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# Indonesia

## Country Procurement Assessment Report

### Reforming the Public Procurement System

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East Asia and Pacific Region  
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**Acronyms and Abbreviations**

ADB	Asian Development Bank
ARDIN	Association of Indonesian Suppliers
BAPPENAS	National Development Planning Board
BEPEKA	Indonesia's Supreme Audit Authority
BPKP	Indonesia's Internal Audit Agency
BUMD	District/Provincial Government Owned Enterprises
BUMN	State-Owned Enterprises
CFAA	Country Financial Accountability Assessment
CFIU	Corruption and Fraud Investigation Unit of the World Bank
CPAR	Country Procurement Assessment Report
GAPENSI	Indonesian Contractors Association
GBHN	Broad Outlines of State Policy
GOI	Government of Indonesia
HAKI	Association of Construction Experts
INKINDO	Indonesian Association of Consultants
ICB	International Competitive Bidding
IG	Inspectorate Generals
JUKNIS	Implementation Guidelines (Petunjuk Teknis)
KADIN	Indonesian Chamber of Commerce and Industry
KKN	Corruption, Collusion and Nepotism (Korupsi, Kolusi, Dan Nepotisme)
LPJK	Construction Services Industry Board
NCB	National Competitive Bidding
NPPO	National Public Procurement Office
SBD	Standard Bidding Documents
SME	Small and Medium Enterprises
UNCITRAL	United Nations Commission for International Trade Law
UNDP	United Nations Development Program

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## PREFACE

This report is a World Bank staff report, based on work done between February and May 2000 by a team<sup>1</sup> of staff from the World Bank and the Asian Development Bank, and a Government of Indonesia Working Group. Field work was conducted from March 20 to 31, 2000. Bappenas (National Development Planning Board) held a procurement seminar on March 8, 2000, and 50 participants helped identify and discuss the country's major procurement policies, regulations and implementation issues, and suggested improvements. The draft report was reviewed with Bappenas during June - August, and in September/ October 2000 by the World Bank's fiduciary mission<sup>2</sup>. Government provided written comments in August 2000.

The main objectives of the Country Procurement Assessment Review (CPAR) are to diagnose the public procurement system in Indonesia, assess actual compliance with the country's procurement laws and regulations on the ground, and identify reforms to improve the existing system in line with internationally accepted principles.

The CPAR team interviewed public officials and representatives of private sector organizations, major donors, business associations, universities, training institutes, and NGOs. It visited three provinces for interviews with provincial and district governments and business associations. The meetings focused on the legal framework, rules and procedures, prevalent procurement practices, major problems and possible solutions for improving the public procurement system.

The World Bank and the ADB team would like to thank Bappenas, central ministries and agencies, local governments, and business associations for providing members of the GOI Working Group, and private sector organizations, universities, training institutes and NGOs for contributing generously to the CPAR study. Pamela Bigart (OCSPR), Bert Hofman, Sarwar Lateef (WBOJ), V.S. Krishnakumar (AFTQK), and Ignatius Santoso (COPP, ADB) made valuable and useful suggestions by reviewing drafts of this report.

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**INDONESIA: COUNTRY PROCUREMENT ASSESSMENT REPORT**  
**REFORMING THE PUBLIC PROCUREMENT SYSTEM**

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## I. OVERVIEW

1. This Country Procurement Assessment Report (CPAR)<sup>1\*</sup> is the World Bank's contribution to a dialogue with the Government of Indonesia (GOI) on ways to make the public procurement system economic, efficient, transparent and more predictable, and at the same time to help improve the accountability and integrity of the procurement process so as to reduce opportunities for corruption. It also provided a key input into the World Bank's Country Assistance Strategy (CAS) for Indonesia.

2. Public procurement is a central pillar in the Government's ongoing efforts to improve governance. Indonesia has regulated the public procurement regime by way of Presidential Decrees, ministerial directives and letters of information, and other decrees and instructions by Governors, Mayors and Bupatis<sup>2</sup>. Procedures and practices have evolved over the years in response to various efforts to improve the legal framework for procurement<sup>3</sup>.

3. An effective public procurement system is essential for good governance. A poor procurement system results in higher costs to government and the public. It delays project implementation which further increases costs, leads to poor project performance and delays the delivery of benefits to the beneficiaries<sup>4</sup>. Procurement problems also increase scope for corruption, generate more complaints and raise concerns about the integrity of the procurement process. And finally, they discourage good firms (both national and foreign) from participating in bidding, thus deprive the country from receiving better prices and goods, works and services of better quality.

4. From all accounts, the public procurement system in Indonesia does not function well. It is not market driven, has been prone to misuse and abuse, and reduces value for money for public funds. The following are some key reasons why the system, despite the considerable evolution of procurement practices over the last two decades, does not yet function well:

- A multiplicity of legal instruments regulating different aspects of public procurement constitutes a source of confusion with the risk of overlapping jurisdiction, and the lack of clarity in important policy and procedural requirements.
- Basic principles and policies governing public procurement are not anchored at a sufficiently high juridical level of the law, with an effect on the level of transparency and clarity of the regulations, and it has made enforcement difficult.
- Absence of a single agency with a mandate for formulation of procurement policy, and monitoring compliance, and for ensuring clear and enforceable sanctions and enforcement mechanisms.
- Weak compliance with existing procurement rules and procedures, lack of oversight and enforcement.

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\* Notes are given at the end of this report.

- Existing regulations have the effect of limiting competition even within Indonesia, thus violating the principle of one-country, one market and forgoing the benefits that arise from increased competition.
- Lack of capacity in the majority of working level staff and members of the tender committees and approving authorities.
- Serious weaknesses in the old certification system for contractors and consultants.
- Undue influence of business associations in the procurement process.
- Corruption and collusive practices, and other outside influence<sup>5</sup>.
- Uneconomic packaging of contracts possibly because of the mixing of conflicting objectives in public procurement, lobbying efforts by interested groups and collusive practices.
- Insufficient advertising especially for small and medium value contracts.
- Lack of follow up on procurement complaints, and virtually no systematic monitoring of compliance with the procurement principles, rules and procedures.
- Absence of a cadre of project managers and procurement practitioners and of a career stream in the civil service for project and procurement management.

5. The above deficiencies mean that despite improvements in procurement regulations over the years, there is continuing high risk of non-economic influence on public procurement and inefficient use of public resources. These deficiencies, unless tackled urgently, decisively and in a coordinated manner could become even more serious with the devolution of government functions to subnational levels under the decentralization program currently underway.

6. Many even within government agree that corruption and collusive practices are wide spread in public procurement in Indonesia<sup>6</sup>. There is now, however, a window of opportunity for fundamental reforms. The Broad Outlines of State Policy (GBHN) have given high priority to comprehensive governance reforms, strengthened public sector management, building institutions, and to eradicate corruption. There is considerable public support for governance reforms. The new Government has already taken several initiatives to improve governance, such as: (i) legal and judicial reforms including the establishment of an Ombudsman's Commission to address corruption and appointment of a Law Reform Commission, (ii) the work to formulate a civil service reform strategy, (iii) draft laws to strengthen public financial management, (iv) the establishment of an Anti- Corruption Commission, and (v) the establishment of the Partnership for Governance Reforms in Indonesia under the sponsorship of the UNDP, the World Bank and ADB. The new Government also issued a Presidential Decree on revised procurement regulations on February 21, 2000<sup>7</sup>.

7. The Government has a unique opportunity to:

- strengthen the public procurement system as part of its efforts to promote good governance and better fiscal management,
- communicate its vision of a government procurement system free of corruption to the public in general and to the civil service to raise awareness, and

- fundamentally change the way public procurement is practiced by all levels of government and by the business community.

8. At the CGI meeting in Tokyo in October 2000, Government confirmed its commitment to reforms of the public procurement system along the lines of the main recommendations contained in this CPAR. In particular, Government committed itself to: (i) ensure that the same fiduciary standards for procurement (and financial management) are applied at national, provincial and district levels; (ii) establish a National Public Procurement Office (NPPO) to formulate procurement policy, and enhance and monitor compliance; and (iii) support NPPO in the formulation of a public procurement law.

9. The potential economic and social benefits will be large. Annual volume of public procurement of goods, civil works and consulting services under the Government's development budget is around US\$10 billion<sup>8</sup>. In addition, State-owned enterprises (SOEs) carry out large volumes of public procurement<sup>9</sup>. Therefore, even a modest improvement of a few percentage points in public procurement by the Government and SOEs could help save hundreds of millions of dollars and possibly more to Indonesia's public exchequer.

10. The procurement regime in Indonesia needs to move, in practice, towards a market driven system based on the internationally accepted principles in which the bidders compete against each other and provide an effective means of enforcement and of checks and balances. International experience suggests the following four basic principles upon which such a system is based:

- Maximizing economy and efficiency.
- Promoting competition and encouraging maximum participation by suppliers and contractors for the supply of goods, construction or services to be procured.
- Fair and equitable treatment of all suppliers and contractors.
- Transparency in procedures and minimizing opportunities for corruption and collusive activities.

11. Within the Indonesia context, priority actions with the most promise to move the country towards such a reformed procurement process include:

***Reforming the legal, regulatory and institutional framework...***

- Requiring that national standards also apply to public procurement at the level of sub-national governments in order to avoid fragmentation of the national market and deterioration in fiduciary safeguards under decentralization.
- Enhancing the mechanism for formulation of national procurement policy and monitoring compliance by establishing an independent National Public Procurement Office (NPPO). The NPPO should also provide regional governments access to the national database on procurement and information. It could set up offices in the provinces. The NPPO should not however have any contracting function, and it should not be a layer in the procurement

processes of the executing agencies.

- Improving the legal framework by enacting a public procurement law, embodying the basic principles and policies in clear and unequivocal language, that applies to all levels of Government.
- Establishing a clear, robust and credible complaints, review and sanctions mechanism to ensure the right of bidders to raise complaints and have them answered satisfactorily.
- Improving transparency and competition by publishing a Procurement Bulletin (both on paper and electronically) to disseminate public procurement opportunities and specific tenders nationally, and announce publicly all contract awards above an appropriate threshold, including the names of firms or individuals awarded contracts and the value of these contracts, and to publicize sanctions on firms when imposed.

***Increasing competition...***

- Assessing benefits and costs of existing procurement policies and regulations that limit competition among bidders based on their size and contract values, and phasing out such policies within a set time table.

***Improving procedures and practices...***

- Strengthening procedures for the selection of tender committees and project managers.
- Ensuring that professional associations develop procedures for certification of contractors and consultants through a consultative process, and that the procedures are transparent and made public.
- Mandating the use of standard bidding and contract documents, including disclosure of the evaluation criteria, at all levels of Government.
- Reviewing and revising rules and procedures to enhance competition and transparency.

***Building professional capacity...***

- Providing training at all levels and building strong institutional capacity.
- Creating a cadre of and career streams for procurement practitioners and professional project managers.
- Selecting procurement staff from the pool of trained personnel, certified in public procurement.

