Journal of the Indonesia Infrastructure Initiative

PRAKARSA

Issue 20 / January–April 2015 double edition

Voices from the Private Sector

Features

This quarterly journal is published by the Indonesia Infrastructure Initiative, an Australian Government funded project designed to promote economic growth in Indonesia by enhancing the relevance, quality and quantum of infrastructure investment. The views expressed in this journal do not necessarily reflect the views of the Australia Indonesia Partnership or the Australian Government. Please direct any comments or questions to the Communications Team at IndII, tel. +62 (21) 7278-0538, fax +62 (21) 7278-0539, or e-mail **enquiries@indii.co.id**. Website: **www.indii.co.id**

SMEC
Local People. Global Experience.

Australian Government
Department of Foreign Affairs and Trade

Australian Aid

Editor's Message

It's common knowledge that Indonesia has a substantial infrastructure gap and that the Government alone cannot provide all the funds needed to fill it. Private investment has an essential role to play in supplying the infrastructure that will enhance economic prosperity. As we wrote last year in ***Prakarsa***, "the Government of Indonesia…needs to make more efficient use of private investment; rationalise incentives; and use performance-based mechanisms to obtain better value-for-money. There is a need for clear guidance on competition, the respective roles of the public and private sectors, and the organisation of public sector functions."

These are not novel ideas; they are often repeated by development experts, and many ***Prakarsa*** articles have stressed them. But what we have not done previously is to offer private sector representatives themselves a chance to explain their views on the climate for investing in Indonesia's infrastructure. This double issue attempts to redress that, featuring interviews with seven experts in infrastructure finance, road building, urban mobility, ports, and water provision. In these pages they share insightful commentary that ranges from illustrative personal anecdotes to broad observations on how the private sector views Indonesian investment opportunities.

Much of what they say reinforces well known strategies that every nation that seeks to encourage private participation would do well to apply: promote regulatory reform, prepare projects and tenders properly, use innovative financing modalities, allocate risk to the parties best able to manage it, incentivise quality, ensure transparency, and create a good governance environment and strong institutions.

Beyond that, some of the themes that emerge feel particularly Indonesian in nature. The consequences of Indonesia's push toward decentralisation continue to reverberate, with desires for more clarity on local versus central government roles and concerns over local institutional capacity. Another recurring theme is Indonesia's need for social infrastructure and the Government's clear responsibility to provide it, along with critical infrastructure in remote areas that might not ever be profitable enough to attract private investors.

So where do we go from here? Ultimately, the Government of Indonesia, Local Governments, the private sector and other institutions all have roles to play. Determining the best and most efficient means for them to carry out their roles calls for ongoing engagement, and is a subject that is sure to appear again in future issues of ***Prakarsa***. • CSW

Infrastructure by the Numbers

7.2%

Portion of Indonesia's infrastructure financing provided by the private sector, according to Bappenas data. State-owned companies account for 38 percent, the state budget for 32.1 percent, and joint financing for 22.7 percent.

Rp 200 trillion

Estimated cost of a high-speed railway to connect Jakarta and Surabaya, an investment that is expected to be required through Public-Private Partnership arrangements.

53

Indonesia's rank in 2014 among 166 countries surveyed in the World Bank's Logistics Performance Index, which measures perceptions by the private sector, academics and others on the quality of a nation's logistics.

1.73

Bank Mandiri's estimate of the "output multiplier" for road, bridge and port development, meaning that a Rp 1 billion investment in these sectors will cause the total output of Indonesia's economy to increase by Rp 1.73 billion.

Rp 1,090.4 trillion

Annual investment in infrastructure required by Indonesia during the 2015–2019 period, according to the National Mid-Term Development Plan. This represents about 12 percent of GDP.

2.3% of GDP

Total expenditure on infrastructure in the 2014 State budget. Prior to the financial crisis of 1998, infrastructure investment was around 8 percent.

Rp 4,272 trillion

Estimated size of the "financing gap" for infrastructure for the period 2015–2019, measured as the difference between State and regional budget allocations for infrastructure development and the amount of investment required.

An Infrastructure Emergency and Ways to Confront It

Courtesy of Bernardus Djonoputro

Bernardus Djonoputro is the founder and chairman of HD AsiaAdvisory, which provides strategic advisory services to investors and corporations to help them develop comprehensive investment strate–gies that take into account the legislative, regulatory and political nuances of the investment environment. He has served as an advisor to many central and local governments on planning and infrastructure projects. From 2010 to 2013 he served as Managing Director of the infrastructure investor and operator PT Nusantara Infrastructure Tbk, managing concessions in toll roads, port, water and power sectors. He is also the Secretary General of the Indonesian Association of Urban and Regional Planners. An alumnus of the Indonesia-Australia Intergovernmental Youth Exchange Program, he holds a degree in Urban and Regional Planning from the Bandung Institute of Technology.

PRAKARSA: You have two interesting roles – Head of the Indonesian Association of Urban and Regional Planners [IAP] and the head of HD AsiaAdvisory.

BERNARDUS DJONOPUTRO: HD AsiaAdvisory, that's my business. In my spare time, I am the President of the Indonesian Planning Institute, which is the opposite number of PIA [Planning Institute of Australia] in Australia. That's a pro bono position. We are the sole professional organisation of urban planners in the country, with about 3000-plus members, of whom are certified planners. We do independent certification and accreditation of planners for government works. In my role with HD AsiaAdvisory, I'm more concerned with investment/infrastructure practicioners.

Do you ever see any intersection between your work with IAP and the kind of advising you do, or are they two totally separate topics?

Well, actually it is related when you look the key issues in the planning today pretty much revolve around the fact that Indonesian cities and regions are not capable of providing their infrastructure, so provision of infrastructure is the key concern.

Do you think investors are afraid to come to Indonesia because they are worried about the quality of the infrastructure?

No, they look at it as an opportunity more than anything else. I think the fear factor for foreign investors today is whether or not they feel comfortable with the regulatory regimes and the policy framework. Also I think investors are looking at the fate of existing infrastructure projects like concessions and BOTs [Build-Operate-Transfer]. So it is about the regulatory regimes that will ensure whether or not their investment is worth while.

Do you have thoughts on the specific changes you'd like to see to the regulatory environment? If you were the new President, what would you do?

I think first and foremost the new government needs to somehow plant the idea that we are in an infrastructure emergency, in terms of the way government is structured and works. I see there are three key emergencies that the new government will need to look at:

First is energy – We have a big challenge in terms of making sure that we have enough energy for the country.

The second emergency in the provision of infrastructure is that we have to get our act together in building the right infrastructure that will optimise the potential that Indonesia has to grow at the level that we all think it can, i.e. 5, 6 or 7 percent. That includes not only basic infrastructure but also the provision of housing. We currently have major backlogs in urban areas in the form of housing, especially affordable housing for middle and low income people.

Third, which is lesser but also is very important for the government is regulatory efficiency. With the latest developments all our infrastructure and all our energy programs are happening at regional levels. So the primary environment that investors are working in today is not so much Jakarta-centric, it is the local playing field. So any investment, or the locations of your housing, or locations of your power plant, or locations of your toll roads – all of this plays out at the Local Government level, so central and Local Government dynamics become very important.

In terms of sectors that the government needs to look at first, it's energy and infrastructure. In "emergency mode," the government needs to go in and from day one identify low-hanging fruit – basic infrastructure that the country needs to develop. The government needs to re-look at its grand strategy. I think the infrastructure strategy needs to be part of a broader, stricter and clearer country strategy. The new government must avoid sending out wrong messages in form of pseudo-policies like MP3EI [the Government of Indonesia's Economic Transformation Master Plan] or that sort of thing, but rather it should come out with very structured long term goals that are cascaded down into medium and short term projects, i.e. we used to have GBHN [Garis-Garis Besar Haluan Negara, the broad outline for national policy] which is the main plan for 25 years or 50 years, and then we translate that into medium term and short term plans that flow from the national to Local Government – that means we have very structured goals.

I think we must avoid looking for short-term political gain. Government can be prone to that. The Yudhoyono administration was prone to short-term political initiatives coming from the various factions of its government. This is my very harsh assessment of the MP3EI strategy, that has not brought the country anywhere near what what it was intended to. I think it is very wrong to come up with a quote-unquote “business case” document, and position it as if it is a country strategy – which is not. That was where the SBY government failed to accelerate investment in infrastructure.

A second issue is that the private sector is not a magic potion to cure infrastructure problems. This should not happen again in the new government. Basic infrastructure is purely a government responsibility. The private sector will come in if there is an incentive or if there is a place where the private sector can participate and obtain returns on their investment, in any project. I truly hope the next government will look at private participation in infrastructure development as an addition or enhancement to government works.

And a third issue is that Public Private Partnership [PPP] is not such an easy thing – it is easier said than done. Experience around the world proves that PPP is not the easiest scheme to implement. The government needs to understand that PPP is something that needs to be clearly defined, clearly prepared and clearly structured. So that it is an exercise in risk sharing and not a magical way to get private resources. We don’t see that this regime of risk sharing has been subscribed to by the government. This will be one of the key challenges for the new government. From what we see so far coming out from the transition team and the preparation work of the new cabinet, I don’t see that they are fully aware of the complexity of this. We still see signals out there looking at PPP and private participation as if it were a magic potion. The new cabinet needs to sit down and figure out how they are going to determine the low-hanging fruit. The low-hanging fruit is very easy – it is simple, and it’s out there.

What are some of the low hanging fruit?

