

TECHNICAL ASSISTANCE COMPLETION REPORT

Division: SEGF

TA No. and Name TA 3728-INO: Commercialization of Public Service Obligations			Amount Approved: \$1,000,000	
			Revised Amount: ---	
Executing Agency: Ministry of State-Owned Enterprise (MSOE)	Source of Funding: ACCSF		TA Amount Undisbursed 204,951 ^a	TA Amount Utilized 795,049
			Completion Date	
			Original 31 December 2002	Actual 31 October 2003
Approval 25 September 2001			Closing Date	
Date Signing 21 November 2001			Original 31 January 2003	Actual Account yet to be closed
Fielding of Consultants 10 June 2002				
Description				
<p>State-Owned Enterprises (SOEs) are entrusted with public service obligations (PSOs) such as reforestation in Sumatra and Kalimantan, supply of vaccines at below cost prices to the public health system, maintenance of unprofitable but socially desirable air and shipping services, and operation of remote air and seaports. These services are either cross-subsidized by SOEs' profitable business units or directly subsidized by the Government. This practice diverts SOEs' resources from profitable activities, lowers overall returns, and impairs their growth potential, while eliminating incentives for efficient provision of PSOs. To overcome these inefficiencies, PSOs may be contracted out transparently to ensure the lowest cost by the service provider. Pure public goods and services may be provided free by government departments and agencies. To increase transparency of operation of SOEs, prepare them for eventual privatization and achieve full management accountability for commercial operations, the Government needs to separate PSOs from commercial activities in SOEs.</p>				
Objectives and Scope				
<p>The objective of this technical assistance (TA) was to identify and measure PSOs in SOEs, and to recommend alternative, more efficient provision mechanisms, including opening of business opportunities for private sector companies to provide PSOs. The TA conducted a survey of SOEs to identify PSOs, assessed the impact of PSOs on the financial performance of selected SOEs, and examined whether the accounting systems of SOEs are capable of allocating their general cost components. The TA identified measures to separate PSOs from commercially viable activities of SOEs, which included (i) establishing separate profit centers; (ii) creating a subsidiary or an independent company; or (iii) returning the activities to the relevant government department or a provincial authority. The TA defined the rules and regulations for tendering the supply of PSOs to private companies, and, for a limited number of SOEs with PSOs, estimated these regulations' financial impact on the SOEs and fiscal impact on the budget.</p>				
Evaluation of Inputs				
<p>The TA had five components, which were supported by international consultants (21 person months), and domestic consultants (42 person months). MSOE provided two full-time counterpart staff to the project, funding for workshops, and office accommodation. The major inputs of the TA for each components were as follows:</p>				
<p>(i) SOE Survey. Two international and six domestic consultant person months were allocated for initial review of about 60 SOEs.</p>				
<p>(ii) Accounting for PSOs. Based on the SOE survey, the nature and cost of PSOs at 10 SOEs were analyzed with six international and 16 domestic consultant person months. The task involved data collection, review of accounting and management information systems, selecting appropriate costing methodology, building financial models, and valuation of PSOs.</p>				
<p>(iii) Commercialization of PSOs. With the input 12 international and 10 domestic consultant person months, the data was further analyzed to identify (a) funding mechanisms, (b) sources of funds and basis for compensation, (c) guidelines for choice of delivery, (d) sample delivery mechanisms, and (e) guidelines for implementation.</p>				
<p>(iv) Dissemination. One international and two domestic consultant person months were used for disseminating the findings of the TA in a number of seminars and workshops to officials from the Coordinating Ministry for Economy, Ministry of Finance, Technical Ministries, and the 10 participating SOEs.</p>				
<p>(v) PSOs and Corporate Governance. Eight domestic consultant person months were allocated for supporting the participating SOEs on integrating PSO analysis and recommendation for commercialization into their statements of corporate intent (SCIs).</p>				
<p>Overall the consultants' performance in terms of efficiency, teamwork and relations with counterpart agencies was very good. Apart from a team of consultants, ADB hired two individual domestic consultants previously working under TA 3714 on corporate governance, to integrate the PSO analysis into the SCIs of the relevant SOEs. Economy and productivity of the inputs were very good, as was the quality of services delivered. A high degree of client satisfaction was achieved. The performance of ADB and the implementing agency, MSOE, is rated as highly satisfactory.</p>				
Evaluation of Outputs				
<p>The TA has made important recommendations for the reforms in the Government's delivery of the obligatory public services. The following are key factors that need to be noted for future follow up:</p>				

^a The consultant is not yet fully paid pending submission of supporting documents.