- Establishing appropriate institutional arrangements (i.e., the proposed Procurement Institute or other arrangements) to provide a focus to the long-term coordination and oversight of the training function at the level of both national and regional governments.

***Preparing for decentralization...***

- Appointing a working group including members of civil society to think through with the NPPO ways to ensure that the procurement system will work effectively in a decentralized environment.

***Strengthening enforcement...***

- Strengthening internal controls and a functioning enforcement capacity within all agencies, and requiring the application of strict sanctions in cases of malfeasance or non-performance.
- Requiring project implementing agencies, bidders, suppliers, contractors and consultants to observe the highest standards of ethics during the procurement and execution of contracts, and to be held accountable for their actions. A code of conduct and ethics for procurement staff or officials should be made public, and be backed by strict enforcement and strong sanctions.
- Instituting a strong anti-corruption program in public procurement, including random, ex-post and independent procurement audits at all levels of government, full investigation of all allegations of fraud and corruption and application of appropriate and publicized sanctions, and submission by NPPO of an annual report on public procurement to the Parliament and legislative bodies at local levels and to the public.
- Conducting annual corruption surveys reflecting the experience of contractors, suppliers and consultants in dealing with government agencies in public procurement, and of the views of civil society about corruption in public procurement to gauge progress, and making the results public.
- Establishing a civil society anti-corruption watchdog group with independent and credible members to advise the NPPO on public procurement.

12. These measures will help make Indonesia's public procurement system economic, efficient, transparent and more predictable. *Yet, they will not be enough by themselves to completely deter corrupt and collusive practices in public procurement.* The most efficiently designed system will be prey to abuse if it is not managed and overseen by a Government with a strong political will to fight corruption and to resist pressure from the strong vested interests. Reforms will therefore also be needed in other areas such as public financial management<sup>10</sup>, auditing, legal and judicial systems, and civil service. All these areas are currently the focus of the Government's efforts to improve governance and fight corruption.

13. Indonesia will reap huge benefits by reforming the public procurement system at all levels of Government. However, these reforms will not be easy in the face of strong vested interests. Some reforms may even take time to fully implement. Yet, it is extremely important to get started and gain momentum. Government has now set up a high level Steering Committee to guide reforms of the public procurement system. It is chaired by the Chairman of Bappenas and includes Echelon I officials from key government ministries, agencies and the Cabinet Secretariat. The Steering Committee is being supported by a small Working Group.

14. The World Bank and ADB stand ready to help the Government in reforming the public procurement system.

### **Strengthening Fiduciary Safeguards in Procurement and Financial Management in World Bank Financed Projects**

15. The overall weak fiduciary environment in Indonesia raises concerns about the value of money and accountability for public funds, especially because practices vary widely from the formal rules and procedures and enforcement is weak. Decentralization, and the increasing shift in the World Bank's new lending to social sector projects, which involve thousands of small-value contracts at the sub-national government level that are generally not subject to prior review by Bank staff, and where capacity for implementation and monitoring is generally weak and the accountability issues are significant, would further increase fiduciary risks in Bank-financed projects.

16. Despite the Bank's best efforts, it is simply not possible to fully insulate Bank-financed projects from the systemic problems in the country's current environment in which they are implemented. The four elements of the World Bank's strategy to help reduce opportunities for corruption and thereby help ensure that proceeds of Bank loans are used for their intended purposes with due attention to economy and efficiency, will be the following (besides the World Bank's broader focus on governance reform and anti-corruption, and collaboration with civil society):

#### ***1. Prevention -- Reducing opportunities for corruption in new projects through strengthened project design...***

- Close attention to the fiduciary environment (public procurement and financial management) and capacity of the implementing agencies and building of adequate safeguards (including actions to strengthen capacity and finalize procurement arrangements at an early stage) in the design of new projects to match with fiduciary risks.
- Priority in new projects to the provinces and districts that demonstrate concerns for economy, efficiency and transparency in the use of public funds.
- Installation of planning, budgeting, and project management reporting systems at an early stage.
- Additional legal provisions to make the National Competitive Bidding (NCB) procedures acceptable to the World Bank. The current side letter on the acceptability of NCB procedures is being substantially strengthened based on findings of this report, for use in all

future projects (see Attachment 2). This requirement would continue until major recommendations of this report are implemented by Government and there is evidence of progress on improving transparency of the public procurement system.

- Greater beneficiary and civil society involvement in the design, implementation and monitoring of projects to enhance transparency and prevent misuse of funds, and third party verification as a feature of new projects.

***2. Supervision and Monitoring -- Strengthening existing mechanisms of fiduciary monitoring and supervision of ongoing projects...***

- Intensification of efforts for requiring updated and satisfactory annual procurement and financial plans and insisting that they are used for guiding implementation and supervision.
- Carrying out regular ex-post procurement and statement of expenditure (SOE) reviews.
- Strengthening capacity of the implementing agencies.
- Follow up on procurement complaints and audit findings.
- Special attention to projects judged to have higher fiduciary risks, based on a risk assessment system.
- An increase in the number of selective site visits to review procurement by sub-national governments and physical progress to match with fiduciary risks.

***3. Enforcement -- Investigating cases of alleged fraud and corruption...***

- The World Bank will rely on its Corruption and Fraud Investigation Unit (CFIU) to investigate cases of alleged fraud and corruption, and apply sanctions where called for. The first visit of CFIU to Indonesia was in November 2000, and a follow-up mission will take place in March 2001.

***4. Supporting Government efforts to reform the public procurement system (and financial management system)...***

This support will follow up on the recommendations of the CPAR and CFAA and the recent fiduciary mission of senior World Bank staff. Full implementation of reforms of the overall systems at all levels of Government will take time. The immediate focus of World Bank support to the Government reform efforts will be on the following:

- Application of national standards, under decentralization, to local government procurement (and financial management).
- Operationalization of the high level committee(s) to guide reform of the public procurement system (and the financial management system).
- Preparation, adoption and publication of action plans to reform the organizational structure and legal framework for public procurement, in particular for the establishment of the National Public Procurement Office (NPPO) which would then formulate national public procurement policy and monitor compliance.

- Revision of current draft laws on State Finance, Treasury and Audit already submitted to Parliament.

17. ***Engaging Civil Society in Monitoring of Project Implementation.*** Building on the positive, recent experience in the Kecamatan Development Project and social safety net adjustment loan models, the World Bank will increase efforts to seek out civil society monitoring of project implementation. Following up on the civil society consultations for preparation of the World Bank's Country Assistance Strategy for Indonesia, the Bank has initiated discussions with "anticorruption" NGOs on ways to activate such a watchdog function to reduce possible corruption in Bank-financed projects. NGOs face financial and staffing constraints, which would need to be addressed as we move forward.

18. *Section II* of this report describes Indonesia's existing public procurement regime and key issues<sup>11</sup>. It makes recommendations for reforming the system in major areas. *Section III* discusses implications of decentralization for public procurement. *Section IV* describes the strategy for strengthening fiduciary safeguards in Bank-financed projects based on lessons of experience and findings of this CPAR. *Attachment one* summarizes key recommendations for implementation which will need to be developed by Government into a time-bound detailed implementation action plan for reforming the public procurement system. *The second attachment* lists provisions required for accepting Indonesia's National Competitive Bidding (NCB) procedures for procurement under Bank-financed projects.

## **II: THE PUBLIC PROCUREMENT REGIME**

### **LEGAL, REGULATORY AND INSTITUTIONAL FRAMEWORK FOR PUBLIC PROCUREMENT POLICY**

19. Indonesia's public procurement system is guided by a number of overlapping legislation, Presidential decrees and implementation regulations. Until the issuance of the Presidential Decree in February 2000 supplemented by the technical guidelines issued in May 2000 by the new Government<sup>12</sup>, all public procurement was regulated by the Presidential Decree issued in 1994<sup>13</sup> with its various amendments, ministerial regulations and manuals. A Construction Law<sup>14</sup> was enacted in 1999 to govern procurement of civil works and related consulting services, and the new Government issued Directives<sup>15</sup> for this law in early 2000. A Presidential Decree in February 2000 also set up a new body (BP4S-PU)<sup>16</sup> for a centralized approval, prior to contract award, of procurement of all public works in infrastructure and facilities with a value of Rp. 50 billion and more (US\$5.56 million) but the new body was abolished in November 2000. In addition, draft laws on State Finance, Treasury and Audit have been prepared. These may have an effect on public procurement. The Law on Small Scale Business (No. 9 of 1995)<sup>17</sup> has an effect on public procurement. Finally, new regulations were issued in November 2000 related to decentralization which have a major impact on public procurement by local governments.

20. In addition, there are a number of detailed implementation regulations by way of ministerial regulations, letters of information from the ministers, and other decrees and instructions by the Governors, Bupatis or Mayors which govern or influence public procurement<sup>18</sup>. Various instruments that were issued following the Presidential Decree in 1994 seem to remain in force or at least their legal status is not clear.

21. The oversight of procurement policy once rested with the Supervisory Committee for Development (WASBANG), chaired by the Coordinating Minister for Economy, Industry and Finance and later by the Coordinating Ministry of Development Supervision and Government Apparatus, under guidance of the Vice President of Indonesia. WASBANG was dissolved in May 1998. The rather unclear position of a central unit became even more fluid with the changes in the ministerial set-up in October 1999 by the new Government. Currently, no organization has an oversight role on public procurement policy and compliance.

#### **22. Key Issues**

- The multiplicity of laws, decrees, and regulations constitutes a source of confusion with the risk of overlapping jurisdiction, and policies and inconsistent provisions governing the same subject.
- The new decentralization regulations allow local governments to establish their own arrangements for public procurement. This could result in fragmentation of the internal market, and deterioration in fiduciary standards.

- Regulation of public procurement through Presidential Decrees has not anchored the basic principles and policies governing public procurement at a sufficiently high juridical level of the law<sup>19</sup>. This has had an effect on the level of transparency and clarity of the law and it has made enforcement difficult.
- A number of basic policy and procedural requirements that are essential for creating a more transparent, efficient and enforceable procurement system<sup>20</sup> are either missing or not clearly defined in the various laws, decrees or regulations governing procurement.
- There is no single agency or a central authority to lay down uniform and consistent policy, rules and procedures in public procurement, and ensure clear and enforceable sanctions and enforcement mechanisms.
- Existing regulations<sup>21</sup> have the effect of limiting competition even within Indonesia by establishing a procurement system aimed at dividing up the internal market among small and medium enterprises (SME) within districts and provinces for certain size contracts, thus violating the principle of one-country, one market, and forgoing benefits that arise from increased competition. Thus public procurement seems to be used as a major policy instrument to ensure that local SMEs get government contracts in each jurisdiction. As noted above, the decentralization regulations relating to procurement could further fragment the internal market and limit competition. Foreign firms are also excluded from competing with Indonesian firms for certain size contracts (see Box 1 for details).