You look at the 24 trans-Java toll roads and Jakarta intra-urban roads that have not been built. A big portion of those contracts you know, have been granted to players back 10 to 15 years ago, and a lot of them have not moved an inch. They are blaming it on technicalities such as land acquisition and stuff like that. With all due respect I think the government needs to be very strict on that and to re-evaluate the existing concessions and if the private sector is not able to build, then revoke the license or the BOT concessions and give them to new concessioners. Alternatively, the government needs to look at the trans-Java toll road and the intra-urban Jakarta toll road as one incorporated Indonesian infrastructure work, where you put them all together and look at major investment as a whole, rather than a piecemeal concession. So government now has the opportunity to re-look at the whole concession and reconsider how those concessions can work.

How would that work if it was one large project?

The first thing is, have everybody that owns the concession sit together and raise their hands if they are not able to build their concessions. Then they have to excuse themselves and not participate in their concession any more. The government has the capacity to do that. Now, it is easier said than done, but if the government has the authority it can work on land acquisition. I think concessionaires will stay if they are bonafide, if they are really up for investing in those concessions. The missing link here, everyone has been saying, is land acquisition, right? If the government can allocate investment, and energy, and use its authority to make sure that land can be acquired, then I think there is no excuse why trans-Java cannot be built within the next five years. That’s the first low-hanging fruit.

What are the other low-hanging fruit?

The second is the first five major water contracts out there that are already in the stage of prequalifications and tender. You have to look at the PPP scheme for all of those water projects. We are talking about Jatiluhur, Lampung, West Semarang, Unggulan and Palu. So the easiest bit is trans Java, second group is the water contracts and some of the port and airport extension plans. The medium size and small airport and ports. Because for the past 30 years we forgot to build any ports. Now, those two areas, the water and ports, all need to be done with PPP because I can assure you that all of those water projects and port projects are profitable. They have a potential to become PPP because the financial benefits are there. And the economic benefit [for the government] is very appealing, very big.

Third is the infrastructure projects in the government's budget. The 2000 km of road that the government will build can be done through government budget. I think the government has enough money to do that. So government needs to work and optimise the role of state-owned company as a locomotive to build those 2000 km of non toll national roads funded by APBN [Anggaran Pendapatan Belanja Negara, the State budget].

So that's a lot of low-hanging fruit. How should the Government get started?

For the first one, the trans-Java and intra-urban roads, all you need is the authority and to optimise the land acquisition. For the third one, the government budget, optimise APBN through the budgeting process.

So the biggest challenge is number two, which is water and port development through PPP. Now, with the PPP what the government can do is very simple. The biggest challenge for the government to look in terms of the infrastructure emergency is PPP, because PPP is not a magic potion, it's complicated. But it is doable. Australia, Korea, UK and some other advanced, mature economies have done PPP and have gone through a few cycles already. Studies show that it is not a simple scheme. It requires very solid government work and initiatives and energy and power. But it also requires very focused private investment. There are very focused investors, players, operators, project sponsors that are already playing in this field around the world. They will be the main driver of any PPP in any part of the world.

So how to jump-start the PPP? I think the President needs to look at some of the options, and one of the easiest ways is to create a PPP centre with the highest possible position under the President. So if the current government can proclaim some sort of emergency mode for the next five years to build the needed infrastructure, PPP can be achieved by having a very focused effort.

How can the PPP centre work?

We've seen how ministries interact. So the best thing is to put the PPP centre directly under the President. This has been successful in various countries. What the PPP centre has to do is very simple – jump-start the procurement, the investment and the concession, i.e. prepare the projects, run the tender and deliver the project until the financial close. So it's mainly preparatory work, do the tender and get it done. So these agencies would not become the contracting agencies, but would act mainly as an enabler so that PPP tenders and PPP work can start. And this is what I think is needed. This centre or these agencies needs to be at the highest position as possible, reporting to the President or Vice President directly and have a cross-ministry role in preparing those tenders.

And dissolve any pseudo-PPP units in various different departments that we have today, and have those people support the centre instead, with the analysis and the cross-ministry work. We should not have PPP in various different ministries like we have today in Bappenas, in Finance, in BKPM [the Investment Coordinating Board]. This centre needs to cut across different agencies. When you look at the PPP in Indonesia today we already have all the required agencies, we have a revolving fund for land, so the government does have money to acquire land and then the concession holders can pay later. We have a guarantee fund, IIGF [Indonesia Infrastructure Guarantee Fund]. The role is to guarantee political risks as well as traffic risks, and then you have government equity participation funds – SMI, IIF [PT Sarana Multi Infrastruktur is a shareholder of PT Indonesia Infrastructure Finance; PT IIF is a private enterprise launched by the Minister of Finance in 2010 to accelerate Indonesian infrastructure investment]. So all of this is in place but what has happened today is that we have not moved beyond procurement, beyond preparation.

At the 2005 infrastructure summit Bappenas listed so many PPP projects, something like 179 then down to 59 down to I think now around 20. Of all the billions of dollars the list represents, nothing goes beyond PQ [pre-qualification], nothing goes into tender yet. There is only one project worth 2 billion dollars that had a completed financial close two years ago, and even today that has not started because of problems with land acquisition; this is the Batam power plant project in Central Java.

So progress for PPP is zero. If Jokowi wants to achieve big numbers I think he needs to look at what is happening today. What's happening is that the guarantee fund draw-down to date is nil, a big zero, so we highly pay people for not delivering anything. Equity participation is measureable, but very small; most of the funds from SMI and IIGF have gone into lending. Lending is not the reason for SMI and IIGF. They should do equity participation to jumpstart a project, not lending; leave the lending to banks. Banks should be focusing on providing the next phase of project financing in this country, not SMI and IIGF.

I think it is very misleading for government equity participation funds to do lending because then you have to ask yourself whether it's a really a bank or an equity institution. And then as I said earlier, as soon as you want to jump-start your program locally you see there there are overlapping regulations between the central government and local governments. And it's very clear that there is no leadership. There is not one single person who takes charge and is responsible for making decisions on PPP. I think this is key.

So back to your question earlier what can this government do. It's leadership. Get it done. So if our new government would like to on its infrastructure targets, if they want to build all this, then the first thing is to declare an infrastructure emergency within the cabinet. Then have BUMN [Badan Umum Milik Negara, the state-owned enterprises] become a locomotive in building the needed infrastructure today with APBN, and the private sector can go with PPP. So to me it's very simple. Coordinate all the already available agencies with a very focused presidential unit, with mandate for only five years, to jump-start the feasibility studies. So all they need is to do preparation and bidding process. That's it.

Let me give you an example – the Lampung water project. Lampung has gone through so many phases of PQ and there is a short list of four consortia. If you look at what Lampung has, the feasibility studies, the basic groundwork done by the contracting agencies, which are local PDAMs [water companies] – this is not enough for any consortium to come up with a good proposal. So what happens is that all those four consortia will have to do their own feasibility studies. The feasibility studies each cost 1 to 1.5 million dollars, easily. So what you see is an expenditure of 6 million dollars, whereas if a sound feasibility study is done by the government, then it will only cost 1.5 million. Then all you need to do is have bidders come in and start bidding. It makes the process quicker and then the winner of the bid pays back the feasibility study costs – it's that simple.

So if you look at 20 priority projects for the next five years, or use whatever numbers you want, 20 times 2 million, that is only 40 million dollars for agencies to jumpstart the process, and the money can be paid back by bidders. This has been done elsewhere in the world. I think for the government to come up with quality bidding documents and feasibility study is very easy. Specialists, technical advisers, and transaction advisers from around the world are available to work on this.

So that's my thought. The agency needs to be non-sectoral, so it's not a ministry, it's an ad-hoc thing, with just enough budget to jumpstart tender processes. It goes as far as bidding and that's it. It is not the contracting agency. It has to have a positive feel for investors, meaning it needs to be commercially savvy, it has to be a commercial entity or commercially driven rather than a bureaucratic engine. It must be able to send out the right messages to the environment, to potential investors and banks and lenders. And all other redundant units are dissolved. That is a shortcut for the government.

Another thing that the government can do is to create integrated infrastructure companies, so we structure one of the good SOEs [State Owned Enterprises] to become an integrated company that can invest in various different concessions. Say, Jasa Marga. It's doable – make Jasa Marga ino an Indonesian infrastructure corporation that can be a project sponsor. Today Jasa Marga is only O&M [operations and maintenance] for toll roads. What I did in Nusantara was to restructure Nusantara from a small toll operator to become an integrated company, an Infrastructure investor. When we did that in 2009 the share price was only about 65 or 85 rupiah. After three years in 2012 I think it was about 325. So Nusantara went from being a small toll operator to being an integrated infrastructure company with eight subsidiaries. That is more stable for and that is what Indonesia needs, an integrated infrastructure company with two tiers, as project sponsors and as O&M. I think we have good pool of builders in the country, from local, state-owned, and international contractors and builders. What we don't have is enough project sponsors. O&M companies will happen eventually, so the toughest part is how to invite people to become sponsors of infrastructure projects.

Is the regulatory framework in place to do that kind of a restructuring of an SOE?

I think Wijaya Karya is already doing concessions. They already have shares in the Bali toll road concession and some other concessions. They were asked by the state-owned ministry to invest. Jasa Marga already has business in non-toll revenues but they are only making peanuts from real estate and rest areas – but that's chump change, crumbs. They need to think bigger, they need to be mandated by the shareholders, i.e. the government, to go into sponsoring major infrastructure projects. When you structure the companies into two-tier project sponsors and O&M, then you can always split the risks internally and get the mandated IRR [internal rate of return] required by your shareholders. I did that, it's very possible. So you share the risks between O&M and project sponsors and you get your money from the O&M companies. And eventually you can float them all into the market if you wish. So I don't see any constraints for the major BUMN to go to in that direction. All they need is the will, for the management to do that.

