third party shall be mutual interests of both parties which shall be arranged in a joint venture which

a. fully establishes the legal rights and ensures the safety by full adherence to written provisions agreed by both parties,

b. gives equal and appropriate benefits and profits to both parties.

Article 3:

The aims of the cooperation is for increased efficiency, productivity, and effectiveness of the Regional Enterprise in the efforts to continue and to ensure sustainability of the Regional Enterprise and to accelerate mobilization of business by means of:

a. developing existing or already running businesses;
b. establishing new enterprises based on considerations prospects and mutual benefits.

Article 5:

(1) The options for cooperation shall be determined by the conditions and objectives of the Regional Enterprise and the capital agreed in the cooperation.

(2) The cooperation shall be made in forms of:

a. Management cooperation, operational cooperation, profit-sharing cooperation, joint-venture cooperation, financing cooperation, or production-sharing cooperation;
b. Management contract, production contract, profit-sharing contract, and facilities sharing contract;
c. Purchase of stocks or bonds from a limited liability corporation which has good prospects;
d. Agency, usage, and distribution;
e. Selling of stocks and bonds and going public with stocks and bonds;
f. Technical assistance cooperation at national and/or international levels;
g. Any combination of two (2) or more of the types of cooperation described in paragraphs a, b, c, and/or f.

Article 6:

The said cooperation shall be done without changing the legal entity status of the Regional Enterprise.

(2) In drawing up the cooperation agreement both parties shall definitely agree on the type of cooperation, ratio of capital, sharing of profits and/or rewards, period of the cooperation, obligations, penalties, and termination of agreement and/or the possibility for extension, and other matters as necessary.

(3) The execution of cooperation as defined in Article 5 shall be reported to the Minister of Home Affairs following the appropriate governmental chain of command.

Article 8:

(2) The proposed partner for the cooperation (a Third Party), in addition to having the same objectives as the Regional Enterprise, shall meet the following requirements:

a. Shall meet the requirements of·
— (for an Enterprise)—the status of a legal entity set up in accordance with the effective laws and regulations;

— (for an Individual)—the NPWP (Taxpayer's Registration Number)
— (for a Foreign Institution/Private Enterprise)—the license/recommendation from the authority in accordance with the effective laws and regulations.

b. Has positive values in terms of its *bona fides* and credibility, concerning:
— good attitude and dedication;
— sufficient competence/experience in the proposed business;
— sufficient capital.

Article 9:

(1) The cooperation with a Third Party shall be executed by the Management of the Regional Enterprise in accordance with the following provisions:
a. For an investment value of up to Rp. 500.000.000,—and with a period of cooperation no longer than one (1) year, the cooperation shall not require approval by the Head of Region/Authority.
b. For an investment value of Rp. 500.000.000,- and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having had approval by the Head of the Region.
c. For an investment value of over Rp. 1.000.000.000,—and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having been approved by the Minister of Home Affairs.
d. For an investment value and period of cooperation which is not as provided in items a, or b, or c, the cooperation shall only be effective after having had the approval by the Authority prescribed of the maximum limit of investment.

(2) The cooperation agreement as defined in paragraph (1) above shall be made in a deed of the Notary Public.

(3) For a Joint Venture cooperation, in addition to meeting the requirements as defined in Article 8, paragraph (2), the parties in the cooperation shall provide the balance sheets

and the profit and loss accounts in the past three (3) years as already audited by a Public Accountant.

(4) The requirements defined in paragraph (3) above shall not apply to a Third Party which is a newly established corporation formed for the exclusive purpose of the joint venture cooperation.

Article 11:

If considered necessary, the cooperation agreement may be reviewed with the Authority (Minister of Home Affairs for Level I Government and Governor of Level I for Level II Government) before the signing.

Article 12:

(1) Within six (6) months prior to the termination of a cooperation agreement, both parties shall together with the relevant Board of Supervisors of the Regional Enterprise, examine and evaluate all the assets and liabilities related to the cooperation and the prospects of the cooperation, and the possibility of extending the said cooperation period with a Third Party.

(2) If necessary, the Head of Region may set up a Team of Verification and Appraisal consisting of elements of the Regional Government, concerned agencies, Board of Supervisors, and a Consultant competent in his field.