Bidders for certain size contracts are required to be from within a given class of bidders<sup>22</sup>. Big enterprises are required to form partnerships or subcontract with small or medium firms. Foreign firms are excluded from bidding on contracts below a certain size. Foreign bidders are required to form partnerships with or subcontract to domestic firms. In addition, although the regulations have a provision to allow firms regardless of their domicile to bid on contracts, the overall context of procurement rules and procedures for advertisement in the Technical Guidelines has the effect of limiting bidding to firms domiciled in the geographical area of the project for certain size contracts.

These provisions protect local firms from outside competition without any time limit that would ensure that firms do not learn to rely on such provisions and improve their competitiveness in the long-term.

**Box 1: Procurement Regulations Relating to Size of Firms**

- Bidding is required to be among firms within the same class/level (see end note 22).
- Reserved contracts for small firms: below Rp. 1 billion (US\$111,110) for works, Rp. 500 million (US\$55,560) for goods, and Rp. 200 million (US\$22,220) for consultants.
- Reserved contracts for medium firms: between Rp. 1 and 10 billion (US\$111,110 – 1.11 billion) for works, Rp. 500 million and 4 billion (US\$55,560 – 444,440) for goods, and Rp. 200 million and 1 billion (US\$22,220 – 111,110) for consulting services.
- Large firms are required to form joint ventures or subcontract with small and medium firms domiciled in the locality of procurement (province, regency or the municipality): for contracts above Rp. 25 billion (US\$2.78 million) for works, above Rp. 10 billion (US\$1.11 million) for goods, and above Rp. 2 billion (US\$222,220) for consultants.
- Foreign firms are allowed to bid for contracts above Rp. 25 billion (US\$2.78 million) for works, and above Rp. 2 billion (US\$222,220) for consulting services, but they must either form joint ventures or subcontract with domestic firms.
- Implementing agencies are required to give priority to local small or medium firms for contracts up to Rp. 10 billion (US\$1.11 million) for works, up to Rp. 4 billion (US\$444,440) for goods, and up to Rp. 1 billion (US\$111,110) for consulting assignments.
- At the time of project planning and preparation of annual budgets, the Ministers, Governors, Regents, Mayors and Directors of BUMN/ BUMD are required to coordinate the allotment of procurement packages to small firms. At the beginning of the fiscal year, project managers are required to provide maximum packages for small firms in their planning, and report the results to their superiors and to the local agencies dealing with SMEs and cooperatives, who then monitor progress in implementation.
- Packages which should be carried out by local small firms can not be aggregated.
- Tenders aimed at small firms are advertised in printed media around the local regency/city, and tenders aimed at for medium firms are advertised in printed media with reach in the province. Although the Juknis does mention that firms from other provinces/regencies/cities are allowed to participate in bidding, limiting advertisement within the geographical area has the effect of limiting competition.

## **Recommendations**

23. Five key recommendations for strengthening the legal, regulatory and institutional framework for Indonesia's public procurement system are:

- Ensuring Uniformity in Procurement Standards at All Levels of Government
- Enacting a Public Procurement Law
- Establishing a National Public Procurement Office (NPPO)
- Publishing a Procurement Bulletin
- Increasing competition

### **1. Ensuring Uniformity in Procurement Standards at All Levels of Government**

24. Allowing local governments to establish their own arrangements for public procurement could further fragment the internal market and weaken fiduciary standards. This would result in loss of economy and efficiency in public procurement, and eventually limit growth. Maintaining uniform standards for public procurement at all levels of Government will require a revision of Government Regulation 105/2000.

### **2. Enacting a Public Procurement Law**

25. A uniform and comprehensive law on public procurement needs to be enacted that will supercede all existing laws, decrees and regulations, and contain in one place, in clear and unequivocal language, the essential policies and procedures governing all public procurement. Together with the substantial experience gained in Indonesia in preparing the various procurement regulations, the model law issued by the United Nations Commission for International Trade Law (UNCITRAL) could provide the basis for preparing a best practice public procurement law.

26. The law will need to provide bidders with the legal means to raise complaints and assist in the enforcement of the rules governing public procurement. It should establish a transparent mechanism for handling complaints and for the recourse available to bidders and contractors if their complaints are not handled properly. The law should include an effective sanctions mechanism against officials and firms involved in corruption and collusive practices. It will also need to provide a legal basis for a National Public Procurement Office (NPPO) that would be responsible for formulation of public procurement policy and regulations, and for oversight and enforcement of the law governing public procurement. The NPPO, however, may have to be established immediately under a Presidential Decree in order to jump start the process of procurement reform.

27. The law will eliminate the gaps and/or fragmentation of the procurement framework, ensure that public agencies do not circumvent the basic principles established under the law, provide for clear and enforceable sanctions and enforcement mechanisms, enhance transparency,

and ensure legal certainty and clarity. It will also enhance the confidence of the business community and of public in government procurement.

### **3. Establishing a National Public Procurement Office (NPPO)**

28. The need for procurement policy formulation at a national level, coupled with regulatory and oversight responsibilities cannot be overstated. A central procurement policy entity established by law with a clearly set mandate and staffed by a competent nucleus of professional staff is key to putting in place a sustainable and comprehensive public procurement system including the legal, policy and human resource capacity and to bring improvements in the public procurement regime in Indonesia. Benefits of such an agency are that it provides the focus for the formulation of the country's procurement policy, and for keeping up-to-date the procurement laws and regulations consistent with internationally accepted public procurement principles. It provides oversight to ensure compliance with the law at all levels of Government, improves transparency, and reduces chances of corruption and collusion.

29. The NPPO should not have any purchasing or contracting function, and it should not be a layer in the procurement processes of the executing agencies.

30. Most countries have established similar units and their experience could be of help to Indonesia in setting and making the NPPO fully operational. The US has the Office of Federal Procurement Policy (part of the Executive Office of the President). The UK and Canada have procurement policy units in the Treasury. Germany has such a unit in the Ministry of Economics. Several countries such as Poland have placed the National Public Procurement Office in the Office of the Prime Minister, and the EU countries are realizing the need to establish such units to provide requisite level of attention and coordination at a national level.

31. Indonesia needs an agency -- National Public Procurement Office, NPPO -- to be responsible for:

- formulating the public procurement law, policies, the public procurement rules and procedures, and standard bidding and contract documents for mandatory application by all levels of government in Indonesia, and keeping them up-to-date with the international practices,
- enhancing transparency through a Procurement Bulletin (see below),
- maintaining a data base on procurement complaints, a list of known and proven arbitrators, and data on the resolution of complaints, and disseminating information,
- overseeing compliance with the public procurement rules and procedures to ensure that public entities and bidders observe the laws and regulations in place, and observe the highest standards of ethics during the procurement and execution of contracts and are held accountable,
- ensuring, as part of its role to monitor compliance, that there are arrangements in place for independent ex-post audits of procurement of a random sample of contracts at all levels of government, and lessons learned to further improve the public procurement system are disseminated,

- disseminating procurement information to the various stakeholders,
- coordinating efforts to raise awareness, at all levels, of the need for efficient and clean procurement, and
- preparing an annual report on public procurement for wider dissemination (to Parliament and local legislatures, the Supreme Audit Agency and public).

32. Government could also consider mandating the NPPO with oversight of compliance by provincial and district governments with the national procurement policy and procedures. The NPPO should provide provincial and district governments access to national procurement database and information. It could also set up offices in the provinces.

33. The NPPO should be led by professional staff of the highest integrity and probity, and with a commitment to bringing sustainable and comprehensive improvements in the procurement regime in Indonesia. They should also have the confidence of the various stakeholders (government agencies, bidders, contractors, suppliers, consulting industry, and civil society). The NPPO should be independent, and it should be provided with adequate budget and staff.

34. The work of the NPPO, and more generally the public procurement system should be subject to a neutral oversight by civil society. It is recommended that Government invite civil society to establish an anti-corruption watchdog group for public procurement, with independent and qualified members chosen through a credible process, to advise the NPPO. Such a watchdog group should not be funded either by Government or by donors to ensure there are no conflicts of interest.

35. The NPPO with its oversight role and independent status should be the agency to fill the absence of a credible complaint and review procedure to bidders who have a grievance on the bidding process or contract award in the public procurement regime<sup>23</sup>. The UNCITRAL model law provides guidance on setting up the review committee and the review procedure. Setting up such a system and mandating the NPPO in the procurement law to facilitate and oversee the process will encourage strict observance of the applicable rules by the tender committees and project managers, and reduce outside influence. At the same time, it will contribute to public confidence, in particular of the business community, which will result in better competition and better prices.

36. In view of the urgency of establishing the NPPO to jump start the reform process, the NPPO could be established immediately under a Presidential Decree. The Procurement Law when enacted will however provide the legal basis for the NPPO.

#### **4. Publishing a Procurement Bulletin**

37. Transparency requires public notification of all procurement opportunities, the use of open competitive procedures wherever appropriate and disclosure of the results of the bidding processes. They are also of critical importance to considerations of economy and efficiency in procurement.

38. A Procurement Bulletin should be published by the NPPO (both on paper and electronically) for:

- dissemination of advance information on future upcoming procurement (based on annual procurement plans for all projects which should be regularly updated),
- mandatory advertisement of all specific procurement opportunities above an appropriate threshold, throughout Indonesia,
- publishing results of the bidding processes (including the names of firms or individuals awarded contracts and the value of these contracts),
- publishing sanctions against certain bidders and officials, who have been determined to have engaged in fraud and corrupt practices, and
- dissemination of information on public procurement.

39. The Procurement Bulletin should cover procurement of goods, works and consulting services that will apply to all ministries, and public bodies at the national, provincial and district level. Publication of a procurement bulletin will go a long way to enhance competition and transparency and result in better prices.

## **5. Increasing Competition**

40. Existing procurement regulations restrict competition within Indonesia. The effect of the overall public procurement policy is such that it amounts to reserved government contracts for SMEs within each locality. Foreign firms are also excluded from competing with Indonesian firms for certain size contracts<sup>24</sup>.

41. Around the world, governments look to the SME sector to help spur economic growth. Indeed, a robust SME sector can have a positive impact on the economy, contributing to growth, providing greater economic opportunity and increased flexibility. However, in many countries, aggressive SME promotion policies have failed to deliver on any of these benefits due to improper program design.

42. Boosting growth with social justice are key objectives in Indonesia. The SME<sup>25</sup> sector has played a critical social and economic role in Indonesia. It will continue to play a significant role in creating future jobs for the more than two million new workers each year. Government has been supporting SMEs for decades through dozens of programs (policy and regulatory policies, business support services, and subsidized credit). Yet, SME performance has been held back by seemingly intractable obstacles. Red tape, and the resulting corruption it inevitably spawns, are reported to account for some 30% of SME business costs. SMEs point to poor skills as a major constraints to expansion, but they hold the Government programs to raise skills in low esteem. Little data exists on the impact of various programs on SME performance and their costs. There is now an increasing awareness that older approaches and policies generally to promote SMEs have not been successful, in developing a dynamic and vibrant SME sector. This is also true for policies that reserve procurement and require mandatory partnerships for promoting the development of construction and consulting industry. Such policies may also be difficult to continue in the future because of impending decentralization and constraints on the budget.