- (i) **SOE Survey.** The following criteria were applied for screening the SOEs for significant PSOs: (a) the PSO is provided for some identifiable community or social benefit; (b) the PSO is based on a specific government directive to a SOE regarding the provision of the PSO and the conditions (e.g. price) of its supply; and (c) the PSO would not be supplied, or would not be supplied on the same conditions by the SOE, if the concerned SOE were acting primarily in its own commercial interest. On this basis, 23 PSOs were identified in 13 SOEs. After further analysis into the nature of these PSOs and consultation with MSOE, 10 SOEs were selected for further analysis in the project: 10 of the PSOs are integral to the core business of the SOEs – port operations (PT Pelindo IV), loss making airports (PT Angkasa Pura 1), loss making terminal operations – (PT ASDP), three loss making toll roads (PT Jasa Marga), rail passenger economy services (PT KAI), loss making shipping route segments (PT Pelni), provision of standard mail service and loss making post offices (PT Pos), hospital and medical services (PT RSCM), and provision of electricity in loss making supply areas below cost (PT PLN). Two PSOs could be performed by the private sector – rail freight operations in West and North Sumatra (PT KAI), and storage and distribution of urea in several provinces (PT Pusri). Two more PSOs are non-core business and are unlikely to be commercially attractive to the private sector – operation of shipping services on emergency routes (PT Pelni), and operation of ferry services on pioneer routes (PT ASDP).
- (ii) **Accounting for PSOs.** The TA reviewed: (a) the current structure of the SOE accounts and their suitability for costing of PSOs and (b) the accounting system, costing techniques currently used and management information systems. Based on this review the consultants developed a common accounting framework for all SOEs as well as a costing methodology. On this basis, individual models for each of the 10 SOEs were constructed allowing to value the losses caused by the SOE's fulfillment of its PSO. The consultants found a diverse range of systems, knowledge and experience in financial and cost management, but generally, systems and financial reporting were inappropriate for product and service costing and profitability measurement. As a consequence, the consultants had to deal with each SOE separately and make recommendations for improvement. PSOs were finally costed using the avoidable cost approach for PSOs whose production could be concessioned or discontinued, and the absorbed cost approach for PSOs which are a substantial part of the total service.
- (iii) **Commercialization of PSOs.** The final output comprises for each of the 10 SOEs identification of the best funding and delivery mechanism for their respective PSOs and the optimal contractual arrangements for implementation. Based on the experience with individual SOEs, the project also redesigned the international PSO model to suit Indonesian policy and experience, assigning specific tasks to each of the parties involved. The key finding of this project is that commercializing PSOs must involve first optimizing internal restructuring, sectoral restructuring and tariff policy such that PSO payments are obviated. MSOE has to work in conjunction with the SOEs, Finance and Technical Ministries to develop the most appropriate methods of delivering each SOE's PSO activities. In cooperation with the MSOE and the Technical Ministries, the SOEs have to identify and account their PSO activities, review constraints, and develop and implement methods for delivering their PSOs. The SOE and MSOE PSO Team have to address internal restructuring, efficiency issues and the external effects of government policy for the sector as a whole.
- (iv) **Dissemination.** Nine workshops were conducted by the consultants during the project as well as two well attended conferences at the end. For the purpose of dissemination of TA findings, a total of 24 reports were produced plus inception, survey, accounting, draft final, and final reports. The consultations resulted in significant improvements of the output.
- (v) **PSOs and Corporate Governance.** The two domestic consultants assisted the 10 participating SOEs in producing SCIs incorporating assessments and proposals for future treatment of their PSOs.

Overall Assessment and Rating

The TA is rated as highly successful, in consideration of the efficiency of its achievements. In addition to developing a framework for a PSO policy, it also proved its applicability in 10 concrete cases. It achieved capacity building in 10 SOEs through training in very sophisticated accounting methodologies and their application in the real world of the SOE. The consultants achieved strong awareness and high interest for the PSO issue in MSOE and technical ministries. They structured the output for maximum utility in future operations in the sector.

Major Lessons Learned

TA implementation started slowly due to SOE management concerns about the confidentiality of the information provided to the consultants. While MSOE had announced the arrival of the consultants, and disseminated objective and scope of the TA, several SOE managers were initially reluctant to supply the necessary information. As the project depended on good cooperation of a large number of individuals in altogether 17 different organizations, a longer inception period would have been helpful for the consulting team to establish credentials and trust with counterpart staff.

Recommendations and Follow-Up Actions

The TA has supported MSOE in implementing phase one of the 10-year SOE reform program. Continuation of these reforms beyond the year 2004 will depend on the agenda of the new President to be elected by October 2004 and the new Government. While fiscal constraints make a continuation of the privatization highly possible, the same constraint will make the implementation of the developed PSO policy very difficult. Appropriate payments for PSOs from the Ministry of Finance to the supplying SOEs causes high up-front costs, which will only be partly recovered over time through higher dividends and corporate taxes. Given the current fiscal situation of Indonesia, a program loan might be an appropriate instrument to finance the cost of the reforms.