(3) The Management of the Regional Enterprise shall prepare an accountability report to the Head of the Region in connection with the execution of a cooperation, with the attachments of the analysis results and evaluations as defined in paragraph (1) and/or paragraph (3) above in order to get approval of the extension or termination of the cooperation.

(4) The termination of an agreement already approved by the Head of Region as defined in paragraph (3) must be recorded in a "Process Verbal" signed by both parties

Article 13:

(1) The extension of a cooperation period must be executed by the Management of the Regional Enterprise after having applied for an approval in principle by the Head of Region and the Authority.

(2) The submission of an application as defined in paragraph (1) above shall have attached a report as defined in Article 12, paragraphs (1) and (2).

(3) The administration process and all its procedures shall be in accordance with the provisions defined in Paragraphs 7, 8, 9, and 10.

Article 15:

General supervision of the execution of cooperation between the Regional Enterprise and Third Parties will be carried out by the Minister of Home Affairs and the respective Heads of Regions.

(kk) Joint Ministerial Decree of the Ministers of Home Affairs, Public Works, and Finance Nos. 160 of 1978, 281 of 1978, and 360/KMK.011 of 1978 regarding execution and development of clean water construction projects with central government aid.

(ll) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 3 of 1984 and 26 of 1984 and 4 of 1984 and 27 of 1984 regarding the establishment of local drinking water enterprises and the development of PDAMs. These Decrees assigned the Ministry of Public Works responsibility for initial water supply planning and development and assigned the Ministry of Home Affairs the principal responsibility for developing the nontechnical aspects of water enterprises. Joint responsibility was assigned to the Ministries of Home Affairs and Public Works for formulating guidelines for the organizational structure of PDAMs.

(mm) Joint Ministerial Decree of the Ministers of Home Affairs and Public Works Nos. 5 of 1984 and 28 of 1984 concerning guidance about the calculation of drinking water tariffs and regarding the organization, accounting systems, structure, and cost calculations of water utilities.

(nn) Decree of the Minister of Finance No. 540/KMK.011 of 1979 regarding the management of central government funds for the financing of PDAM projects

(oo) Decree of the Minister of Health No. 2180/YANKES/INSTAL/XI of 1981 regarding the establishment of water quality standards and an environmental team.

(pp) Decree of the Minister of Public Works No. 269/KPTS of 1984 regarding BPAMs which provides for a shorter period before they are changed to PDAM status.

(qq) Decree of the Minister of Finance No. 862/KMK.01 of 1987 regarding the issuance of securities through a stock exchange.

(rr) Instruction letter of the Minister of Home Affairs No. 5 dated March 19, 1990, regarding the anticipated change of the form of all regional government enterprises to one or the other of two forms of legal entity, i.e., PERUMDA (*Perusahaan Umum Daerah* or Regional Public Company) and PERSERODA (*Perusahaan Perseroan Daerah* or Regional Limited Liability Company) upon enactment of a law to replace Law No. 5 of 1962.

(ss) Circular letter of the Minister of Home Affairs No. 690-1595 of 1985 which authorized the creation of PMDUs.

(tt) Circular letter of the Minister of Home Affairs No. 690/7072/SJ dated July 10, 1985, to all level one governors, all *bupatis* and *walikotas* of level II, and all directors of PDAMs regarding the possible release by level one and two governments of PDAMs from the duty to provide 55% of their net profits to those governments as provided under Article 25 of Law No. 5 of 1962 if such funds are required for projected development and replacement needs.

> First: to make preparation of the change of the form/type of the legal entity of all Enterprises owned by the Regional Government, which capital is partly or wholly owned as Regional separated assets, such as a *Perusahaan Daerah* (Regional Government Enterprise), *Perseroan Terbatas* (Limited Liability Company) and/or other business activities which in fact are managed according to sound economic principle, ... except the Bank *Pembangunan Daerah* (Regional Government Bank), into 2 (two) types of Legal Entity, i.e. the *Perusahaan Umum Daerah* (PERUMDA = Regional Public Enterprise) and/or the *Perusahaan Perseroan Daerah* (PERSERODA = Regional Limited Liability Company).

(uu) Decision of the Chairman of BKPM No 17/SK of 1986 concerning foreign share participation in existing businesses.