43. Government has traditionally viewed small businesses as an economically weak group. But guaranteeing government contracts to SMEs, without opening them to competition from firms outside their geographical area and from larger firms, makes them grow complacent, and undermines their competitive ability. Having been sheltered from market competition, SMEs are left in a more vulnerable position when benefits delivered by GOI contracts may come to an end. Several decades of such practices have resulted in the development of a local contracting industry characterized by oversupply of contractors in relation to the size of the market and low quality. Government has ended up paying higher prices for lower quality goods, works and services, and receiving less value for development expenditures.

44. At the same time, blanket and elaborate mechanisms to enforce procurement policies that aim at dividing up the internal market among SMEs within districts and provinces for certain size contracts have resulted in lobbying by vested interests and uneconomic slicing, further increasing costs. They may also make collusion easier among contractors and possibly involving even tender committees because the public agencies get used to the same providers, and it does not promote competition.

45. Mandatory partnerships involve immense compliance costs on large firms. Large firms generally enter these partnerships to comply with the regulations and under pressure from the Government. Significant economic inefficiencies are created. Partnerships (joint ventures and/or subcontracting) that emerge through market mechanisms rather than by government mandated rules, and facilitated by improving information flows or reducing transaction costs, have been found to be more beneficial to the SME sector and overall economic growth.

46. Government policies should encourage entrepreneurs to undertake risk and innovation in response to perceived market opportunities. Market oriented enterprises are more flexible and responsive to market signals, and they have higher productivity. High turn-over is common without exception in the SME sector world-wide and it is part of a dynamic process of competition. Curtailing past practices to restrict competition with bidding advertised widely and open to all contractors will probably result in the closing of several firms, but overall it will strengthen the industry, increase firms' competitiveness, and provide the Government with higher quality works at lower prices. Over time, this will also result in the development of a more competitive contracting industry.

47. Procurement policies should foster market-oriented competition between districts in a province, between provinces, and between domestic and foreign firms in order to stimulate growth. Faced with competition, firms, if they have to survive and grow, would be encouraged to achieve and sustain high levels of productivity by continuously improving the efficiency of use in their inputs through investments in new technology, worker training, improved management practices and improved organization of their production and services. Recent research shows that increased trade increases growth by spurring efficiency as well as accumulation of human and physical capital, and this applies equally to domestic trade (i.e., inter-district and inter-province free movement of goods, services, and labor). Trying to balance a range of conflicting social, political and economic concerns through interventions in the market via public procurement policies is sure to undermine long-term competitiveness, economic growth and jobs. At the same time, such policies result in less value for public expenditures.

International experience shows that different goals are better pursued by different policies. The SME sector is best served by improving the performance of the existing support systems and encouraging private provision of services and financing.

48. Elimination of the procurement practices that limit competition will not be easy given the various vested interests. The new decentralization regulations that allow local governments to establish their own arrangements for public procurement could further fragment the internal market. An assessment of the net benefits or costs of procurement policies and practices related to competition, advertising procedures, and mandatory requirements for joint ventures or subcontracting needs to be made as a matter of priority.

49. Government should phase out the following requirements to increase competition: (i) restrictions that favor bidders domiciled in the geographical area of procurement for certain size contracts, (ii) bidders for certain size contracts to be from within a given class of bidders, (iii) large enterprises to form mandatory partnerships with or subcontract to small or medium firms, and (iv) foreign bidders to form mandatory partnerships with or subcontract to domestic firms.

### **ORGANIZATION, PROCEDURES AND PRACTICES**

50. The head (or project manager or Pimpro)<sup>26</sup> of each project unit is responsible for project implementation, including procurement. Project managers are required to appoint tender committees (TC) for procurement from its initial planning stage to the recommendation for contract award. TCs are formed on an ad hoc basis as needed; as a result there are no standing or permanent committees for a project or in the agency concerned. TCs have at least five or other odd number of persons staffed from the implementing agency, and for technical matters, officials from the related technical unit may be invited. Generally, project managers and members of TCs are from lower grades in the civil service, and are appointed for a particular project and/or procurement work. In Indonesia, there are virtually no cadre of procurement professionals and career streams for project management and procurement practitioners. Project managers have the authority to award contracts for goods, works and consulting services up to Rp. 50 billion (US\$5.56 million). Contracts of higher value require approval of the Minister, Governor, Mayor, Bupati or the president of a State owned enterprise.

51. Indonesia has a licensing or certification system (generally called in the regulations “pre-qualification”) to certify contractors and consultants to undertake contracts up to certain prescribed values. Recognizing the problems with the past system, the new Construction Law has created a Construction Services Industry Board (LPJK)<sup>27</sup> to certify contractors and consultants for civil works and related services.

#### **Key Issues**

52. Key issues in the organizational set up, procurement procedures and practices that have an effect on the economy, efficiency and transparency in procurement are the following:

## **1. Tender Committees**

- Typically, weak capacity of tender committees, with members who have inadequate qualifications and experience, particularly at the provincial and district levels and for the evaluation of bids for their technical adequacy. As a consequence, reviews of bids tend to focus mainly on administrative requirements. Ad hoc nature of the TCs can also discourage capacity building and affect record keeping.
- Inadequate budgets for TCs for advertising, typing and printing of bid documents, travel and communication<sup>28</sup>.
- Concerns about the independence of individual members and the tender committee as a whole.

## **2. Certification System for Contractors and Consultants**

- Over-reliance on submitted documents without proper verification, lack of sanctions in cases of misrepresentation of facts or nonperformance, and registration under several names and different size firms to enhance the chances of winning jobs for the same owner, etc. In sum, the certification system had not worked and was unreliable.
- Weaknesses in the post-qualification for capacity prior to contract award<sup>29</sup>.

## **3. Procurement Procedures**

- Even for procurement of simple goods and civil works, bidders are required to register in order to become eligible to bid. In addition, inadequate time given for registration or “pre-qualification” limits competition.
- Inadequate time given for the various steps in the procurement cycle, including bidding.
- Uneven use of standard bidding documents in particular for procurement financed from domestic resources, and no nationally mandated SBDs (leading to poor procurement practices and higher administrative costs). This may even lead to bidding documents that favor particular suppliers or contractors.
- Frequent amendments in contracts and general lack of enforcement and sanctions on poor contract performance.

## **4. Procurement Practices**

- Undue influence of business associations of contractors, suppliers, consultants and higher authorities in the procurement process.
- Uneconomic packaging of contracts possibly because of a desire or pressures to distribute work among as many firms as possible.
- Insufficient advertising especially for small and medium value contracts at the provincial and district levels which limits competition<sup>30</sup>.
- Use of rigid technical specifications with automatic disqualification of proposals with minor technical deviations without a material impact on performance of the goods offered.
- Use of vague and poorly defined evaluation criteria, inadequate disclosure, and problems in bid evaluations which are not strictly in accordance with the disclosed evaluation criteria.

- Automatic disqualification of bidders on minor administrative grounds.
- Breach of confidentiality in the bidding process in particular during bid evaluation which potentially compromises the integrity of procurement decisions.
- Lack of follow-up on procurement complaints.
- Virtually no monitoring of compliance with the procurement rules and procedures.
- Overuse of shopping and direct selection procedures on grounds of urgency.

53. The procurement experience under the World Bank and ADB financed projects has also not been immune from the weaknesses in Indonesia's procurement procedures and practices<sup>31</sup>. This can result in loss of economy, efficiency and transparency in public procurement.

## **Recommendations**

54. Recommendations to improve the legal, regulatory and institutional framework for Indonesia's public procurement system will also have a positive effect generally on the procedures and practices. Some additional actions for further strengthening are the following:

### **1. Tender Committees**

- Procedures for the selection of tender committees should be reviewed and revised to ensure their independence, and only members with probity and minimum qualification and experience in public procurement should be appointed. Tender committees should be provided with adequate operating budget for the preparation and printing of bid documents, advertising and other expenses.

### **2. Certification System for Contractors and Consultants**

- Rules, criteria and procedures governing classification/ accreditation of contractors and consultants by the Construction Services Industry Board (LPJK) should be developed through a consultative process, and made public. The procedures should provide for verification, sanctions and appeal<sup>32</sup>. LPJK should publish a national list of approved contractors using very strict criteria and indicating the capacity for each at any time that may not be exceeded. Inclusion in the national list should be equivalent to an International Standards Organization (ISO) certification of rigorous criteria. The list should be regularly updated<sup>33</sup> (see Box 2 on the construction industry).

### **3. Procurement Procedures**

- Clear guidelines and conditions should be provided for using non-competitive methods of procurement.
- Restrictions on participation in bidding should be eliminated.
- The practice of requiring automatic retendering when the number of bids is less than three or the lowest bid price exceeds the budget ceiling should be eliminated.
- A set of standard bidding and contract documents for goods, works and professional services should be prepared, adopted and issued. Their use by reference should be mandated by law for all public procurement at the national, provincial and district level<sup>34</sup>.
- Time allowed for procurement steps should be reviewed and increased to ensure equal opportunity to all bidders and maximum competition, to give sufficient time to bidders to submit well prepared and responsive bids, and to allow reasonable time to tender committees to do quality procurement work.
- The procedure of requiring registration or pre-qualification for procurement of simple goods and small works should be eliminated, but contracts should be awarded only after post-qualification for capacity.

### **Box 2. Construction Industry**

Indonesia's construction industry grew rapidly until the 1997 crisis, employing about 3.5 million workers. About 1,400 medium and large construction firms consisting of state-owned contractors, and private and a few joint venture construction companies with foreign partners are members of HAKI (Association of Construction Experts). About 43,000 small and medium construction firms are members of GAPENSI (Indonesian Contractors Association). GAPENSI has offices in all provinces and in almost two-thirds of the districts. About 3,450 consulting firms are members of the Indonesian Association of Consultants (INKINDO). Except for some medium-size consulting firms, the consulting industry is still weak. In the past, ARDIN (Association of Indonesian Suppliers) was also involved in the certification of all suppliers that had an interest in government contracts. In addition, KADIN (Indonesian Chamber of Commerce and Industry) has substantial interests in government procurement. It has offices in each provincial capital.

The main problems facing the construction industry, in particular small and medium firms, are the lack of managerial and skilled workers and lack of resources, and there has not been enough market pressure to improve quality and efficiency. A very large number of firms (around 80%) are dependent on government financed contracts. The current structure does not favor specialization. Firms are certified improperly for all types of construction work. Subcontracting to non-qualified firms is also widely practiced. This has now become a central concern of the trade associations and Government. Recognizing the serious problems with the old certification system<sup>35</sup>, especially at the district level, and the need to strengthen the construction industry, a new Construction Law has been passed, which also set up a Construction Services Industry Board (LPJK) to oversee proper certification of the contractors and consulting engineering firms, and to help develop the industry.