How big a role do you think foreign investors will need to play?

Very big – on PPP – foreign investors will play a very big role in (a) the capital market, and (b) as the right investor or project sponsor in the PPP project. The appetite of the local oligarch or the local businesses is very small, and history shows that in the past 10 years only a handful of local companies will be prepared to play a role in major infrastructure. So it really depends a lot on the appetite of foreign investors and capital markets, but if you combine the three major areas – trans-Java, PPP and the APBN projects, probably all foreign investors can fill in not more than 30 to 35 percent of the total required budget. Then you have another small part from the local investors. When I say local investors or foreign investors or international investors, that means players as well as institutional investors. So there are two tiers of investment, the capital market and direct project sponsors – so if that's 35 percent and then the government today also can only afford 30 to 35 percent then you end up with another 30 percent gap in the financing. And this is where the government needs to look very careful, cleverly, smartly at the BUMN role. Because I think the number of local Indonesians that will have the appetite to go into infrastructure is very small.

They just don't have the capacity, or…?

Well, there are 250 million consumers out there who need consumer products. So to go into a 20 or 30 year infrastructure project – for local Indonesian businesses, it's just too big a bite to chew at the moment. Consumer goods, real estate, manufacturing businesses, these are still up for grabs. In the past 10 years we haven't seen more than five local companies that are seriously working in infrastructure, and if you look at the so-called conglomerates – well there are not more than five, maybe just three. So it is very important for Indonesia to create a conducive environment for investment or institutional investors or project sponsors to have the right contract regimes with the government.

I think it is very unfortunate, the situation that the government is in right now. They had a big opportunity to do something significant 10 years ago to improve the situation. That's why I give very mixed reviews to the MP3EI. We hear a lot about groundbreakings. It's a politican game, politicians love groundbreaking with the safety helmets and the safety shoes on – but what are those, nothing, they are all commitments to do something but no real projects, and none of them are PPP. All those are APBN projects and none of them have invited real foreign investors for infrastructure. There are some for manufacturing, for consumer goods, the government is growing opportunities in the consumer business, cars and stuff like that, but for infrastructure I think it's nil.

Do you think this is going to change a lot under the new administration? There is a sense that there will be a different set of priorities.

It has to change a lot. But I think it will not be as progressive and aggressive as we would like it to be. With Jokowi and Jusuf Kalla, the priority is on stability of staples, food for people, and health. That will distract from their work on infrastructure. So there will be constant battling over the most populist issues in the government stability, staples, agriculture and maritime. What needs to be done is the government needs to put the right people in place who can move the supporting agenda. If the government cannot build the needed infrastructure, then those populist agendas will not succeed, because Indonesia will lack the connectivity and the logistical supply chain infrastructure. But I think it is going very tough for Jokowi and Jusuf Kalla to have a very sharp infrastructure agenda.

I see we've just about used up our allotted time – is there anything you haven't had a chance to mention that you wanted to add?

My last point is that I think most stakeholders in the infrastructure sector now realise that there is a compelling need to address the bottlenecks. Other countries have gone through similar situations. Australia has gone through that, Korea, the Philippines. Most countries with a very mature PPP environment have faced something like Indonesia's situation today. But what is interesting is what has been done in Canada and Australia in particular, where you have a multistakeholders forum that can become a partner with the government or the contracting agencies based on its credibility and its capability to move investment and capital around. A stakeholder forum or centre is needed in Indonesia to represent players, stakeholders and government alike, to really become catalyst so Indonesia can focus on on the right and best projects to move forward. ■

Financing Infrastructure: A View from the Banking Sector

Courtesy of Sarah Darmawan

Sarah Darmawan is Senior Vice President – Head of Project Finance Department at PT Bank Sumitomo Mitsui Indonesia and prior to that was a Director at KPMG Indonesia. She has more than 15 years of experience in consulting, with particular interest in the infrastructure and government sector. She has worked extensively on a variety of engagements that include policy formulation, investment planning, business case development and transaction advisory services.

She has played a key role in strategy setting, organisation structuring and system and process design aided by comprehensive economic analysis for major public and private sector clients in Indonesia. She was also involved in corporate restructuring, corporate refinancing and fund raising projects for national companies including State Owned Enterprises and Regional Owned Enterprises.

In providing advisory services to government, she has been involved in many feasibility studies, development of business cases, and project management. On the private sector side, she has assisted companies to develop corporate strategy plans, business plans, budgeting and fund management strategies, and institutional strengthening through financial and contract management. Some of her key recent experiences include: Lampung PPP, SHIA Rail Link, Mass Rapid Transit Jakarta, Financial Reforms of 20 PDAMs under PP no 29/2009, PT MRTJ, Project Esperanza (JICA), Jatiluhur Jakarta Pipeline (Stage I: Pre-Feasibility Study), Study on Feeder Bus Services, Asahan Hydro Power, and Sumsel 9&10 IPP.

PRAKARSA: What is your background in Indonesian infrastructure?

SARAH DARMAWAN: In 2009 when I was still working at KPMG Advisory, we were contracted by the Indonesia Infrastructure Initiative as financial consultants to work on Government of Indonesia [GoI] programs in an effort to promote local water companies [PDAMs] through the Perpres [Presidential Decree] 29 Phase I-III incentive program. My enjoyable experience working with many kabupaten and city PDAMs made a big impression on me. The experience was valuable, because as a person born, raised, and living in Jakarta, I had the opportunity to see and interact directly with the life of common people in Indonesia’s rural areas. The life, life style, and the dynamics of the people and politics, including how the Local Government interacts with the Local House of Representatives in each region, differ from one another; each is unique and I was able to compare them. In addition, the scope of work gave me the opportunity to know, study, and understand in more depth that infrastructure is an important basic need and one of the factors that plays an important role in contributing to people’s welfare. I simply hope that with my limited capability and role, I can contribute to providing benefits to other people, through means such as giving input to the government/local community and helping PDAMs to develop business plans, so people can enjoy clean water from their PDAM.

I also see a very large business opportunity in the infrastructure market which global consulting firms have not yet focused on. Therefore, I submitted a proposal to KPMG management to consider the infrastructure sector, specifically within Indonesia, as one of our business development sectors in Asia. I felt motivated to submit such a proposal because KPMG, as a global company, has a special infrastructure division supported by expertise in various infrastructure sectors from all over the world. Apart from the company's strong credentials, they have the advantage of global networking. I could consult with my colleagues all over the world to discuss and find the best solutions adjusted for Indonesia's conditions. So in 2012 I was entrusted to establish and become a director of PT KPMG Infrastruktur Advisory.

I like infrastructure because it enables me to make contribution to the people. By developing a feasibility study, conducting dialogues with stakeholders, carrying out field surveys, and becoming part of the planning up to the implementation process, I help develop infrastructure that will reach the people and have immediate impacts. That's what made me become interested in infrastructure. Everything in my position as Head of Project Finance Department at Sumitomo Mitsui Indonesia is related to infrastructure.

What made you move from working in consulting to banking?

The first reason was my realisation that it was not easy to obtain funding from banks, although I have done a lot of work as a consultant in infrastructure. At that time I was asking myself many questions, specifically: why is it so difficult to implement a business plan and feasibility study, even though they were well prepared and approved by the project owner?

All business, activities, and work always carry risks. Entrepreneurs are aware that there are risks, but I noticed a difference in perspective toward risks as seen by entrepreneurs and consultants, which is different from the perspective of bankers.

In the case of consultants, the client expects the consultant to identify risks and provide input as to how to manage and mitigate them. Talking about infrastructure from the project-owner's point of view, the emphasis should be placed on how to make the project profitable and manage existing risks. In general, the project owner makes a self-assessment and requests the assistance of an external consultant to provide an objective evaluation. The proposal is then sent to the bank for processing in order to obtain funding.

The bank continues the process by analysing the risk management plan submitted in the project owner's proposal. The next stage is the bank analysis, which focuses on the methods used to calculate the risks and mitigate them by eliminating or preventing them, or transferring them to other parties. It is the knowledge of the bank's internal process that I still had to acquire and that I wanted to study, in order to understand the entire process of infrastructure procurement.

The second reason I moved into banking is my passion for continuous learning. The more I read, the more I realise that science and knowledge have no limits. I very much enjoyed my work as a lecturer for eight years at the Faculty of Economics of Atma Jaya Catholic University, because through teaching we also learn. I ceased my activities as a lecturer in 2011 as it became difficult for me to manage my time. My father also taught, and motivated me never to be afraid to try new things. Everybody has gone through the experience of doing something for the first time. If you feel fear, just consider every risk and what is the worst that can happen in that new activity. If you feel you can handle the worst and how know how to mitigate the risk of the new activity, then just do it. Honestly, I like challenging and innovative problem solving and strategic thinking. I feel excited every time I succeed in getting an answer or overcoming a challenge. By working at a bank I learn and have the opportunity of gaining experience in internal bank processing.

Can you tell us about the projects your bank is working on related to Indonesian infrastructure?

Sumitomo Mitsui Banking Corporation [SMBC] in Indonesia is one of the project finance banks which is very active in financing IPPs [Independent Power Plants], oil and gas, and metals and mining. SMBC has experience in various types of power generating plants based on coal, hydro power, geothermal energy, gas, and wind. SMBC also owns 14.9 percent shares in IIF [PT Indonesia Infrastructure Finance, a non-bank financial institution established together with the Minister of Finance through PT Sarana Multi Infrastructure, the Asian Development Bank, the International Finance Corporation, and Deutsche Investitions- und Entwicklungsgesellschaft mbH].