(vv) Decision of the Chairman of BKPM No. 5/SK of 1986 regarding local equity participation requirements in joint ventures with foreign investors. This Decision

followed and implemented the provisions of Article 27 of Law No. 1 of 1967, Circular Letter from the Chairman Nos. 1195/A/BKPM/X of 1974 and B 109/A/BKPM/II of 1975, and BKPM Internal Guidelines of 1981. The Decision was further modified by Decisions of the Chairman Nos. 08/SK and 16/SK of 1989. Also see Decision of the Chairman of BKPM No. 13 of 1986 which amended Decision Nos. 5 of 1986 and 10 of 1985 which largely concerned the procedures for application for approval and facilities for domestic and foreign investments.

(ww) Guidelines on the Accounting System of PDAMs of August 1990 issued by the Minister of Home Affairs.

(xx) Implementing Guidelines for Regulation No. 690-536 of 1988 (Interim Report) (undated) regarding the calculation of drinking water tariffs by PDAMs.

(yy) Organizational structure of PDAMs (undated) issued by the Minister of Home Affairs.

(zz) Decree of the Governor of the Special Province of Jakarta No. D.IV-a.12/1/49 of 1974 on the regulation of digging and drilling for groundwater in Jakarta Special Province.

(a') Decision of Jakarta Governor No. 664 of 1980 concerning the organization, structure, and work division of the drinking water company of the Special Municipality of Jakarta ("PAM Jaya").

(b') Provincial Regulation of East Java No. 6 of 1980 amending the provincial water regulation of East Java of 18 November, 1938, on the use of water.

(c') Provincial Regulation of East Java No. 5 of 1983 concerning drilling and the use of underground water in East Java.

(d') Provincial Regulation of East Java No. 2 of 1987 regarding the establishment of PDABs.

(e') Surabaya PDAM Regulation No. KPTS/29/411.61 of 1985 regarding private sector service contracts for bill collection.

COLLECTIONS OF, AND COMMENTARIES ON, INDONESIAN LAWS

A collection in the Indonesian language of relevant laws and regulations on regional enterprises (including water supply activities) is contained in a soft cover book entitled *Himpunan Peraturan Perundang-Undangan Perusahaan Daerah* published in 1990 by PUOD.

A collection of laws and regulations in the English language on private sector investments in Indonesia is contained in a soft cover book entitled *Investment Law and Regulations* published by BKPM in an unspecified year after 1985.

A general description of the Indonesian legal system in the English language is contained in a soft cover book entitled *Law in Indonesia* by Professor R. Subekti, S.H., published by Gunung Agung, Jakarta, in 1973.

15. LIST OF ACRONYMS, ABBREVIATIONS, AND INDONESIAN LANGUAGE TERMS COMMONLY USED (SEE WORKING PAPER G)

ANNEX

THE COLLECTED TEXTS OF SELECTED RELEVANT INDONESIAN LAWS, REGULATIONS AND OTHER DOCUMENTS

SHORT DESCRIPTION OF SELECTED PARAGRAPHS/ARTICLES OF INDONESIAN LAWS & REGULATIONS TO PSPUWS

1. *Basic/Constitutional Law—1945*

Article 33:

2. *Law No. 5 Year 1974*

Regarding: "Basic Principles of Administration in the Region (Level I and II Government)".

Objective: The implementation of a real and responsible autonomy of the Region (means Province/Level I and Local/Level II Government) which may secure the progress and development of the Region.

Selected Articles:

Article 2

To organize and establish an Administration, the territory of the Republic of Indonesia shall be divided in Autonomous Regions and Administrative territories.

Article 3:

(1) In the framework of the implementation of the decentralization principle, shall be organized and established Region of the First Level and Region of the Second Level

Article 7:

The Region has the right, is authorized and is obliged to organize and manage its own services in accordance with the prevailing laws & regulations.

Article 8:

The additional transfer of governmental affairs to the Region will be stipulated by Government Regulation (see further below as example: G.R. No.14 year 1987).

Article 13:

(1) The Regional Government consists of the Head of the Region and the Regional House of Representative.

Article 38:

The Head of Region with the approval of the House of Representative issues the Regional Regulation (Perda).

Article 39:

(1) Regional Regulation (Perda) and/or Decisions of the Head of Region may not be in contravention with the general interest and statutes of Regional Regulations of the higher level.