The market for public works is segmented. Excessive slicing leads to small contracts reserved for a limited number of small contractors registered in each district. GAPENSI gives top priority to getting projects to its members. Such an approach protects poor performers from competition and Government receives less value for development expenditures. Supervision is lax on deficiencies for various reasons, and contractual standards are generally not enforced.

#### **Recommendations**

- If the construction industry is to be strengthened, it must be opened up to market competition. Segmentation must be phased out to increase competition<sup>36</sup>.
- The new certification of firms by the Construction Services Industry Board should be based on a very strict and transparent criteria, equivalent to an International Standards Organization (ISO) certification of rigorous criteria. And the list should be regularly updated.
- For making public procurement work effectively, the business community of contractors, suppliers and consultants will also need to be trained by the private sector in the concepts of public procurement, and in the technical, managerial and project management skills.
- The trade associations should be asked and encouraged to adopt a strict code of ethics and collaborate with the Government to make the entire public procurement process economic, efficient, transparent and free of corruption.
- Finally, the Government should become more rigorous in enforcing contract performance.

#### **4. Procurement Practices**

- Project implementing agencies, project managers, tender committees, bidders, suppliers, contractors and consultants should be required to observe the highest standards of ethics during procurement and execution of contracts, and to be held accountable for their actions. The code of conduct and ethics for procurement staff or officials should be made public, and be backed by strict enforcement and strong sanctions.
- A strong anti-corruption program in public procurement should be instituted by NPPO. It should include random, ex-post and independent procurement audits, full investigation of all allegations of fraud and corruption, and application of appropriate and publicized sanctions.
- Timely and effective audits should be introduced and internal control systems should be strengthened.
- Media and civil society organizations should be invited to raise incidents of abuse of the procurement rules, and mechanisms to address the issues raised should be put in place.
- Bidders, suppliers, contractors and consultants should be given the confidence that they are encouraged to raise concerns when they see wrongdoing by government officials in procurement, without being concerned about punishment by the bureaucracy.
- Various procurement procedures should be streamlined to enhance competition and minimize discretion.

### **PROFESSIONAL CAPACITY FOR PUBLIC PROCUREMENT**

#### **Key Issues**

55. There are about 4,000 project managers responsible for project implementation including procurement at the national level. Including members of tender committees, some 30,000 persons are involved in procurement. If local governments are included, the numbers would be significantly higher.

56. Procurement proficiency is, however, limited to a very small number of individuals, mainly in selective line ministries (e.g., the Ministry of Settlement and Regional Infrastructure) and in large state-owned enterprises. There is virtually no cadre of procurement practitioners and there is no career stream for project management and procurement management. Project managers and tender committees return to their former positions upon completion of a particular project. Barring some exceptions, the majority of working level staff have a poor understanding of the principles of good national and international public procurement, rationale for procedures, ethics, and even of rules and procedures. This is particularly true of staff at the level of local government and in social sectors, such as education and health. Many are not familiar with the recent procurement regulations, as well as of the specific procurement requirements of externally funded projects. Weak capacity of staff handling procurement has no doubt contributed to the failures in the procurement practices.

57. A few line ministries have training programs for upgrading skills of staff in the sector. The Ministry of Settlement and Regional Infrastructure, however, has a more significant program and training facilities for capacity building. It offers for its staff several short courses to upgrade skills in project management, one five-week course in procurement management, one degree course in project management, and training courses for contractors and suppliers. Some universities and management institutes offer short courses in project management, and degree programs in construction management, including procurement modules.

### **Recommendations**

58. A well planned and systematic training program is required not only to improve the quality of the procurement process but also for effective implementation and success of the broader procurement reforms. Four key recommendation for developing human resources for good public procurement are:

- Development and introduction of regular and customized training for senior government officials, project managers and procurement practitioners. Training would need to cover the principles of public procurement, government procurement rules and procedures, requirements of international financial institutions and development partners, ethics of public procurement, Government's anti-corruption program, and also the preparation of technical specifications, development of evaluation criteria and methodology, other commercial and legal aspects, record keeping, handling of disputes, and contract management.
- Priority be given to training in the provinces and districts with weak capacity.
- Selected universities be encouraged to include project management and procurement modules in undergraduate courses, on national and international procurement and contracting in the public and private sector.
- After the establishment of capability for a continuous training program, a cadre of and career streams for project managers and procurement practitioners be created, and procurement staff be selected only from the pool of trained personnel, certified in public procurement.

59. As a follow-up to the CPAR work, ADB has provided a technical assistance grant (\$780,000) for a detailed assessment of the training needs, preparation of a training plan, training of 100 trainers, design and production of training courses, changes in civil service regulations that may be required to professionalize procurement (a certification system for procurement professionals and a career and salary advancement for civil servants pursuing a career in procurement), and on a study to ensure sustainability of the training program; the various ADB financed activities are expected to be completed by December 2001. The World Bank has also financed technical assistance to the Ministry of Settlement and Regional Infrastructure for training of trainers and workshops for disseminating current procurement regulations under Presidential Decree 18/2000 to local government officials.

60. For some time, Government has also considered establishing a *Procurement Institute* to strengthen professional capacity in public procurement. The CPAR team shares the Government's objective of establishing a focal point for the training function. The technical assistance by ADB would therefore also assess the institutional requirements for the long-term

oversight of the training function in such areas as the updating of curricula, setting of standards, certification and sanctioning of procurement professionals and accrediting training institutions for course delivery. It will make recommendations on the appropriate government agency or agencies, both central and local, to assume this function and on the resources and budget needed. It will also initiate implementation during the course of the technical assistance.

## **ENFORCEMENT**

61. Even though there are certain problems with the rules and procedures governing public procurement, a large number of the problems with Indonesia's current public procurement regime are because of weak compliance with the rules and that they were not strictly enforced. Thus, mechanisms for compliance and enforcement with the rules must be central to any reforms of the public procurement system.

62. International experience suggests that the following four elements are essential for an effective compliance and enforcement system:

- strong political will to fight corruption and to resist pressure from the strong vested interests,
- means to ensure that public servants observe well established and clear procurement rules,
- existence of an enforceable complaints and review mechanism for aggrieved bidders, and
- strong oversight of public procurement by public bodies including Parliament, auditing agencies and civil society.

63. Many of the reforms this report has recommended are important in themselves but they also compliment each other by addressing different aspects of the above elements of an effective enforcement mechanism. For example:

- observance of the rules by public servants will be enhanced by the creation of the NPPO charged with oversight and enforcement, a comprehensive national law on public procurement will ensure clarity of rules, strengthening of the audit functions will ensure proper application of the rules, and a code of conduct and ethics for all public servants involved in procurement will help set strong standards,
- bidders' oversight over the procurement process will be enhanced by greater transparency through a Public Procurement Bulletin and clearer rules for disclosure of information during the bidding process, the law will establish clear rules for complaints and how they are to be handled, and the adoption of its own code of conduct and ethics by the business community and monitoring of the business practices by its members will help ensure better business practices, and

- oversight by public bodies will be enhanced by requiring the NPPO to provide an annual report on public procurement to Parliament and legislative bodies at the local levels and to the public, and because of increased transparency in the procurement process, civil society will have better opportunities to confirm whether the rules are being observed.

64. The report also recommends the following three actions to help strengthen enforcement:

- Strengthening internal controls, effective auditing and a functioning enforcement capacity within all agencies (see Box 3 on Government auditing), and requiring the application of strict sanctions in cases of malfeasance or non-performance.
- Conducting annual corruption surveys of the experience of contractors, suppliers and consultants in dealing with government agencies in public procurement, and of the views of civil society about corruption in public procurement to gauge progress, and making the results public.
- Establishing a civil society anti-corruption watchdog group with independent and credible members to advise the NPPO on public procurement.

### **Box 3. Government Auditing**

The Supreme Audit Authority (Bepeka) is empowered with auditing of the State finances and reporting the results of the audits to the Parliament. The thrust of its audits of the government departments has been on compliance with financial regulations and procedures. Recently, the focus of some audits has been on the effectiveness of programs and the efficiency of managing resources. The Government's Internal Audit Agency (BPKP) reports to the Office of the President. It has some 8,000 staff and conducts audits of government agencies at the provincial and district levels, (until recently) the financial statement audits of SOEs, and audits of externally financed projects including those by the World Bank and ADB, and monitors performance accountability of government agencies. Each ministry has its own unit for conducting internal audits headed by a Inspector General (IG) and reporting to its minister.

According to the recent Country Financial Accountability Assessment (CFAA), whose findings and recommendations are reported separately<sup>37</sup>, the internal control environment is lax due to:

- weak enforcement of laws and regulations,
- systemic corruption, collusion and nepotism (KKN),
- lack of sanctions under the civil service code of conduct when mishandling of public funds are reported,
- unclear roles, responsibility and authority of the various external and internal audit functions,
- lack of understanding of internal controls and of internal audit skills in the IG units,
- poor personnel policies and practices, and
- inadequate Parliamentary oversight and public reporting of financial information.

The Government's financial statements for presentation to the Parliament and the public have generally not been timely. Follow up on the audit recommendations needs significant improvement.

Absence of an integrated financial management system and weak capacity at the provincial and district levels risk a potential loss of accountability for the use of budget funds under decentralization. The new decentralization regulations allow local governments to establish their own arrangements for financial management. This could result in further deterioration of fiduciary standards. Financial management, accounting and audit arrangements at the local government level should be consistent with existing central government regulations.

Audit reports under Bank-financed projects have highlighted overpayment, weak internal controls, inadequate compliance with the terms of reference and regulations, delays in completion of project activities, and cases of ineligible expenditures. There are also concerns about evenness of quality of audit reports from BPKP.

### III. IMPLICATIONS OF DECENTRALIZATION FOR PUBLIC PROCUREMENT

65. The current legal framework (Laws 22 and 25 of 1999) will give Indonesia substantial decentralization. Over time, over 40 percent of general government spending will be managed by over 350 provincial and local governments, more than double the current share. Except for national defense, international relations, justice, monetary policy, development planning, religion and finance, districts and cities will manage most of the Government services, including health, education, urban services and infrastructure. As a consequence, a substantial part of public procurement will be managed at subnational level.

66. If managed well, decentralization can achieve substantial efficiency gains because decisions will be taken at a level of government that has better information, and is more accountable to the local public. But decentralization runs the risk of exacerbating existing weaknesses in the procurement system as well. The Government has a strong political imperative to decentralize, but it has an equally strong imperative to make decentralization work, to protect the unity of the economic space of Indonesia, and to ensure probity in managing taxpayers' money. It must therefore act quickly to address potential risks in decentralization.