SMBC has significant exposure in large infrastructure projects in Indonesia. For example in the electric power sector: Tanjung Jati B, Tanjung Jati A, Paiton, Cirebon IPP, Central Java IPP, Wampu hydropower, Asahan hydropower, Sarulla geothermal, and Rantau Dadap geothermal. In oil and gas, the Donggi Senoro LNG Project, West Java FSRU, PT Pertamina, and PT PGN, among others. And for example in mining, PT Newmont.

SMBC is the market leader among Indonesia's project finance banks. It's ranked third largest in the world by Infrastructure Journal and Project Finance Magazine and it received the IJGlobal Asia Pacific Bank of the Year award.

Why are infrastructure projects difficult to implement? Is it because of the large amount of funds needed?

To give you an idea of the level of difficulty, risk, and requirement of funds in financing, let me offer the following illustration:

Currently the large, active, international infrastructure banks are capable of issuing a lending ticket in the vicinity of USD 30–250 million/bank/project (Rp 360 million to 3 trillion). Meanwhile the capacity of local banks is approximately Rp 500 million to Rp 1.5 trillion/bank/project.

Let's take for example an infrastructure project in transportation. The fast train project between Soekarno-Hatta and Halim airports requires an investment of Rp 28 trillion. If financed in Rupiah under a PPP [Public Private Partnership] scheme it would need the participation of over 25 local banks. As an additional information, although this project has not reached tender stage, let alone implementation, an increase has already occurred in the planned investment, from Rp 20 trillion on the date of its first announcement in 2012 to Rp 28 trillion in 2014, because of the instability in the exchange rate (exchange rate risk).

Indonesia's accelerated electric power generation program calls for 35,000 megawatts. If one megawatt requires an investment of, on average, USD 1 million, the total funds needed would be USD 52.5 billion, or Rp 630 trillion.

Since 2012, the widening trade deficit has caused pressure on the State Budget [APBN], and the Government needs to seek alternative funding that does not rely on the APBN. The National Development Planning Agency [Bappenas] estimates that the infrastructure financing needs from the APBN in the National Five-year Development Plan 2015–2019 is Rp 2,216 trillion, or 40 percent of the total amount required. In order to realise the 2019 infrastructure development target set by the Kabinet Kerja [Working Cabinet], the Government must allocate an infrastructure budget of at least Rp 443.2 trillion annually. The government also expects the remaining 60 percent to come from the participation of the private sector, in the amount of Rp 665 trillion per year.

Are all Public Private Partnerships in Indonesia considered high risk?

PPP is a partnership between the public and private sectors, in which the partners jointly develop products and/or services which contain risks, costs, and profits that may be shared. One of the keys to the success of a PPP project is the appropriate allocation and mitigation of risks.

Risk allocation is the sharing of joint project risk based on the principle that risk should be borne by the party most capable of controlling that risk. It is one of the steps taken in risk management, during the risk analysis phase. Risk allocation covers sharing of the project risk between the Government and the private enterprise. Both the Government and private enterprise should take into account the risk factor in implementing a PPP project in order for the collaboration to proceed successfully and yield profits for both parties.

In terms of infrastructure project risk, I may be able to briefly illustrate the downside of an infrastructure financing project from the banker's point of view. The dominant characteristic in infrastructure is the life span of the project, which in most cases ranges from 10 to 30 years and requires a huge capital investment, while general revenues and sources of payment are derived from user charges. A major risk in Indonesian PPP projects, as seen by the market players, is the political risk, such as changes in laws, regulations, and direction of policies. For example,if an infrastructure project has a credit tenor of 15 years, this means that: (1) during the credit tenor there will be a change in leadership (government elections) three times; (2) there is a high probability of changes in policies; (3) this implies a possibility that the existing PPP contract will no longer comply with new regulations; (4) consequently the change in policies and regulations will affect the rights and obligation of the contracting parties; and (5) a further consequence is that banks will be faced with non-performing loans because of termination of operations or delays in receiving the loan payments as a result of the above – etcetera.

PPP projects backed by a government guarantee (covering political risk, the risk of non-payment, etc.) will be considered to have a lower risk compared to PPP projects with a non-government guarantee. The banking sector will classify projects with government guarantees as belonging to a low risk category if the GoI can provide incentives through the OJK [Otoritas Jasa Keuangan] regulations where PPP projects with guarantees are categorised as projects that do not need the bank's capital reserves, meaning that the PPP project will be profitable to the bank.

How are guarantees provided?

The regulation underlying the provision of government guarantees and support is Presidential Decree no. 67/2005 on Partnership between the Government and Private Enterprise in Providing Infrastructure. Presidential Decree No. 56/2011 gives some amendments.

In general, guarantees provided by the national government are for priority projects where the GoI selects and determines which projects are of national priority. The Government, together with the project-owner/Government Contracting Agency [GCA] assisted by an independent consultant, will calculate and analyse the form and magnitude of the guarantee. In addition, the Government will also provide an opportunity for GCAs who wish to obtain a GoI guarantee to file an application and comply with the procedures and requirements made by the GoI.

In line with prudent practices in providing loans, banks cannot wait in a state of uncertainty and bear the risk for delays in loan repayments if projects possessing government guarantees which have been declared in default by the GoI are filing claims. The guarantee by the Ministry of Finance [MoF] generally does not stipulate in detail the process of settling claims. There are two courses that commercial banks can take in order to obtain payment under guarantee claims, namely via the Export Credit Agency [ECA] or the Indonesia Infrastructure Guarantee Fund [IIGF].

Currently almost all ECAs require a government guarantee if a company intends to obtain a loan from ECA to undertake a project. Advantages of ECAs participation in providing infrastructure loans include: (1) long tenor – up to 25 years; (2) interest rates below rates; (3) provision of direct lending up to 60 percent of the project value; and (4) provision of a counter guarantee so that in case of default, ECA can disburse claim-bridging funds to commercial banks. In addition, ECA will manage and make the arrangements with regard to the GoI claim guarantee.

IIGF is the guarantee institution owned by GoI. All infrastructure players have expressed great appreciation for GoI's policy to establish the IIGF. The IIGF also actively disseminates information about its products and business processes. In my experience there has been a solid response from the market and private sector. The only question from the banks at the moment is whether in terms of IIGF's own assets, they are able to pay the claims, and the certainty that guarantees can actually be executed. To this day there has been no precedent set as to how IIGF together with the MoF conducts the decision-making process, in terms of time, in determining that the PPP project is in default. And there has been no precedent for settling a claim under the IIGF guarantee after a project has been declared in default. The banks risk managers obviously will undertake due diligence to ensure that an IIGF guarantee will truly be executable and will be disbursed according to schedule (specified in days) in line with the contract guarantee. As an input, the MoF can establish the regulation on the methods for declaring a default and the cross-institutional claim procedures, along with the roles and the duration of the process for the respective authorised parties, to ensure legal certainty and schedules.

Indonesia previously established a precedent within the international community when the MoF addressed its obligations to settle loans and contracts with private parties. The MoF handled the 1998 monetary crisis by settling all of its obligations in accordance with the terms of the contract, such as the Paiton power generation project, where SMBC was one of the banks providing a loan to Paiton. In my opinion, given that capacity is limited, it would be better to allocate government guarantees to mega-size priority projects – billion dollar projects – because it is most likely that private parties and banks may not be capable of carrying financial losses in case of default, so they will minimise a system-wide impact.

What should the government do to ensure that risks borne by the private sector in infrastructure projects can be managed?

The role of the government is to establish a set of rules and regulations that provides the business community incentives to provide infrastructure services. The incentives can take the form of policies (system and tariffs), taxes, import duties, labour force regulations, permits, land, etc., according to the agreement with the business community.

Risk sharing in PPP projects shall be borne by the party who can most afford it. Currently the IIGF has a procedure and matrix in place on risk sharing. The government has developed various regulations followed by implementing rules. However, PPP is something new, and Indonesia has not even been able to make a successful new-era PPP; in practice operators are still facing many constraints. Therefore, the government is continuously developing improvements to the institutional setting, PPP regulations, sectoral and cross sectoral regulations, and to implementing regulations.

It needs to be better understood that not all infrastructure projects are suitable for a PPP scheme. It also must be understood that a government guarantee is not the same as government support, particularly to GCA/Local Governments. I found many projects which are conceptually quite interesting, but because the Local Government puts on too much pressure for a hasty launch of the PPP projects, they usually backfire. The reason is that the capable private entrepreneurs with the necessary capacity lose interest and even withdraw if the project offered does not have a good risk allocation and is not bankable. In addition to using their own capital, the private sector still needs external financing to fund their projects. Therefore, the projects offered should, apart from being economically and financially viable, also be acceptable and attractive to the financial sector.

What has to be done to improve the legal framework so that infrastructure is more attractive to foreign and local investors?

In order to work on infrastructure I have to read a lot about cross-sectoral regulations, and also listen to discussions on this subject. My educational background is management and I am not an expert in law, I can only give my views about my findings in the field.

The government has developed decision making mechanisms for each stage in Regulation no. 3/2012, issued by Bappenas, on General Guidelines for the Implementation of Public Private Partnerships for infrastructure. My question is always why, until this day, in spite of the many amendments, new regulations and laws that have been issued, it does not work. And the problems are not only technical, capacity and coordination issues, but more because of a crisis in leadership.