(2) The Regional Regulation shall be signed by the Head of Region and counter signed by the Chairman of the Regional House of Representative.

Article 55:

Sources of Regional Revenue are:

a. Original revenue of the Regional Government consisting of:

1. revenue from regional tax
2. revenue from regional retribution
3. revenue from Regional Enterprise
4. other legal regional revenue

b. Revenue originating from subsidy from the (central) Government consisting of:

1. subsidy from the (central) Government
2. other contributions regulated by statutes.

c. Other legal revenue.

Article 59:

(1) The Regional Government may set up a Regional Enterprise of which the execution and maintenance shall be carried out based upon the principle of cost accounting.

(2) Basic stipulations on Regional Enterprise shall be determined by Law (Statute).

Note: See Law No. 5/1962.

3. *Law No. 5 Year 1962 on Regional Government Enterprise*

CHAPTER II: CHARACTERISTIC, OBJECTIVE AND FIELD OF ACTIVITY

Article 4:

(1) Regional Government Enterprise* is established with Regional Government Regulation (Peraturan Daerah = PERDA), based on this Law.

(2) The Regional Government Enterprise as meant in para (1) is a Legal Entity, the status of which is obtained with the existence of this Law.

(3) The Regional Government Regulation as meant in para (1) comes into force after getting legalization from the superiors (For Special Regions of Level I Government is the President, For Provincial Level I Government is the Minister of H.A., For Local Level II Government is the Governor of Level I).

Article 5:

(1) The Regional Government Enterprise is a production unit which have the characteristic of:

a. providing service

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*It can mean: — Provincial (Level I) Government Enterprise
— Local (Level II) Government Enterprise.

b. to organize public need
c. to gain revenue

(2) —

(3) —

(4) The important/main production branches for the Region which have the effect on the life of the community of the Region concerned, is managed by the Regional Government Enterprise, which capital wholly or partly belongs to the separated asset of the Regional Government.

CHAPTER III· CAPITAL

Article 7:

(1) The capital of the Regional Government Enterprise consists of assets wholly or partly belongs to the Regional Government, which forms a separated asset.

(2) The capital of the Regional Government Enterprise does not comprise of shares.

(3) —

(4) —

CHAPTER V: THE MANAGEMENT

Article 11:

(1) The Regional Government Enterprise is managed by a Board of Directors, which number and composition is stipulated in its Establishment Deed (Articles of Association).

(2) Members of the Board of Directors are Indonesian Nationalities to be appointed and dismissed by the Head of Regional Government*

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* — the Governor for Regional Enterprise of Provincial Level I Government
— the Walikota (Mayor) for Regional Enterprise of Kotamadya/City Local Level II Government.

(3) The appointment as meant in para (2) is for a period of 4 (four) years at the latest. After the said period ends, the said member of the B.o.D. may be re-appointed.

Article 15:

(1) The Board of Directors (B.o.D.) makes decision on the management policy of the Regional Government Enterprise (RGE).

(2) The B.o.D. executes and manages the asset of the RGE.

Article 16:

The stipulations on the limited power (authority) of the B.o.D. are regulated in the R.G.E's Articles of Association.

Article 17:

In each RGE is to be established a Supervisory Board. Which is further regulated in the PERDA (the Regional Government Regulation on the establishment of RGE).

CHAPTER VII: CONTROL

Article 19:

The B.o.D. is under control of the Head of the Region or an Agency appointed by him.

CHAPTER VIII: STIPULATION ON THE USE OF PROFIT AND THE CONTRIBUTION OF PRODUCTION SERVICE

Article 25:

(1) —

— the Bupati for Regional Enterprise of Kabupaten/rural Local Level II Government.

(2) The use of the net profit after deduction of depreciation, reserve and other real deductions within the Enterprise, is determined as follows:

a. for the Regional Development Fund 30%
b. for the Regional Expenditure Budget 25%
c. for General Reserve Fund, social and education fund, production service, Retirement Fund & Donation, the amount of each is stipulated in the Articles of association of the Enterprise, with a total of 45%.

CHAPTER XIV: PERSONNEL

Article 26:

(1) The status, salary, retirement fund & donation and other income of the B.o.D. members and personnel/employee of the Regional Government Enterprise is regulated in the PERDA (Regional Government Regulation) and is effective after getting legalization from the Governor for Level II Government Enterprise and the Minister of H.A. for Level I Government Enterprise, taking into account the stipulations of the prevailing Regional Government Salary Regulation.