#### 67. Issues

- *Limited Capacity.* Past experience in procurement at the district and province level -- whether managed by local governments or by deconcentrated units of central government -- has shown that capacity to manage procurement is generally limited. The same is true for the capacity of small and medium size contractors in the districts and of consulting firms.
- *Limited competition.* Current procurement regulations and practices effectively limit bidding, in particular for small and medium value contracts, to those domiciled in the geographical area of the project. In the past, there have been cases where local authorities issued their own instructions to influence the procurement process contrary to the national regulations. Moreover, the new decentralization regulations issued in November 2000 allow local governments to establish their own arrangements for procurement (and financial management). This could result in a scattering of the market for government procurement into more than 350 jurisdictions, a development that would severely limit competition. Local regulations on business licensing could further aggravate such fragmentation.
- *Limited accountability.* Political accountability, financial management, and audit arrangements for decentralized government are yet to be established. Moreover, the limited, own tax base of local governments, absence of working mechanisms for an appropriate handling of complaints, and inexperience of local parliaments further undermine the accountability of subnational governments. If combined with the lobbying powers of the local business community, the limited accountability could increase the risk of corruption. On the positive side, competition among jurisdictions is likely to limit the scope for abuse by regional governments.

The Presidential decree for public procurement (Keppres 18/2000) currently requires the concerned Inspector General to supervise procurement practices at subnational level, with copies of the reports to BPKP. Keppres 18/2000 does not specify who should follow up on the remedial actions<sup>38</sup>.

### **Recommendations**

68. Government has an opportunity to shape the modalities of decentralization. The center should use its authority under Laws 22 and 25 well, and balance the need to retain Indonesia's economic unity and increase probity in government with the need to allow for local initiative and flexibility which will make decentralization work.

- *Legal Framework.* The proposed Public Procurement Law should apply to regional governments<sup>39</sup> as well as to central government. This would ensure that basic principles, policies, rules and regulations, including the use of standard bidding and contract documents, and the mechanisms for effective complaints and review procedures and sanctions also apply to the regional governments.
- *Publicity.* Like any public agency, regional governments and public bodies should be required to publicize nationally all tender opportunities above an appropriate threshold size, contract awards and sanctions. The best means for doing so is through the proposed Procurement Bulletin. Regional governments should also be required to use approved standard bidding and contract documents, and to request individual approval of documents, if the standard documents are not used.
- *Supervision.* Uniformity in the application of Procurement Law at all levels of Government is important to increase transparency and to make optimal use of available skills for procurement work and of limited oversight capacity. The new national law on public procurement should therefore clearly specify the central government's authority over regional governments in supervising procurement. Government could consider mandating the proposed NPPO with oversight of compliance by regional governments with the national procurement policy and procedures. The NPPO should provide regional governments access to the national database on procurement and information. It could also set up offices in the provinces.

In a broader sense, building the core accountability mechanisms of government is the best guarantee against abuse of procurement. Details on financial management and reporting, accounting, internal control systems, audit, and accountability of governments towards the regional parliaments therefore must be finalized with urgency.

For central government money spent by regional governments -- whether earmarked grants or co-administered tasks -- it is common policy in other countries that central government rules, regulations, and supervision apply.

- *Capacity Building.* In the short run, key to procurement capacity at the regional level is a smooth transfer of the civil servants. In regional offices of central government, there is some capacity for managing procurement issues. In order for this capacity not to be lost, Government should, together with regional governments, draw up a plan for distributing this capacity among regional governments.

Over time, a procurement career stream and procurement training at the regional level will be decisive for increasing capacity. For regional governments, such training can probably be more cost-effectively organized at the provincial level, rather than at the district/city level. However, to maintain the desired degree of unity in the application, Government must maintain control over the curriculum of these regional training programs. The Procurement Institute proposed by Government could be the appropriate authority to manage this, in coordination with LAN.

- Government should invite civil society to serve on a group to think through with the NPPO how to ensure that the public procurement system can be made to work effectively in a decentralized environment.

#### **IV. LESSONS FROM BANK EXPERIENCE**

##### **PROCUREMENT EXPERIENCE UNDER BANK-FINANCED PROJECTS**

69. The current portfolio of Bank-financed projects in Indonesia has 56 operations<sup>40</sup> with net commitments of \$4.33 billion compared with 72 operations and net commitments of \$7.3 billion in FY98. The size of the portfolio will continue to decline as more projects are closed than are added. Total disbursements in FY00 were \$700 million under investment projects and \$300 million under two adjustment loans. Generic implementation issues facing the Indonesia portfolio are: weak institutional capacity, compounded by further changes taking place under the decentralization program, the budget process and delays in budget releases, weak project management and governance, limited monitoring and capabilities, and ineffective fiduciary functions (procurement, financial management, internal control and reporting).

70. Before discussing the procurement experience in Bank-financed projects in Indonesia, it is important to note at the outset that the overall environment of Indonesia's procurement regime also applies to Bank-financed procurement. The Bank's experience with procurement in its projects has been broadly consistent with the procurement system discussed in the previous sections.

71. Procurement under Bank-financed projects under International Competitive Bidding (ICB) procedures use Bank-mandated Standard Bidding Documents (SBDs) and are subject to prior review by the Bank. In these cases, the Bank has the opportunity to correct concerns about the procurement process by asking the implementing agencies to take corrective actions before a problem arises and before bids are invited and a contract is awarded. Areas of concern which continue to require attention are the procedures for advertisement, technical specifications, the pre-qualification process, evaluation criteria, the bid evaluation process and decision making for contract award. The same process and experience applies to contracts under National Competitive Bidding (NCB) that are subject to prior review. The magnitude of the concerns during the procurement process even under contracts subject to prior review has depended on the capacity and experience of the implementing agencies. More problems arise however in contracts that are below the prior review thresholds and are thus subject to ex-post review after contract awards.

72. The nature of projects financed by the Bank in Indonesia has been changing. The procurement mix has moved away from traditional, large infrastructure projects which use ICB procedures, with a decline in the share of procurement subject to prior review. More projects are now in social sectors (e.g., education, health, rural development, village infrastructure and urban poverty) which involve thousands of small-value contracts at the sub-national government level that are generally not subject to prior review by Bank staff, and where capacity for implementation and monitoring is generally weak and the accountability issues are significant. The consequence of these changes is that increasingly a larger share of procurement in future will be subject to ex-post review after contract awards with an associated increase in fiduciary risks.

73. In response to these concerns, the World Bank has taken a number of steps to ensure that project implementing agencies follow procurement procedures agreed with the Bank, and to mitigate fiduciary risks, including the following:

- Tightening of reviews of implementing agencies' procurement financed by the Bank.
- Intensifying ex-post reviews of a sample of those contracts that are not subject to prior review by Bank staff, and declaring misprocurement and canceling loans when significant deficiencies are detected under the Bank's guidelines. Misprocurement declared in FY98-00 and FY01 to-date amounted to US\$9 million.
- Paying more attention to assessment of the capacity of executing agencies to carry out procurement and financial management, and to procurement arrangements and issues at early stages of project preparation.
- Maintaining a database of complaints on procurement irregularities that are received by the Bank directly or as copies of complaints filed with project implementing agencies (see Box 4 for details).
- Protecting resources allocated within the Bank's Indonesia country program budget to project supervision despite pressures on the overall administrative budget.
- Promoting beneficiary involvement in the design and implementation of Bank-financed projects, particularly by building relations with civil society and local communities to help prevent misuse of development funds. Additionally, the Bank prepared a portfolio brief in June 2000 (in English and Bahasa Indonesia) to inform civil society about the Bank-financed projects.

74. Despite the Bank's best efforts, however, it is simply not possible to fully insulate Bank-financed projects from the systemic problems in the country's environment in which they are implemented. The Bank will continue to exert maximum efforts to help ensure that the proceeds of any loan are used for the purposes intended, with due attention to considerations of economy and efficiency.

#### **STRENGTHENING FIDUCIARY SAFEGUARDS IN BANK-FINANCED PROJECTS**

75. The fiduciary risk in procurement in Indonesia is continuing to be high, particularly because practices vary widely from the formal rules and procedures, enforcement is weak, and sanctions are rare. Some important provisions of the current rules and regulations are also at variance with the internationally accepted practices and the Bank procurement guidelines. As noted earlier, the ongoing decentralization in the current weak overall procurement environment in Indonesia will keep the Bank's fiduciary risk at a high level until the fundamental reforms of the public procurement system as suggested in this report are completed.

76. This CPAR and the parallel Country Financial Accountability Assessment (CFAA), jointly with ADB, were followed by a mission of senior World Bank staff in September/ October 2000 to review the overall fiduciary environment, and make recommendations to strengthen the public procurement and financial management systems and to further strengthen the fiduciary oversight of World Bank-financed projects.

**Box 4. Experience with Procurement Complaints Related to Bank-financed Projects in Indonesia**

As part of its efforts to strengthen fiduciary controls, the Bank has been maintaining a data base on complaints on procurement. All complaints are reviewed and investigated according to established guidelines. Complaints have been filed relating to 132 cases (19 in August-December 1998, 56 in 1999, and 57 in 2000).

Most complaints tend to relate to allegations of irregularities in procurement processes – lapses in procedures relating to pre-qualification, preparation of short-lists, practices that restrict competition, bid opening, bid evaluation, decisions on award of contracts, contract management, and the use of collusive practices. As of December 2000, 72 cases had been closed following reviews by Bank staff and Government of Indonesia.

Actions taken relating to these complaints included the following:

	<u>No. of. Cases</u>
Barring of firms by GOI from participation in future procurement	2
Refund of expenditures by GOI to the Bank for ineligible expenditures	3
Decision to reject all bids and invite new bids	11
Placing of complainant firms on short-lists when justified	5
Signing of contracts on terms in the original bids or proposals	2
Requiring re-advertisement, reopening bid registration, stopping the use of practices that restricted competition, and strict application of the evaluation criteria	5
Requiring a supplier to comply with the specifications in the original bid	1
Rejection of a complaint by an Indonesian court	1
Upholding of decisions by the project implementing agencies based on satisfactory explanation of the procurement process	22
Decision to have no further follow-up because cases did not merit further action	9
General complaints	4
Cases unrelated to Bank-financed projects	6
Project closed	<u>1</u>
Cancellation of loan amount for the contract	<u>1</u>
Total No. of Cases Closed	<u>73<sup>41</sup></u>

Of the cases closed, just about half did not require action because the Bank upheld the procurement decisions taken by the implementing agency, or because the cases did not merit action or because the complaints did not relate to Bank-financed activities.

77. Building on the outcome of the above work, four elements of the World Bank's strategy to help reduce opportunities for corruption and thereby help ensure that proceeds of Bank loans are used for their intended purposes with due attention to economy and efficiency, will be the following (besides the World Bank's broader focus on governance reform and anti-corruption, and collaboration with civil society):

**1. Prevention – Reducing opportunities for corruption in new projects through strengthened project design.**

- Close attention to the fiduciary environment (public procurement and financial management) and capacity of the implementing agencies and building of adequate safeguards (including actions to strengthen capacity and finalize procurement arrangements at an early stage) in the design of new projects to match with fiduciary risks.
- Priority in new projects to the provinces and districts that demonstrate concerns for economy, efficiency and transparency in the use of public funds.
- Installation of planning, budgeting, and project management reporting systems at an early stage.
- Additional legal provisions to make the National Competitive Bidding (NCB) procedures acceptable to the World Bank. The current side letter on the acceptability of NCB procedures is being substantially strengthened based on findings of this report, for use in all future projects (see Attachment 2). This requirement would continue until major recommendations of this report are implemented by Government and there is evidence of progress on improving transparency of the public procurement system.
- Greater beneficiary and civil society involvement in the design, implementation and monitoring of projects to enhance transparency and prevent misuse of funds, and third party verification as a feature of new projects.