A legal breakthrough is needed, a lex specialis to serve as a bridge between overlapping cross-sectoral regulations and the mandate holder. Related regulations need to be synchronised to minimise conflicts between prevailing laws and regulations. Countries with a high level of legal certainty will be more attractive to investors as they will feel more secure to invest. The government realises this, which is demonstrated by the enactment of laws such as the Geothermal Law no. 2/2012 on land acquisition.

Deliberations need to be held on how to shorten the lead time in preparing regulations, starting from the drafting to the actual enactment of both new regulations and amendments to existing regulations. In practice these lead times are still quite long, even taking years, and in the meantime ambiguities arise in their interpretation and implementation. If necessary, a cross institutional/departmental Standard of Procedures should be adopted by the high institutions in authority.

Is there a possibility that the disparity between long-term loans and short-term deposits may constrain financial sector participation in the financing of long term projects? What can be done to resolve the situation?

A mismatch between assets and liabilities has always been a classic problem in infrastructure financing. Currently in India, PPP projects may for the most part be financed by local banks. The Ministry of Finance and the Financial Services Authorities actively encourage local and international banks as well as the capital market to participate in financing infrastructure projects. Ideally infrastructure financing will use long tenor loans (more than 10 years) at a single digit loan interest rate. GoI has made many breakthroughs in fiscal policies in its efforts to empower the private sector to accelerate infrastructure development. In order to encourage the Indonesian and international financial sector to take on a more active role, GoI should also address monetary policies in order to encourage the realisation of PPP infrastructure projects.

The majority of funds in the Indonesian banking sector comes from the general public, placed in savings and deposits with a tenor of three to twelve months. As I mentioned earlier, the government can provide incentives through OJK Regulations where government guarantees for PPP projects are categorised as projects that do not require the banks' capital reserves and therefore, PPP project financing is for banks safe, very profitable, and of low risk. In addition, these regulations should be followed by loosening banking regulations – among others, rules on risk concentration and legal lending limits for debtors who are involved in infrastructure projects.

From the side of local bank funding, this can be solved by adding equity through additional bank capital from the shareholders, issuing medium term notes, and issuing bonds using the existing underlying credit assets.

Bank Indonesia (BI), the Indonesian Central Bank, in its role as regulator and executor supporting the creation of an extensive and healthy financial market with the availability of liquid assets in the domestic financial market, has become increasingly important in realising infrastructure financing. This support was manifested through bank hedging activities with Bank Indonesia to mitigate the risk exposure to the rupiah exchange rate fluctuations. Banks very much need hedge counter parties that can provide long term fixed interest rates and currency swaps at competitive costs. Bank Indonesia's regulation no. 15/17/PBI/2013, on hedging swap transactions with banks, can accommodate demands for swaps because they are based on underlying transactions owned by the bank or the client. BI's support is sought to consider a longer tenor in the event that the underlying transaction owned by the client covers sell-swap transactions between the bank and the relevant client, with hedging over: overseas loans in the form of loan agreements and/or by issuing bonds; direct investment; foreign currency derived from exports; investment in infrastructure development of general and production facilities; investment in securities issued by the Indonesian Government, and/or investment in other economic activities. The tenor of swaps currently offered by BI is only a maximum of three per year.

Reviewing my earlier illustration about the Airport Fast Train Project where the exchange rate risk is high, this can be mitigated using BI's role as a swap agent.

From the side of the Indonesian capital market, pension funds and insurance companies are ideal long term investors with a minimum IDA+ [International Development Association] rating in line with long term obligations. The Government may grant credit enhancement, tax incentives such as tax holidays or lower income tax, and consider ring fencing to ensure the certainty of payments.

Does the capital market have a greater role to play in infrastructure financing?

The need for funds in infrastructure development is huge. Therefore, measures need to be explored to increase private investment, and other potential alternative funding that can be encouraged by the government, apart from the conventional APBN and APBD [regional budget]. Examples of government funding outside of the conventional APBN scheme are asset-backed securities issued or guaranteed by the government which can utilise the debt capital market. Or a contractor scheme such as modified turnkey or performance based annuity schemes [PBAS]. Payment for the PBAS will be made in phases by the government over a medium or long term arrangement based on performance in order to guarantee repair and maintenance by the contractor. In addition, the Transportation Law also provides an opportunity to take advantage of Road Funds in road infrastructure funding scheme, even for non-toll roads.

Currently I am working on a study to utilise funds through the capital market such as pension funds and insurance to be placed as capital market instruments by having banks participate in financing local infrastructure projects because not all developments of infrastructure projects can use a PPP scheme or are feasible to get bank credit. PPP and financing through bank loans or project based banks are suitable for infrastructure projects which generate sufficient revenue and meet banking requirements. While infrastructure projects that do not generate revenues such as rehabilitation of kabupaten roads, renovation of market, etc. are also needed to support the local economy, for these projects alternative financing schemes need to be found.

Currently, there is no alternative financing available for infrastructure projects supporting local economies where those projects provide economic benefits, but do not generate revenues and therefore, in the private entrepreneur’s view, are financially not viable and not bankable. A study is being undertaken to determine how local infrastructure financing can reduce dependency on the APBN to finance local infrastructure, by seeking affordable alternative government funding sources aimed at accelerating local infrastructure development. At the same time this can assist the Local Government to improve its efficiency in capital spending and implementation. It maximises the role of government institutions, appointed by MoF, that have a mandate to execute local loans to finance local infrastructure projects.

This scheme is designed to develop an infrastructure financing system by issuing securities through a securitising process entrusted to a body called Special Purpose Vehicle. For prompt implementation relevant to present market conditions, the model should as much as possible refer to the existing legal framework. With this infrastructure financing system, it is expected that infrastructure financing by issuing securities will be able to resolve issues of viability and bankability.

This study is expected to provide valuable additional information, references, and input to policy makers and market players on how to meet the challenge of finding alternative sources of funding to enhance infrastructure development. ■

Size Does Matter, and So Does Supervision: Delivering Quality in Indonesia's Road Construction

Alpino ("Pino") Iskandar is the CEO of PT Conbloc Infratecno, which he helped found in 1974. The company started as a concrete block paving plant, and has grown to become a group of businesses in road building, contract mining, and building materials manufacturing. It is a major contractor in the field of road infrastructure known for its continuous innovative approach, utilisation of technology, equipment and new materials; and pioneering in the area of environmentally-friendly pavement recycling technologies. Pino graduated from the University of New South Wales with a degree in Industrial Engineering in 1973.

Courtesy of Carol Walker

PRAKARSA: Hopefully in this interview today we can talk about what you think are the most critical issues facing you, and outline your feelings on the state of the road sector. It's important to talk about your role vis-a-vis state-owned enterprises, the issue of how Government procures contracts, and particularly the difficulties that are created by very small contract sizes. As a voice from the private sector, how do you deliver messages on these topics? Do people in government who are making decisions fully understand why there are concerns?

ALPINO ISKANDAR: Looking back as a private contractor in this country, we've been in the game for 30-odd years. And this industry, in our view, has been one of the worst industries anyone could be involved with. If you look at other industries, like retail, telecom, hotels and tourism – they all have very sustainable growth, except for a couple of distractions.

But the infrastructure industry has been – I think the best word is "neglected", through what we think are incorrect procurement policies made by the government.

During the Suharto days, they had Keppres 80 [a Presidential Decree laying out government procurement rules]. It stated that contracts under a certain value had to be given to the small contractors, small companies. This created tens of thousands of contractors, and the legacy is still there.

This is in huge contrast with what happened in developed countries like Australia and Malaysia. In Australia, they have Pioneer Road Services, EMOLEUM [Esso]; serving only asphalt and emulsion. You have companies specialising only in stabilisation. Of course you have general contractors like Leighton, but you have lots of specialists. In this country, there are almost no specialists; everyone is a general contractor. And so it is very difficult for these small contractors to develop size, to develop human capacity, to develop equipment and technology, and to develop R&D.

Why doesn't the government recognise that as a problem?

When the jobs are distributed, on a smaller scale, then everything is managed according to the size.

So it's easier for them, they don't have to go the procurement hoops?

It keeps people happy. Except that the roads of course don't last.

That keeps people happy too?

Yes. So, the main issue is: who will the government grow as contractors? Because if you look at other industries, like oil and gas, the government nurtures a few domestic players to become international-level players. Companies like Medco, like IKPP, like Tripatra – they rise to the demands of the industry. They serve Chevron, they serve Total – they become really professional companies.

Now, in the past we had those opportunities. We had Hyundai building the Jagorawi highway, which was the first and the very best toll road ever built in this country. And we had Takenaka with Hutama Karya that built the Tangerang-Tomang road. But beyond that, there was no more transfer of technology. If we look at how other industries become elevated in their competence, it's through foreign players. If we look the hotel industry in Bali, this is foreign dominated; if we look at the retail industry, we have people like SOGO, Debenhams…they're all foreign players. The same also with the banks. So we have an international benchmark, to elevate industry to the level of an international playing field.

A PT Conbloc Infratecno road construction project in Flores. *Courtesy of Alpino Iskandar.*

In the road industry here, we missed the occasion. We did send our contractors to Malaysia in the 1980s to build highways, and at that time, they were learning from us after we built the Cawang-Priok Elevated Highway. But after that, we stagnated and they took off.

But, are there regulatory restrictions on the involvement of foreign contractors and financiers?

Not as such. But we talk to them, people like Thiess. And I've asked – why haven't they gone into infrastructure here? Because first of all, it is dominated by SOEs [State-Owned Enterprises] and they said, "We don't know that game, we don't know the landscape, and the playing field seems exclusive." It's kind of an enclosed circle, like Freeport and Newmont and Tangguh are enclosed for foreign contractors.