4. *LAW on WATER RESOURCE No. 11 Year 1974*

Article 2:

Water and its resources, including the nature richness contained therein has social function and used for the maximum welfare of the people.

Article 3:

(1) Water and its resources is managed/controlled by the State.

(2) The State therefor gives the authority to the Government:

a. to manage and develop the use of water and/or water resources.
b. to formulate, legalize and/or issue license according to planning and technical planning of water/water resource management.

c. to organize, legalize and/or issue license for the purpose, the use and the supply of water and/or water resources.

d. to organize, legalize and/or issue license for the exploitation of water and/or water resources.

e. to determine and arrange legal deeds and legal relations between persons and/or corporate bodies in water and/or water resources matters.

Article 4:

The authority of the Government as meant in art. 3 can be delegated to Government agencies/units, at Central as well as at Provincial and Regional Level and/or to certain legal entities based upon the requirements and procedure to be determined by Government Regulation.

Article 5:

(1) The Minister, who is given the task of water resources affairs (Ministry of P.W., Directorate General of Water Resources), is authorized and responsible to coordinate all regulations concerning planning, technical planning, control, exploitation, maintenance, protection and the use of water and/or water resources; with due consideration of the interest of other related Ministries and/or Institutions.

Article 11:

(1) The exploitation of water and/or water resources, aimed to enhance its benefit for the welfare of the people is basically carried out by central as well as Regional Government.

(2) Corporate Body, Social Organization and or person exploiting water and or water resources, must obtain license from the Government.

5. *Law No. 1 Year 1967*

Article 2:

Foreign Investment in this Law means:

a. foreign exchange which does not form a part of the foreign exchange resources of Indonesia, and which with the approval of the Government is utilized for financing an enterprise in Indonesia.

b. equipment for an enterprise, including rights to technological developments and materials imported into Indonesia, provided the said equipment is not financed from Indonesian foreign exchange resources.

c. that part of the profits which in accordance with this Law is permitted to be transferred, but instead is utilized to finance an enterprise in Indonesia.

Article 3:

(1) An enterprise as intended by Article 2, which is operated wholly or for the greater part in Indonesia as a separate business unit, must be a legal entity organized under Indonesian Law and have its domicile in Indonesia.

(2) The Government shall determine whether an enterprise is operated entirely or for the greater part in Indonesia as a separate business unit.

Article 5:

(1) The Government shall determine the fields of activity open to foreign investment, according to an order of priority, and shall decide upon the conditions to be met by the investor of foreign capital in each such field.

(2) The order of priority shall be determined whenever the Government prepares medium and long-term development plans, taking into consideration developments in the economy and technology.

Article 6:

(1) Fields of activity which are closed to foreign investment exercising full control are those of importance to the country and in which the lives of a great deal of people are involved, such as the following:

a. harbors;

b. production, transmission and distribution of electric power for the public;
c. shipping;
d. telecommunications;
e. aviation;
f. drinking water;
g. public railways;
h. development of atomic energy;
i. mass media.

(2) Industries performing a vital function in national defence, among others, the production of arms, ammunition, explosives, and war equipment, are absolutely prohibited to foreign investment.

Article 18 :

Every permit for investment of foreign capital shall specify the duration of its validity, which shall not exceed 30 (thirty) years.

Article 23:

(1) In the fields of activity open to foreign capital, cooperation may be effected between foreign and national capital, with due consideration to the provisions of article 3.

(2) The government shall further determine the fields of activity, forms and methods of cooperation between foreign and national capital, utilizing foreign capital and expertise in the fields of export and the production of goods and services.

Article 27:

(1) Enterprises mentioned in article 3 of which the capital entirely foreign, are obligated to provide opportunities for participation by national capital, following specified period and in proportion to be determined by the Government.

(2) When participation as intended by section (1) of this article is effected by selling pre-existent shares, the proceeds of such sales can be transferred in the original currency of the foreign capital concerned.

Article 28:

(1) Provisions of this Law shall be implemented by coordination among the Government agencies concerned in order to ensure harmonization of Government policies regarding foreign capital.

(2) Procedures for such coordination shall be subsequently determined by the Government.