**2. Supervision and Monitoring – Strengthening existing mechanisms of fiduciary monitoring and supervision of ongoing projects.**

- Intensification of efforts for requiring updated and satisfactory annual procurement and financial plans and insisting that they are used for guiding implementation and supervision.
- Carrying out regular ex-post procurement and statement of expenditure (SOE) reviews.
- Strengthening capacity of the implementing agencies.
- Follow up on procurement complaints and audit findings.
- Special attention to projects judged to have higher fiduciary risks, based on a risk assessment system.
- An increase in the number of selective site visits to review procurement by sub-national governments and physical progress to match with fiduciary risks.

**3. Enforcement – Investigating cases of alleged fraud and corruption.**

- The World Bank will rely on its Corruption and Fraud Investigation Unit (CFIU) to investigate cases of alleged fraud and corruption, and apply sanctions where called for. The first visit of CFIU to Indonesia was in November 2000, and a follow-up mission will take

place in March 2001.

**4. Supporting Government efforts to reform the public procurement system (and financial management system).**

This support will follow up on the recommendations of the CPAR and CFAA and the recent fiduciary mission of senior World Bank staff. Full implementation of reforms of the overall systems at all levels of Government will take time. The immediate focus of World Bank support to the Government reform efforts will be on the following:

- Application of national standards, under decentralization, to local government procurement (and financial management).
- Operationalization of the high level committee(s) to guide reform of the public procurement system (and the financial management system).
- Preparation, adoption and publication of action plans to reform the organizational structure and legal framework for public procurement, in particular for the establishment of the National Public Procurement Office (NPPO) which would then formulate national public procurement policy and monitor compliance.
- Revision of current draft laws on State Finance, Treasury and Audit already submitted to Parliament.

78. Yet, these steps may not be enough. Civil society has been concerned about the integrity of Indonesia's public procurement process and effectiveness of past efforts in reducing corruption. During the World Bank's consultations with civil society for the preparation of the Country Assistance Strategy for Indonesia, civil society put forward a number of ideas for reducing corruption and monitoring procurement performance in development projects. These include:

- adoption of a strict code of conduct including the anti-bribery and anti-KKN practices pacts by the national associations of consultants, contractors and suppliers,
- for the Government to make information available on donor financed projects to civil society (i.e., under a freedom of information act),
- for the Government to enact a "witness protection act" to protect those who report corrupt practices in development projects,
- in order to further improve transparency and accountability, the Government should make available information on planned project budgets, procurement plans and tenders, details of tender awards, status of project implementation, and financial results, and
- the Government should ensure more involvement of local communities in the design, planning, implementation and monitoring of development projects.

79. **Engaging civil society in monitoring of project implementation.** Building on the positive, recent experience in the Kecamatan Development Project and social safety net adjustment loan models, the World Bank will increase efforts to seek out civil society monitoring of project implementation. Following up on the civil society consultations for preparation of the World Bank's Country Assistance Strategy for Indonesia, the Bank has initiated discussions with "anticorruption" NGOs on ways to activate such a watchdog function to reduce possible corruption in Bank-financed projects. NGOs face financial and staffing constraints, which would need to be addressed as we move forward.

80. There is clearly a need for new ideas and approaches which are forward looking, provide adequate safeguards, allow for innovations, and help strengthen the institutions handling public procurement. In new Indonesia, there is hope that active partnership and collaboration among key stakeholders – civil society, Government and donors – can result in finding the right solutions to reform the public procurement system and contribute to good governance.

#### **TECHNICAL ASSISTANCE TO SUPPORT PROCUREMENT REFORMS**

81. The World Bank stands ready to assist and facilitate Government efforts to reform the public procurement system by:

- offering financial assistance under suitable ongoing Bank-financed projects or a new operation,
- sharing the international experience on procurement reforms, and on programs for institutional development and provision of training for quality procurement work. ADB recently initiated technical assistance for developing Indonesia's training programs and capacity. The World Bank is ready to support this effort which provides a head start to the training initiative, as recently done with the Ministry of Settlement and Regional Infrastructure, and
- helping to mobilize resources for procurement reforms under the Partnership for Governance Reforms in Indonesia, under the sponsorship of the UNDP, ADB and the World Bank, and/or from bilateral sources.

## **Summary of Key Recommendations for Reforming the Public Procurement System**

### **Getting started:**

- Government confirmed its commitment at the CGI meeting in Tokyo in October 2000 to reforms of the public procurement system along the lines of the main recommendations contained in this CPAR.
- Government established a high level Steering Committee to guide reforms of the public procurement system. The Committee is chaired by the Chairman, Bappenas and includes Echelon I officials from key government agencies and the Cabinet Secretariat. It is supported by a small Working Group.

### **Reforming the legal, regulatory and institutional framework:**

- Actions to require uniform national standards for public procurement at all levels of Government.
- Prepare, adopt and publish action plan to reform the organizational structure and legal framework for procurement.
- Establish and make operational a National Public Procurement Office (NPPO) with a clear mandate to formulate national public procurement policy and monitor compliance.
- Enact a Public procurement law and implementation regulations.
- Publish a Procurement Bulletin.

### **Increasing competition:**

- Assess benefits and costs of existing procurement policies including procedures for advertisement that have the effect of limiting competition among bidders based on their size, contract values, and geographical location, and phase out such policies within a set time table.

### **Improving procedures and practices:**

- Strengthen procedures for the selection of tender committees and project managers.
- Ensure that the certification system for contractors and consultants is developed through a consultative process and that it is transparent and made public.
- Issue nationally mandated standard bidding and contract documents.
- Review and revise procurement rules and procedures to enhance competition and transparency.

**Building professional capacity:**

- Plan and initiate training at all levels.
- Create a cadre of and career streams for procurement practitioners and project managers.
- Select procurement staff from the pool of trained personnel, certified in public procurement.
- Establish appropriate institutional arrangements to provide a focus to the long term coordination and oversight of the training function (Procurement Institute or other arrangements).

**Strengthening enforcement:**

- Strengthen internal controls and enforcement capacity and require strict enforcement and application of sanctions in cases of malfeasance or non-performance.
- Require all stakeholders to adhere to a strong code of conduct and ethics, and hold them accountable for their actions. Make the code of conduct and ethics for procurement staff or officials public.
- Institute a strong anti-corruption program in public procurement, including random ex-post reviews, fully investigate all allegations of fraud and corruption and apply publicized sanctions, and the NPPO to submit annual reports on public procurement to the Parliament, legislative bodies at the local levels and to the public.
- Conduct annual corruption surveys reflecting the experience of bidders, suppliers, contractors and consultants in dealing with government agencies in public procurement, and of the views of civil society about corruption in public procurement to gauge progress, and make the results public.
- Establish a civil society anti-corruption watchdog group with independent members to advise the NPPO

**ACCEPTABILITY OF NATIONAL COMPETITIVE BIDDING PROCEDURES  
(Provisions to be included in Loan/Credit Agreements as a Schedule)**

To address the shortcomings experienced in Bank-financed projects, the procedures to be followed for national competitive bidding (NCB) would need to meet the requirements listed below. In accordance with Articles 6.3 and 21(3) of Keppres 18/2000 (Guidelines for the Implementation of the Procurement of Goods/ Services for Government Agencies), dated February 21, 2000, if there are any inconsistencies between the provisions of Keppres 18/2000 and this Schedule, the provisions of the Schedule shall prevail.

In order to ensure economy, efficiency, transparency and broad consistency with the provisions of Section 1 of the Guidelines:

1. Registration

(a) Bidding shall not be restricted to pre-registered firms.

(b) Where registration is required, bidders (i) shall be allowed reasonably adequate time to complete the registration process, and (ii) shall not be denied registration for reasons unrelated to their capability and resources (e.g., mandatory membership in professional organizations or their local chapters, classification, etc.) to successfully perform the contract, which shall be verified through post-qualification.

2. Pre-qualification

Pre-qualification shall not be used for simple goods and works. When pre-qualification of bidders is required for large or complex works: (i) eligible bidders (both national and foreign) shall not be denied pre-qualification, and (ii) invitations to pre-qualify for bidding shall be advertised in at least one widely circulated national daily newspaper, at least 30 days prior to the deadline for the submission of pre-qualification applications.

3. Joint Ventures

A bidder declared the lowest evaluated bidder shall not be required to form a joint venture or to subcontract part of work or part of the supply of goods as a condition of award of the contract.

4. Preferences

(a) No preference of any kind shall be given to national bidders.

(b) Regulations issued by a sectoral ministry, provincial regulations and local regulations, which restrict national competitive bidding procedures to a class of contractors or a class of suppliers shall not be applicable to procurement procedures under the Loan/Credit.

5. Advertising

(a) Invitations to bid shall be advertised in at least one widely circulated national daily newspaper, allowing at least 30 days for the preparation and submission of bids. During this period, potential bidders will be allowed to purchase bidding documents up to 24 hours prior to the deadline for the submission of bids.

(b) Bid documents shall be made available, by mail or in person, to all who are willing to pay the required fee.

(c) Bidders domiciled outside the area/district/province of the unit responsible for procurement shall be allowed to participate regardless of the estimated value of the contract.

(d) Foreign bidders shall not be precluded from bidding. If a registration process is required, a foreign firm declared the lowest evaluated bidder shall be given an adequate opportunity for registering.

6. Bid Security

The bid security, at the bidder's option, shall be in the form of a letter of credit or bank guarantee from a reputable bank.

7. Bid Opening and Bid Evaluation

(a) Bids shall be opened in public, immediately after the deadline for submission of bids. If bids are invited in two envelopes (technical and price), both envelopes shall be opened at the same time.

(b) Evaluation of bids shall be made in strict adherence to the criteria declared in the bidding documents, and contracts shall be awarded to the lowest evaluated responsive bidder who is qualified.

(c) Bidders shall not be eliminated from detailed evaluation on the basis of minor, non-substantial deviations.

(d) No bidder shall be rejected merely on the basis of a comparison with the owner's estimate and budget ceiling without the Bank's prior concurrence.

8. Rejection of Bids

- (a) All bids shall not be rejected and new bids solicited without the Bank's prior concurrence.
- (b) When the number of responsive bids is less than three, rebidding shall not be carried out without the Bank's prior concurrence.