An obvious issue is that SOE contractors get a lot of the bigger projects. They are probably not subject to the same competition or competitive pressure that some in the private sectors are. In the private sector, the opportunities are chopped up so small, and it's very difficult for companies like Conbloc to consolidate and become effective competition for SOEs.

And then there's the question of the huge scale of work that must be done. You will face this question with the Trans-Sumatera toll road: 6,000 km of new toll road expressway are needed. Plus 12,000km of upgrading works on the rest of the network. A big, big task. How do we establish the capacity to deal with that task? Should we be involved in foreign contractors and foreign financiers in helping to develop the program? What does it mean for private sector state-owned market?

As you've noted, there are pockets of opportunity in the economy that have led to strong private sector and SOEs competing effectively and becoming very high quality, efficient and effective in telecoms, in the airline sector, in retail, in banking. But for some reason with public works that hasn't happened.

Let's just compare industries – maybe something very close like mining. The way they operate in Adaro, in KPC [PT Kaltim Prima Coal], in Freeport, in Newmont, you feel safe, because when you first get to their sites you sit down for your induction, for half an hour. It's all about safety, and the safety mechanism is like in Australia. Everything – even the breakfast, the camp, the vehicles, the safety, the procedures, the work requirements, the KPI [key performance indicators] – everything is done the same, completely Australian. So here is this world standard practice, being done in Indonesia by Australian companies, and the employees are Indonesian. When I was working in Newmont, Nusa Tenggara breakfast closed at 5:45 am. At 6 am, everyone is already at site.

Maybe the government did not have the intention of bringing international standards to the industry, but that's what happened. You know mining and infrastructure are very similar; we talk about the best equipment, world class practices, the best of people, R&D. In infrastructure, the operators, the mechanics, the work methods, and everything – this is not being done.

So, how do you move to that situation – meeting world class standards?

SOE contractors are doing very well – I don't know if everyone agrees – but they have work coming out of their ears. They are very busy.

So they don't need road works, because they have lots of other works?

Yes, I've asked – "how much road work do you have in your entire portfolio?" And they say, "We don't make money [on road projects] and the projects are insignificantly small, we don't really care about them. We have to deliver profits for our owners; our mission is not to build roads. If the government decides to chop the cake into small little pieces to give to little players, it's their problem, it's not our problem."

Other countries approach this question by moving towards PPP [Public Private Partnerships]. If there is an international tender PPP project with KPIs that include all safety considerations, all those high quality standards of performance, management systems reporting, accident prevention and all those sort of things – then it's foreign financiers who make sure that the contractors deliver that quality, otherwise they don't get their money back. Is that the way to go?

Yes. I was aware of one particular job, funded by JICA in Timor Leste. Some 50 km of roads, and the owner's estimate for that job was 75 million dollars. Now, in our country, none of the road packages get anywhere near the size of 75 million dollars. The best, the largest package with standards in this country was around 50 million dollars. In Timor Leste, 75 million dollars for 50 kilometres of roads. International players were there. Why don't we make the packages bigger?

Agreed. There are two ways of managing these larger contract sizes. One is to break from the tradition, set up an organisation within or outside Public Works that can commission international tender for suppliers outside Public Works. Another way, and this is what the Government had been thinking until recently, is to use the SOEs to manage that process – say, Hutama Karya. What do you think of that approach? Would that work?

There is a big difference between what we do and what the SOEs do. These SOEs are general contractors. Some of them, they do specialise in certain things, and they're very good in quality. But other than that, these SOEs, they tend to just outsource, and some of these outsourced companies are small, some of them are medium size. But – we tried a few times to become a subcontractor with SOEs, and it wasn't easy, payment-wise, bureaucracy-wise and so on.

But on the other hand, if the government is trying to create infrastructure…and they can create packages for ports, airports, the trans-Sumatera toll road – who knows who can bid, international players can bid, and then people can put a consortium together: SOEs with foreigner, or foreigner with people like us.

In the debate about that, you only hear government talk, you don't hear anything from the private sector. It's a worry that the private sector is very cynical about governance here, about problem of corruption, the procurement process and its transparency. How could government, if it was going to commission these international tenders for these packages, how could it assure the international market that things have changed? That there are long term opportunities, that you can trust the government, you know that you'll get paid – what needs to be overcome to create that situation?

It's not difficult. Again, let's look at other industries, take the banking industry. Our banking industry today is one of the healthiest in the region. And Bank Indonesia as the central bank, and previously as the bank regulator, is very good. But now we have the OJK [Otoritas Jasa Keuangan] as an independent financial services authority that is very tough, stringent, reliable, and credible. It's a very professional organisation – they're paid even higher salaries than the BI guys. And this is a good sign. So, these things can be done. The government can create an institution that has the mandate to call for an international tender. The size cannot be just 10 million dollars; the size can be 100 million, or 200 million dollars. You call in all those people here, and you engage with the Baker McKenzies of the world, you engage Standard Chartered to back up the finance – you create a whole new playing field.

But does it require that special institution to break loose from the existing situation?

In my opinion, yes. With the last government, they weren't going to do that. You need someone from Jokowi's administration to coordinate, to break the wall.

That obviously applies to the bigger programs, the expressway program in national toll roads, that sort of thing. Meanwhile those thousands of kilometres of arterial roads and sub national roads need to be improved. How can they be more effectively delivered? How can you break the habit of breaking up contractors so small for those kinds of projects?

There is a whole range of concepts. One is the area-wide maintenance contract. Take for instance one of the industrial estates I have been working with. I was shocked, because they asked me to do road re-alignment. And then I opened up [the road] to what was built underneath, because I wanted to recycle it. It was very poorly built. This is a Japanese owned industrial estate and when you travel around you feel you're not in Jakarta, you're in Yokohama, except for the road.

So, what I want to do is propose the area wide maintenance contract here, three to five years, at unit rates, because, at the moment, we talk about PBC [Performance-Based Contracting]. PBC is risk transfer, you're transferring the risk from the Government to the private sector. And the private sector, people like us, are not yet ready. It takes time to get ready. And if we do PBC, we have to do complete assessment of the roads: to investigate so many test pits. Because when we pick up anything here, we find very poor materials. So as a good compromise, we could do a unit rate contract for a couple years – redesign the drainage, rehabilitate weak spots, take out all the bad materials area wide, say for one whole estate in Kelapa Gading or Bumi Serpong Damai. Then you can put your resources there – put the plant there, your equipment there and people there, and the contractor would be able to serve and maintain the whole area, rather than have one contractor for Rp 5 billion here, Rp 10 billion there, and then six months later, it will all break apart.

So, this is one area for which I think the area wide maintenance contract is a good concept. It could be easily applied and it doesn't have to be for 10 years, it can be for three to five years, depending on the performance of the contractor. And the contractor will have sustainability of work, which is good. And the road users will get the benefits.

It is true that Bina Marga has taken some steps towards performance-based contracts but they have perhaps not managed very well. Does the trick lie in persuading them to continue these experiments or in creating some demonstration project on how it should be properly done, and having got that under your belt, persuading them to adopt it more widely?

But from the very transparent exchange of experiences and ideas during the IRF Meeting in Bali in November 2014, the PBC players – Adhi Karya, Waskita Karya, even Hutama Karya – all parties are not ready in terms of the size of the package, in terms of the engineering, because the engineering carries risk and you must do a lot of investigations. Also the engineering skills of the contractor may not be there. If you do not know your engineering, you do not know your advantages, you do not know your climate and conditions, and you've never done this before, the risk of what could happen in year 5 or year 6 could be very big, let alone in year 10.

And your financiers are not going to be attracted by that either.

Yes, and then financially it could kill you in year 7, because you know the road could collapse. So the "PBC 101" here has not been all that impressive. Now that we're going to "PBC 201", it's very scary. Because the amount of investigation that interested parties like us will have to do will be time-consuming, at least two to three months. And it will take a lot of work to ensure that we know what we're doing.

Let's say, we know what's inside, what's underneath. And we have to predict the traffic volume, the traffic and the performance, and then we have to predict the weather, landslides and so on. So, all these risks in PBC are transferred. All these risk transfers make it very risky.

If you look at the Malaysian model, it is more like the area wide maintenance scheme; a contractor is been chosen because they're reliable, because they have delivered, because they did really well, and everything gets done.

You know, Indonesia's [preliminary] PBCs so far have not been successful, and now they're talking about the real PBC with a lot of rehabilitation; it's very risky and in my opinion, it may fail.

The subject comes about, because the Government is not talking to the market about what's realistic and what's not, what would be the expectation, what would not, and what risks you can manage. They seem to cook up these schemes quite separate from any understanding of the market. Why is that?

Because the government has not had enough dialogs with the players. There may be some discussions but they don't involve the private sector.

The thing is, there are one hundred and twenty thousand companies in Indonesia. Only 1 percent are large-scale, 12 percent are medium, and the rest are small-scale, so this is the focus of concern for the government – to support the small companies.

But it's not just about volume, it's about attitude – caring about quality and insisting on performance. Why don't project managers care about this? Can contract management be strengthened?

I've seen every extreme. In the private sector, we get jobs because of our reputation. And very often our prices are higher than the competitors because we deliver better quality. And at the same time, we consciously try to be better than other competitors.

Secondly, in the private sector we're now working in a company – I can't mention the name. This job is designed and supervised by a British consultant that is extremely strict and goes by the book, and everything is referred to specifications. They act as if we're working in the UK. I've never had such an experience. It's extremely difficult but we are coping. The quality that we deliver is beyond belief. Because everything has to be tested, tested and tested according to the specifications.