6. *Law No. 6 Year 1968 Concerning Foreign Investment*

Article 1:

(1) That which is intended by "Domestic Investment" in this Law is a portion of the property of Indonesian society, including rights and goods, owned either by the State or by National Private or Foreign Private domiciled in Indonesia, which has been reserved/made available for the operation of an enterprise insofar as such capital is not governed by the provisions of article 2 of Law No. 1 of 1967 concerning Foreign Capital Investment.

Article 2:

That which is intended by "Domestic Investment" in this Law is the use of property as referred to in article 1, either directly or indirectly for the operation of a business in accordance with or based upon the provisions of this Law.

Article 3:

(1) A national enterprise is an enterprise of which at least 51% of the domestic invested therein is owned by the State and/or National Private Enterprise. This percentage shall be increased so that on January 1, 1974 it will amount to not less than 75%.

(2) A foreign enterprise is an enterprise which does not satisfy the conditions of section (1) of this article.

(3) Should an enterprise intended by section (1) of this article be a limited liability company, then at least the percentage of the

total shares as referred to in section (1) of this article must be identified by holder.

Article 4:

(1) All fields of activity are in principle open to private enterprise. State activities in connection with the development of fields of private activity include fields to be initiated or pioneered by the Government.

(2) Fields of State activity include especially those field of undertaking which the government is obligated to conduct.

7. *Government Regulation No. 14 Year 1987*

Article 2:

Without decreasing the task and responsibility of the Minister of P.W., part of Public Works affairs are transferred to Heads of Level I and Level II Government, based upon stipulations provided in the Government Regulation.

Article 3:

Part of Public Works affairs as meant in art. 2 which are transferred to Provincial/Level I Government, are:

c: in the field of Human Settlement (Cipta Karya):
6: the development towards planning, construction, maintenance and management of clean water in the rural areas, piping system and artesian wells.

Article 4:

Part of Public Works affairs as meant in art. 2, which are transferred to Local/Level II Government are:

c: in the field of Human Settlement (Cipta Karya)·
10: The construction, maintenance and management of infrastructure, facility of clean-water supply.

Article 8:

(1) The Minister of P.W. organizes technical guidance and control on the execution/implementation of Public Works affairs which have been transferred to and carried out by Level I Government and Level II Government.

(2) Technical guidance as meant in para (1) shall further be regulated by the Minister of P.W. after obtaining advise and consideration from the Minister of H.A.

(3) Technical control as meant in para (1) shall further be regulated by the Minister of P.W.

Article 10:

(2) All charges (taxes) in the field of Public Works which have been transferred to Level I and Level II Government become Level I and Level II Government income and shall further be determined in the Regional Government Regulation (Perda).

8. *Government Regulation No. 22 Year 1982 on "Water Management"*

Article 2:

(1) In the system of water management should be based on the principle of public benefit, balancing and everlasting.

(2) Water right is the Right of water-use.

Article 5:

(2) The Regional Government is responsible for the implementation of authority within the frame of "duty to assist the Central Government" towards water and/or water resources within his regional boundary.

(3) The authority towards water and/or water resources crossing more than one regional boundary is still in the hands of the Minister of P.W

Article 11:

(1) The exploitation of water and/or water resources with the purpose of improving its benefit for the people welfare, is basically carried out by the Central as well as Provincial/Local Government.

(2) Legal Entity, Social Body and/or Person exploiting water and/or water resources should obtain license from the Government and based on the principle of joint and mutual operation.

(3) The implementation of this article will be further stipulated by Government Regulation.

Article 13:

(1) Water for the need of drinking forms the top priority above other needs.

Article 16:

(1) Any person has the right to use water for the need of his daily life and/or the animals under his care.

(2) The use of water derives from water source as meant in para (1) of this article can be benefitted as long as not resulting damage on water source and its environment or public building concerned.

Article 19:

(1) The use of water and/or water source besides for the needs as meant in article 16 must obtain license.

(2) The use of water and/or water source as meant in para (1) of this article, covers the use for the needs of urban activity, agriculture, power, industry, mining, water traffic, recreation, health and other necessities in accordance with development.

9. *Regulation of Minister of Home Affairs No. 4/1990*

Article 2:

The basis for the cooperation (RGE & DSP) shall be for mutual interests of both parties which shall be arranged in a joint which:

a. fully establishes the legal rights and ensures the safety by full adherence to written provisions agreed by both parties,

b. gives equal and appropriate benefits and profits to both parties.