## NOTES

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<sup>1</sup> The previous CPARs were in FY92 and 97 prepared under the then Bank guidelines with the sole objective to document the country procurement practices in order to identify inconsistencies with Bank policies and procedures. In June 1998, the World Bank revised its policies to reorient the old style CPARs, recognizing that the public procurement policies and procedures are an essential element of good governance. The new CPARs such as this report are undertaken by agreement and in partnership with the borrower countries. They are intended to diagnose the public procurement system in the country, assess actual compliance with the country's procurement laws and regulations on the ground, and identify reforms to improve the existing system. They also identify the compatibility of the country's public procurement system with Bank policies to detect practices not acceptable under Bank-financed projects, and provide recommendations on the nature and extent of Bank procurement supervision. This full CPAR is in accordance with the World Bank's circular of June 1, 1998 on the New CPAR Procedures, issued by the Operational Core Services Network, Procurement Policy and Services Group (OCSPR).

<sup>2</sup> Heads of district governments.

<sup>3</sup> See Section II for discussion of the legal, regulatory and institutional framework, and organization, procurement procedures and practices. In brief, since the early 1980s, Indonesia has had detailed regulations concerning how State funds may be spent for goods and services. Formal procurement rules were first introduced in 1979 (Keppres 14/1979). The rules have been updated and modified several times to improve the public procurement system (Keppres 14/1980, Keppres 14A/1980, Keppres 29/1984, Keppres 30/1984, Inpres 1 of 1988, Keppres 16/1994, and the newly issued Keppres 18/2000). Until the issuance of Keppres 18/2000, procurement rules were part of regulations for the State Budget. They apply to procurement by government agencies, SOEs and regional SOEs.

Procurement regulations in Indonesia have always had multiple objectives: efficient use of State funds, promotion of domestic products and services, equity and social justice. Therefore, while Keppres 29/1984 aimed at establishing procedures for the most effective and efficient use of the State budget and in this regard dealt with economical purchasing, tendering procedures, contract provisions, etc., it also made obligatory use of domestic products and capabilities to the maximum extent, and reserved certain size contracts for economically weak groups and local bidders to cultivate and nurture economically weak businesses and foster social equity. Because of these multiple objectives of the procurement system, Keppres 29/1984 may have meant different things to different people in its interpretation.

There have been many improvements in procurement regulations over the years. In addition to the principles of economy and efficiency, Keppres 16/1994 explicitly referred to the principle of transparency in procurement. It introduced procedures for pre-qualification, registration, and certification of bidders. It placed more emphasis on advertisement in widely circulated media. Keppres 18/2000 no longer gives preference or reserves certain size contracts to economically weak contractors. However, it has introduced preference for small and medium firms depending on the size of contracts.

The procurement system has also moved away from the overly centralized decision making for contract awards to a more decentralized approach. In 1988, ceiling for centralized approval of contract awards was raised from Rp. 500 million to Rp. 3 billion. They were further raised under Keppres 16/1994 to Rp. 10 billion. In early 1999, approval authority was further decentralized to delegate full authority to the project managers for contracts up to Rp. 50 billion (\$5.56 million). Contracts of higher value require approval of the Minister, Governor, Mayor, Bupati or the president of SOE.

Keppres 18/2000 has clarified responsibilities of project managers and tender committees to improve accountability. It introduced certain qualifications for project managers and for the first time it allowed outsourcing of project managers. It also introduced principles of ethics to guide procurement professionals. It removed restrictions based on domicile of the bidders, but overlooked to change the advertising procedures. Keppres 18/2000 also included improvements in the selection procedures for consultants. It introduced further improvements in the advertisement procedures. Continuing the practice started with Keppres 16/1994, Keppres 18/2000 has been followed by the issuance of detailed technical guidelines for implementation of the procurement framework.

<sup>4</sup> E.g., the provision of text books to school children, furniture to schools, drinking water to people, improved road maintenance, delivery of extension services and credit to the farmers, and so on.

<sup>5</sup> In public procurement, international experience shows that corruption generally consists in fraudulent behavior (usually some form of collusion between the two sides – contractors, suppliers or consultants on the selling side, and officials responsible on the public contracting side) by persons concerned with the procurement process leading to losses for the State. Corruption can occur at the pre-award stage as well as during contract management. Some of the possible corrupt practices on both sides – buyers and sellers -- could include the following: biased specifications, splitting of contract packages, use of non-competitive bidding procedures, limited advertisement and shortened bid submission periods to reduce competition, overlooking the need for rigorous assessment of capacity during pre-qualification or at the post-qualification stage prior to contract award, overuse of shopping procedures on grounds of urgency, breach of confidentiality during bidding and evaluation stage, bribes, bid-rigging, bringing outside influence during bid evaluation, lax contract administration, unjustified contract amendments, over- or under-invoicing, false certificates, inaccurate disclosures, etc. *Also see, end note number 6.*

<sup>6</sup> Problems in Indonesia's public procurement system were captured very well by Dr. Boediono, former Minister of State for National Development Planning/ Chairman of National Development Planning Agency, in his statement on July 22, 1999, in discussing the agenda in public procurement, "Generally speaking these reforms were positive in at least their intent. However, we have had numerous problems in implementation. Problems have been most serious in the pre-qualification phase where tenders have often been reduced to a formality; because of poor business practices and ethics on the part of contractors; with poor supervision and law enforcement in discovering and prosecuting cases of abuse; and because of poor compliance with the rules designed to foster increased participation by cooperatives, small businesses and domestic firms."

<sup>7</sup> Keppres 18/2000, Implementation Guidelines for the Procurement of Goods/Services of Government Agencies, February 21, 2000; and technical guidelines (Juknis) issued in May 2000.

<sup>8</sup> Government's investment budget (development budget). About 35% of the development budget is externally financed.

<sup>9</sup> This report focuses on the public procurement system as it applies to government procurement. Reforms of the public procurement regime would have to also focus on the practices of SOEs and regulations for arranging private participation in public infrastructure provision.

<sup>10</sup> The World Bank jointly with GOI and ADB also conducted a Country Financial Accountability Assessment (CFAA) in April 2000. The draft CFAA report was discussed with Government in September/October 2000.

<sup>11</sup> Legal, regulatory and institutional framework, organization, procurement procedures and practices, human resources and enforcement.

<sup>12</sup> Keppres 18/2000, Implementation Guidelines for the Procurement of Goods/Services of Government Agencies, February 21, 2000; and technical guidelines (Juknis) issued in May 2000.

<sup>13</sup> Keppres 16/1994, March 22, 1994.

<sup>14</sup> Undang Undang (UU) 18/1999.

<sup>15</sup> PPs.

<sup>16</sup> The body called BP4S-PU, chaired by the then State Minister of Public Works, was established under Keppres 12/2000. Under a reorganization of ministries, it was transferred to the Ministry of Settlement and Regional Infrastructure. In November 2000, Keppres 166 however abolished BP4S-PU.

<sup>17</sup> Small scale businesses are defined as those with net assets of less than Rp. 200 million (US\$22,220), excluding land and building, and annual sales below Rp. 1 billion (US\$111,110). They also need to be of Indonesian nationality and independent of medium or large enterprises.

<sup>18</sup> Ministerial regulations (Kepmen), and letters of information from the ministers (Surat Edaran).

<sup>19</sup> Undang Undang (UU).

<sup>20</sup> E.g., limiting discretion on the use of non-competitive procurement methods, publicity on contract awards, a clearly enforceable review and complaints system for the bidders who have a grievance with the procurement process, and provisions on maintenance and availability of records of the procurement process.

<sup>21</sup> Keppres 18/2000 and related Juknis, and Law 18/1999 on Construction Services and related Government Directives (PP).

<sup>22</sup> Contractors are classified by the Presidential Decree in different classes based on judgment of their capacity for works. The new classification system is the following: Rp. 0-400 million - small 2 (K2), Rp. 400 million -1 billion – small 1 (K1), Rp. 1-10 billion – medium (M), and above Rp. 10 billion – big (B). Similar classification systems exist for suppliers of goods and for consultants. As indicated in Box 1, contractors in the next higher class(es) are restricted from bidding on contracts reserved for contractors in the lower class(es).

<sup>23</sup> Under the current system, bidders have to initially file a complaint with the Project Manager (Pimpro) who is also the person responsible for the procurement process through the tender committee. Based on international experience, such a review authority should be an independent authority and not the Project Manager (Pimpro) or the next higher level in the concerned ministry.

<sup>24</sup> Preferential treatment of certain domestic enterprises within the domestic market is also not allowed under National Competitive Bidding (NCB) procedures in Bank-financed procurement.

<sup>25</sup> Law 9 of 1995 defines small scale businesses.

<sup>26</sup> Technical guidelines (May 2000) define the qualification criteria for project managers and a method for their appointment (Secretary General in a ministry, Territorial Secretary of a Governor, Territorial Secretary in a municipality on behalf of the Mayor, or an appropriate Director on behalf of the president of a State or region owned enterprise (SOE).

<sup>27</sup> LPJK will be led by the industry, including members from the main business and professional associations, academia and GOI.

<sup>28</sup> Insufficient budget for TCs may also lead to feeble commitment to the procurement policy objectives or insufficient political will to enforce regulations.

<sup>29</sup> Post-qualification generally did not even occur.

<sup>30</sup> Incomplete information on packages, unacceptable media and/or media of limited circulation newspapers, buying up all copies of the newspaper, placing advertisement in inconspicuous locations, running advertisements for very short periods and/or even fake advertisements.

<sup>31</sup> Uneconomic procurement packaging and excessive slicing, insufficient advertising to limit competition, lax diligence in assessing contractors' capacity to perform, lack of oversight and enforcement of sanctions, and collusive practices, which can lead to loss of economy, efficiency and transparency in public procurement.

<sup>32</sup> Registration should be considered a "right" of qualified contractors, suppliers and consultants, to be granted to all that are entitled, and to be denied or revoked only on the basis of clear evidence of failure to meet clearly defined criteria. The classification and pre-qualification systems should be geared toward ensuring quality, not distributing work, and they should not preclude larger firms from bidding smaller contracts, but curtail unqualified firms from bidding larger contracts. The system should also allow participation of foreign bidders without registration, but make the contract award subject to meeting reasonable requirements.

<sup>33</sup> The tender committees should however retain the right to award contracts based on post-qualification for capacity.

<sup>34</sup> The SBDs should be used by reference only in order to ensure quality and consistency, substantially reduce the volume of paper work, and achieve cost-effectiveness in the administrative cost of procurement work.

<sup>35</sup> Contractors were classified without fully meeting the criteria.

<sup>36</sup> Increased domestic trade between districts in a province and between provinces leads to increased growth just like international trade.

<sup>37</sup> The CFAA report makes specific recommendations in the areas of budget process, financial management and audit.

<sup>38</sup> Articles 37 and 38.

<sup>39</sup> Regional governments refer to provincial and district governments.

<sup>40</sup> Including projects financed under the Global Environment Facility (GEF).

<sup>41</sup> Action in one case led to two actions – barring of a firm from future procurement and rebidding of procurement.