In Bina Marga the strictest one is the Australian funded job. We decided early on to cooperate with that because we want to deliver like that, so we chose that mindset.

Whether or not the supervision is there, we do not have double standards in my company. It's hard when you know when the supervisors are not there, or they don't know. But overall we try to maintain a single standard.

This is the sort of thing you would expect to be a concern for Bina Marga or the Public Works Ministry. They have to deal with the huge backlog in infrastructure that is needed. And the role of the Ministry of Finance is to insist on better value for money in the delivery of the program. Is there any prospect that things might tighten up?

I believe in the cliche that "size matters", because if you have the size you can recruit the best people, you can buy the best equipment, you can spend money on R&D, you can bring in the best experts from around the world and you can have economies of scale, so you make your cost lower and you can deliver quality. Size and sustainability of work are very important and so you invest [in growth]. The SOEs don't invest as much in the road industry as they don't specialise very much. In road construction, they outsource. And the people they outsource to don't have a strong mindset about quality, they let things pass. So to pass the quality standards for a job, it's not that difficult, unless you work for an Australian-funded job!

What will happen to Indonesia when the Asian market opens up and there are more opportunities for outsiders to come in?

I was on an infrastructure panel recently and spoke to a few friends from Thailand, Australia, Malaysia. Their main concern is: how can they compete against the SOEs? They said they don't know the playing field, so they need good local partners who can take them by the hand and bring them onto the playing field. They said, we intend to bring in our bankers, our financial strength, and we intend also to put in equity, as long as we have the confidence that the rules are transparent, that the rule of law is transparent, and contracts are signed. And they want the involvement of international consultants, because if it's only the Government and controlled in the same old ways, they said they won't come to Indonesia. The litmus test I think is to ask whether or not Macquarie Bank is ready to come to Indonesia. Macquarie Bank is everywhere except in this country. If they go to Indonesia, everybody else will follow.

Exactly, and if you look around the world, there are all sorts of opportunities for these sorts of companies. Indonesia is the last frontier. It's a huge need and yet the framework hasn't been put in place.

So Indonesia must open the door, because there's plenty of money outside, there's plenty of strength outside, bu so far we keep to ourselves here.

Why is that? I mean, why the distrust of foreigners? Do they think that foreign competition will be bad for the SOEs, or will take too much of the pie out of Indonesia somehow?

I think it's human nature. But someone has to break the wall, recognise the crisis of our infrastructure, bring out the truth, start the dialogue.

I think you have touched on a very important point here, that the dialogue is missing; maybe this is a topic we can conclude with. Government people need to talk with the people like you, with people like financiers, people like other contractors, and to understand what the constraints are and what they must do to open doors. So, what you're suggesting – forums, conferences and small working teams – those can air the issues, and make people aware of the both sides of the story.

I'm very interested to push dialogue, to have an ASEAN or Asia-Pacific infrastructure network, to exchange ideas on how governments in each of our respective countries manage their infrastructure problems. At the national level I'd like to propose an infrastructure national network. We can have a group of people from the government, bankers, lawyers, and SOEs and contractors. We can have a dialogue because there are 10,000 contractors that need to be given work. But they can be trained, they can be organised by the bigger contractors, even though it's not so easy to keep feeding them with works as sub-contractors. If the government is very determined, we have to make the larger contractors become what we call in Bahasa Indonesia bapak angkat – a stepfather – to smaller guys. They will manage the quality, the logistics, the finances, etc. But these big boys have to be strong. ■

Public Transport Needs Private Investment and Expertise


Courtesy of Eka Sari Lorena Soerbakti

Eka Sari Lorena Soerbakti is an Indonesian businesswoman. She is the leader of PT Eka Sari Lorena, the largest land transport company in Indonesia, which was founded by her father G.T. Soerbakti. In addition to being the Chief Executive Officer of the Lorena Group, she also serves as director of PT Ryanta Mitra Karina and PT Prima Sari Boga. In 2010, Eka Sari Lorena became Chairman of Organda, Indonesia's national organisation of land transportation entrepreneurs. She received the Young Entrepreneur of the Year award in 2007, and was a finalist in the Fun Fearless Female Indonesian Competition by Cosmopolitan magazine in 2002. She was selected as one of the "20 Most Powerful Women in Indonesia" in 2013 by Fortune magazine, as well as one of the "10 Most Inspiring Women in Indonesia" in 2014 by Forbes Indonesia.

She earned a Bachelor of Business Adminsitration degree at Wright State University in Ohio, and a Master of Business Administration at the University of San Francisco.

PRAKARSA: Tell us about your role in Indonesia's transportation sector.

EKA SARI LORENA SOERBAKTI: I was born in a transportation environment and I grew up in this industry. My family has transportation companies for passengers and also for goods throughout Indonesia. Our first company, dealing in intercity/interstate buses, was established in 1970. My playgrounds on the weekends were the workshop and the operations department. Those are two areas that I admire the most.

Apart from operating and participating in the industry, I also play a significant role in organisations like Organda and Kadin [the Indonesian Chamber of Commerce]. This is how I approach transportation in Indonesia – I learn how to operate; I learn about the technical strategy and the non-technical approach; and also about policy and laws, including local laws by the Local Governments. Due to decentralisation, a lot of things have changed and I'm not sure if, in Indonesia, we have a lot of people who have proper knowledge regarding transportation. Knowing, understanding, and being able to perform in the transportation system is a big thing.

As chairman of Organda Indonesia, I would like to socialise the public and educate students. I want people to understand the kind of service the government should make sure they have access to, so they have mobility. If Indonesia wants to reach 7 percent economic growth, the number one fact to consider is that you have to have a clear platform regarding mobilisation of people and goods. I don't think we can have a very strong economy if we can't travel efficiently. Kids can't always walk to school, it's too far. People have to be able to go to the office. What if you want to manufacture goods but you cannot bring the material to the manufacturing plant? And once the goods are manufactured, you have to be able to distribute them.

What does the transporation sector hope to see from the new government?

We need to have strong enforcement of the laws. Given the size of our country and its population, if you only have 4 or 5 percent economic growth, it means you will have a high rate of unemployment. About the change in national leadership – we have a lot of expectations.

They say corruption has reduced. I don't agree with that. It has just taken different forms. So I really hope that the new leader, supported by the people, will make changes. Number one is being transparent. You don't have to be a genius to see the value of being transparent. A lot of people will be sympathetic and willing to support programs for increased transparency.

The new president is very different from the previous one. I have never seen a person who has risen to such a high level in such a short period of time. This is very rare. He faces a big challenge, because the people in the parliament are not from the same party. But I look at this as a positive sign because if they were from the same party, transparency could be compromised. However, since they are from different parties, they will keep each other in check. So hopefully, implementation will be proper.

I hope this time we will have ministers who understand the transport industry very well. Not people who are just put in office for political reasons, but like in other countries where all the strategic departments have someone in charge who has a very good understanding of the business.

If you look at the situation now, transportation is not the focus of the government. Only fairly recently has Indonesia started to pay attention to public transportation, mass transit, and connectivity. The traffic is always jammed and people are stressed. We need the right people in power and we need better collaboration.

How do we go about addressing Indonesia's transport problems?

Sometimes I tend to be outspoken. But when we convey that there is something to be fixed, we should also propose the solution. If we only complain and we don't propose a solution, it's just acting like a child. My two year old can do that. But we are mature human beings with responsibilities, so we need to come up with solutions. And we learn that when working within an organisation, we cannot propose solutions only from our own point of view.

We need to figure out the needed investments and what the benefits are. I don't believe that the technical matters are difficult. What is challenging are the non-technical issues.

Indonesia is part of the global community. Organda has partners in the Netherlands, Switzerland and the US. It's easy to get data; exchanging information isn't difficult. Again, the difficult work is the non-technical aspect. For example, if you want to construct a terminal. Even after research has been conducted and a suitable location has been identified, there can be a sudden change in plans. Why? Because the land belongs to the relatives of the Mayor. That wasn't a technical issue, was it?

Therefore, I think our new leadership needs a lot of energy, as there is a lot of homework for them to do. Problems have become extreme. Transportation and logistics are deadly serious matters. Indonesia has not had any sustainable concept for supporting the transport industry so that the industry can bring more benefits to the country. And most importantly, the Government must have the courage to enforce the law. Their homework assignment is to figure out how to do that. If they don't, Indonesia can still move forward, but very slowly.

In your opinion, what should the Government of Indonesia or Local Governments do to attract private investment in the transportation sector?

The best approach is to collaborate with existing parties. In Indonesia, each kabupaten has a different style. If we don't have the local knowledge; if we cannot analyse local traditions and local preferences, initiatives won't work. You can have the money and overseas experts but projects won't work efficiently.

Therefore, we need to create a platform that can bring together local entrepreneurs and investors. We have to be able to utilise existing, established companies that have the blood, pulse and a strong nervous system, but maybe because of a lack of direction, lack of development, and lack of capital, they couldn't grow. Why don't we embrace them? For me, as long as I can still embrace the local operators, I will do that.

Can you elaborate on the drawbacks and challenges faced?

Urban transport is quite tough. For the system itself, or the materials procurement, it is possible to manage them. But for operating – that is difficult, because public transport operators face so much competition from private vehicles, motorbikes and cars. It is because both motorbikes and cars are cheap and easy to get. This is a strange country; policies encourage private vehicle use instead of public transport.

It is important to commit to the core issues, things that will have the biggest impact. It's true that everything needs improvement. But let's look at the most crucial problems first. We have to be smart enough to set priorities.