Article 3:

The aims of the cooperation is for increased efficiency, productivity, and effectiveness of the Regional Enterprise in the efforts to continue and to ensure sustainability of the Regional Enterprise and to accelerate mobilization of business by means of:

a. developing existing or already running businesses;

b. establishing new enterprises based on considerations prospects and mutual benefits.

Article 5.

(1) The options for cooperation shall be determined by the conditions and objectives of the Regional Enterprise and the capital agreed in the cooperation.

(2) The cooperation shall be made in forms of:

a. Management cooperation, operational cooperation, profit-sharing cooperation, joint-venture cooperation, financing cooperation, production-sharing cooperation;
b. Management contract, production contract, profit-sharing contract, and business-area-sharing contract;
c. Purchase of stocks, bonds from a Limited Liability corporation which has good prospects;
d. Agency, usage, and distribution;

e. Selling of stocks, bonds, and going public with stocks and bonds;
f. Technical assistance cooperation in national and/or international levels;
g. Combination of two (2) or more of the types of cooperation described in paragraphs a, b, c, and f.

Article 6:

The said cooperation shall be done without changing the legal entity status of the Regional Enterprise.

(2) In drawing up the cooperation agreement both parties shall definitely agree on the type of cooperation, ratio of capital, sharing of profits and or rewards, period of the cooperation, obligations, penalties, and termination of agreement and or possibility for extension, and other matters as necessary.

(3) The execution of cooperation as defined in Article 5 shall be reported to the Minister of Home Affairs following the hierarchy.

Article 8:

(2) The proposed partner for the cooperation (a Third Party), in addition to having the same objectives as the Regional Enterprise, shall meet the following requirements:

a. Shall have meet the requirements of:
   — (for an Enterprise)—the status of a legal entity set up in accordance with the effective laws and regulations;
   — (for an Individual)—the NPWP (Taxpayer's Registration Number)
   — (for a Foreign Institution/Private Enterprise)—the license/recommendation from the authority in accordance with the effective laws and regulations.
b. Has positive values in terms of bonafidity and credibility, concerning:
   — good attitude and dedications;
   — sufficient competence/experience in the proposed business;

— sufficient capital.

Article 9:

(1) The cooperation with a Third Party shall be executed by the Management of the Regional Enterprise, in accordance with the following provisions:

a. For an investment value of up to Rp. 500.000.000,-; and with a period of cooperation no longer than one (1) year, the cooperation shall not require approval by the Head of Region/Authority.

b. For an investment value of Rp. 500.000.000,-; and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having had the approval by the Head of the Region.

c. For an investment value of over Rp. 1.000.000.000,-; and with a period of cooperation of over five (5) years, the cooperation shall only be effective after having had the approval by the Minister of Home Affairs.

d. For an investment value and period of cooperation which is not as provided in items a, or b, or c; the cooperation shall only be effective after having had the approval by the Authority means:
   — Minister of Home Affairs for Level I Government,
   — Governor of Level II for Level II Government,
   with due observation of the maximum limit of investment.

(2) The cooperation agreement as defined in paragraph (1) above shall be made in a deed of the Notary Public.

(3) For a Joint Venture cooperation, in addition to meeting the requirements as defined in Article 8 paragraph (2), the parties in the cooperation shall provide the balance sheets and the profit and loss accounts in the past three (3) years as already audited by a Public Accountant.

(4) The requirements defined in paragraph (3) above shall not apply to a Third Party/an Newly established corporation for the exclusive purpose of the joint venture cooperation.

Article 11:

If considered necessary, the cooperation agreement may be consulted with the Authority means:

— Minister of Home Affairs for Level I Government,
— Governor of Level II for Level II Government, before the signing.

Article 12:

(1) Within six (6) months prior to the termination of a cooperation agreement both parties shall together with the related Board of Supervisors of the Regional Enterprise shall look through and evaluate all the assets and liabilities related with the cooperation and the possibilities related with the cooperation and the possibilities to extend the said cooperation period with a Third Party.

(2) If necessary, the Head of Region may set up a Team of Verification and Appraisal consisting of elements of the Regional Government/concerned agencies, Board of Supervisors and a Consultant competent in his field.

(3) The Management of the Regional Enterprise shall prepare a accountability report in the execution of a cooperation to the Head of Region, with the attachments of the analysis results and evaluations as defined in paragraph (1) and/or paragraph (3) above in order to get the approval for extensions or termination of the cooperation.

(4) The termination of an agreement as already approved by the Head of Region as defined in paragraph (3) shall be recorded in a Process Verbal signed by both parties.

Article 13:

(1) The extension of a cooperation period shall be executed by the Management of the Regional Enterprise after having applied for an approval in principle by the Head of Region and the Authority.

(2) The submission of application as defined in paragraph (1) above shall be attached with the report as defined in Article 12 paragraph (1) and (2).

(3) The administration process and all its procedures shall be in accordance with the provisions defined in Paragraphs 7, 8, 9, and 10.

Article 15:

General supervision to the execution of cooperation between the Regional Enterprise and Third Parties is carried by the Minister of Home Affairs and the respective Heads of Regions.

Article 16:

With the effectiveness of this regulation, Minister of Home Affairs Regulation No. 1/1983 is declared as invalid.

10. *Minister of Home Affairs Regulation No. 690-536 dated 30 June 1988*

Regarding: The Guidance on Water Tariff Determination by PDAM

Article 2:

To determine the amount of drinking water tariff is based upon:

a. The ability to cover the following expenses:

1. Salary of the personnel
2. The use of PLN electricity
3. Chemicals
4. O & M
5. General Administration
6. Depreciation
7. Rate of interest.

b. Clear calculation of revenue to be obtained or the rate of return based on prior calculation.

c. Tariff of drinking water can be reached by any member of the community.

d. The pattern of National Tariff Structure is "the strong help the weak".

e. The pattern of the efficient use of water.

Article 3:

The system applied for determining drinking water tariff is the progressive tariff system.

Article 4:

(1) Customer category is divided:

Category	I :	Social
	II :	Non-Commercial
	III :	Industry
	IV :	Special—Commercial

(2) The Categories as mentioned in para (1) above, may also be specified according to situation and need.

Article 5:

The tariff of drinking water is determined by the Head of Region with his Decision Letter (Decree = Surat Keputusan) upon the proposal of the Board of Directors through the Board of Supervisors.

Article 6:

(1) Prior submission to the Head of the Region, it should first be discussed and considered by the Board of Supervisors.

(2) The consideration by the Board of Supervisors covers the political, social, economic and cultural aspects.

(3) If it is considered necessary, the Board of Supervisors may alter the said proposal with or without the approval of the Board of Directors.

(4) The decision of the Head of the Region regarding the tariff determination becomes effective after it is legalized by·

— the Governor (for PDAM Level II Government)

— the Minister of H.A. (for PDAM Level I Government).

Article 7:

(1) The Board of Directors in submitting its proposal for tariff determination of drinking water to the Head of the Region, should be covered with complete considerations/ suggestions, such as:

a. The objective of tariff determination
b. Photocopy not clear
c. Price Calculation of water sale
d. Analysis of water price
e. The method of tariff investigation
f. Final Determination of the Tariff Structure.

(2) —

(3) The Head of the Region is not bound with the tariff proposal of the Board of Directors.

11. *Instruction Letter of the Minister of Home Affairs No. 5/1990 dated 19 March 1990 to all Governors of Level I and Bupatis/ Walikotas of Level II*

Regarding: The change of the form (type) of Regional Government Enterprise into 2 (two) forms/types of Legal Entity, i.e. PERUMDA (Regional Public Company) and PERSERODA (Regional Limited Liability Company).

First: to make preparation of the change of the form/type of the legal entity of all Enterprises owned by the Regional Government, which capital is partly on wholly owned and as Regional set aside assets, such as Perusahaan Daerah (Regional Government Enterprise), Perseroan Terbatas (Limited Liability Company) and/or other business activity which in fact are managed according to sound economic principle, etc..... etc. except the Bank Pembangunan Daerah (Regional Government Bank) into 2 (two) types of Legal Entity, i.e. the Perusahaan Umum Daerah (PERUMDA = Regional Public Enterprise) and/or the Perusahaan Perseroan Daerah (PERSERODA = Regional Limited Liability Company).


WASH