What is the best means for financing public transport?

We need financing, but not from the bank. Banks are too rigid and have interest rates that are too high. In my opinion, we need a platform that makes cooperation easier between domestic and international businesses.

Finding the expertise to implement financing isn't easy – maybe it is in theory. But it is a comprehensive effort to take care of everything, starting with a transportation services permit, an AMDAL [environmental impact] permit, discussions about terminals – lots of paperwork requirements. And many requirements that are not on paper. So ideally you need strong local knowledge supported by a large global network of resources. Investors can have good intentions, but the outcome will not be good if they don't have local knowledge and local network to go with their financing.

The size of this country is overwhelming. So many people need public transportation services, which have not yet been properly provided. The government should consider cross-subsidies. It can tell businesses: you invest here, and then we will regulate it this way. You can invest here, but you have to provide support in the region. It is not easy to go out into the field and talk to Local Governments about these issues, though. And that is only the tip of the iceberg.

Do you think Local Governments are part of the problem, or the solution?

To be honest, if we're talking about the present, I think they are more a part of the problem. This is because so many of them have people in charge who lack the needed competencies. Therefore, we are currently proposing to the Ministry of Transportation that they should issue a competency standard to be a Kadishub [local transportation agency head]. A Kadishub needs certain skills, they can't just be selected because they have connections with the right people – I know of one case where a person was appointed who previously worked for a government funeral agency, just because he was a friend of the governor!

What can we do to ensure the roles of Local Governments can be more positive?

Do you remember that there used to be 17 measures instituted to handle traffic jams, as initiated by the vice president? How is that going now? Do you know who the people in charge are? All of them are from government. This demonstrates that a one-sided approach isn't enough. We need constructive input from all sides – operators and academics too, not just government alone.

Organda can bring different sides together – recently Organda had a meeting that included Korwil [Regional Coordinators] from all over Indonesia. And Organda has a think-tank team of professors. Operators need to invite them into the process. Consider this: Researchers need funds. Operators earn money. So operators can support the researchers – if they need funds, we are ready. It will be to our mutual benefit, right? From their side, they will contribute to some projects that are useful. Some of their research will be utilised. Sometimes people say this is too much "out of the box" thinking. But I believe this is the way it should be.

Later I would propose to have the terminals privatised – start with just two terminals. I will do a make-over on them so that women aren't afraid of coming there. It should also be easy for pregnant ladies and old women. The elderly need transport, and not all of them have money [for private vehicles]. But it's hard for them to go up and down the stairs at the terminals.

Somebody should think about this. You know, all of the heads of agencies are male, aren't they?

It can be hard for mothers who have to take care of small children, maybe change diapers, while they are at the terminals.

They [heads of agencies in charge of planning facilities] don't think about this. However, we can be smart when we address this. We can refer to Law 22 [Law no. 22/2009 on national transport policy on subsidies] which is going to be enacted soon. Private companies can establish terminals. Clarity is coming on what we can do. Now we will start to prepare the SPM, Minimum Services Standards.

The strength of private companies is that we are more resilient. We have already become used to a lack of support. It is common for us to have a limited budget. We have got used to working under pressure. So what have we got to lose? We should just go for it.

Both Government and private sector are involved in various aspects of urban transportation provisions. What are the best roles for each of them?

First I think we need to ask a lot of hard questions about how these parties are performing. Does Jakarta's APTB [Angkutan Perbatasan Terintegrasi Busway, or Busway-integrated outlying transport] run more successfully than Metromini? Not really. Even busways are starting to be broken within less than seven years time. No one should be too arrogant about what they can do. At the same time, the government has a lot of authority, so it needs to be involved. We must create more mutual trust.

Currently, the Government wants to be the bus operator. Yet there has not been any successful public transportation run by the Government. What has been the profit? Trillions have been invested, but the profit is only 2 percent. This is the people's money that the Government is using.

Regulators should create a good policy framework. They should help [companies develop], rather than becoming the operators, or competing with them. Unless the investment is so huge that it is difficult for the private sector. For example, in Singapore the MRT [Mass Rapid Transit] is run by the government. The investment was huge. But don't get me wrong – the feeders, the buses, all of those are private. The government invites operators. What do they tell them? They say, "We will give you this, we will guarantee you will get the profit. We guarantee it will be sustainable. But you have to meet minimum service standards. If you don't meet the standards, your permit will be revoked."

That's the basic approach. And talk to companies – they will tell you what they think. Rather than kill each other off, it is better to have a consortium.

If we may ask a slightly personal question – It isn't very common to find a woman in charge of infrastructure matters. Any tips for other women in the infrastructure industry?

I believe women are powerful enough to be successful in this business, which peope think is quite a challenging one. Women are good listeners. We actually can learn a lot by listening to people. There is no need to study at Harvard. You listen to people well and analyse them, and you learn.

Second, women tend to be more patient, and hence are able to cope better under stress. This is a very stressful industry.

Third, women are usually more capable of multitasking. We need people who can juggle various tasks. We have already got the basic capital to be successful in infrastructure. I learned about infrastructure because I've been everywhere; right to the regions, by land, by plane, sometimes by ferry, and others. This way I can see, I analyse, I listen, and then I find out about the various needs.

Last but not the least, women have strong analytical skills. Also, there has to be a passion, because even though you have all the aforementioned traits, you must have the passion. I don't believe that women cannot be successful. I'm waiting to see women to be even more successful. ■

A Private Sector Role for Water Provision in Indonesia

Courtesy of Carol Walker

Tom Shreve heads up Acuatico Pte. Ltd., the largest private sector municipal water system operator in Indonesia. Tom has extensive experience in mergers and acquisitions, capital markets, project finance and management of financial services companies. He managed the acquisition of Inter Milan Football Club on behalf of a group of Indonesian businessmen in 2013. An American citizen and a 1983 graduate of the Northwestern University School of Law, Tom has been resident in Indonesia since 1991 and is a licensed member of the California State Bar.

PRAKARSA: Tell us about Acuatico.

TOM SHREVE: Acuatico is exclusively a water infrastructure company. We have three projects in Indonesia and one in Vietnam. In all of our Indonesia projects we run the system, bill the customer base, and have a direct customer relationship with the end users. Of course there are many models for developing water infrastructure involving the private sector, and many of those are available in Indonesia. But we have a competitive advantage in our ability to handle the billing and customer service, which is something we have been doing for years. We are the owner of the company which is the operator of the water system for East Jakarta, where we have over 400,000 customers. We have a very large system, able to produce and distribute over 9,000 litres per secon of clean water. We've been handling all of the operations, the entire value chain of the water business for East Jakarta, since Acuatico bought the company from RWE Thames Water in 2007.

How does your experience in Indonesia compare with your experience in Vietnam?

Vietnam is very dependent on aid-funded projects, and even the projects that the private sector is participating in often get concessionary loans for their projects. But they seem quite focused and are able to move forward efficiently and strategically, and consequently they have a lot better overall water system in Vietnam than they have in Indonesia. In Indonesia, the water systems are basically left up to the Local Government. That has advantages and disadvantages.

Can you expand on how the water infrastructure business works in Indonesia?

Basically in Indonesia since we work with the Local Governments, there are hundreds of possible government sponsors for a project. That is advantageous in some ways, because if for example you are in the private power business you basically have one possible customer, which is PLN [Indonesia's State electricity company], who will buy the power from you. Consequently lots of issues arise in private power where the developer wants a government guarantee of payment because the only customer of a private power business is PLN. Whereas with us, we can go to any number of different agencies and institutions in order to find the right opportunity, one that is the best and most attractive for our investment funding. The disadvantage with Local Governments is that they generally have much less capacity. They don't have that scale, of being responsible for the whole policy or the whole infrastructure for the entire country; they are just looking at a very small area. They may have no experience at developing their own infrastructure or being involved in a Public Prive Partnership [PPP]. Consequently, we often have to get involved and even help to design the project, to fund the feasibility study and to work out the exact terms of how concessions need to be designed and structured.

Do you think anything could be done at the national government level to solve some of those problems with lack of capacity at the local level?

Certainly there needs to be some centralised support function. Currently we have an agency called BPPSPAM [Badan Pendukung Pengembangan Sistem Penyediaan Air Minum – the Coordinating Agency for the Development of Water Supply] that is part of the Ministry of Public Works. Their main mandate is to coordinate and assess the various government-owned water companies around the country, to help them determine what they can't and can do, what they should and shouldn't do, and also to develop their master plans, as well as their own businesses and any private sector participation. Then of course there is the IndII project, which also does capacity building with the water companies. We think it is very important; this area needs as much resources as possible because in general the water companies are very welcoming of assistance in capacity building, and they understand the need so they can serve their customers better.

There is also a thought that perhaps the provincial governments could be used in a bigger way to help to coordinate and assist the local water companies. We have so many kabupatens and kotas in Indonesia, with such a huge range of capabilities and financial strength, that it's really difficult at the national level to go out and help those PDAMs [Perusahaan Daerah Air Minum – local water companies] individually. We think there is a potential role which has never been tapped yet for the provincial government to get involved. And there are a number of cases where provincial governments need to be involved simply because the appropriate scope of given water project will sometimes cross the border among the kabupatens. In Jakarta, the concessions are provincial and not based on the five districts or kotas of Jakarta. And in Bali, there has been a great deal of difficulty establishing the feasibility of projects that are limited to one kabupaten. In principle, it has been decided that the provincial government needs to get involved to solve the water problems of Bali, because the individual kabupatens don't have the right combination of raw water and demand in order to create their own water system without linking to the other kabupatens.

Could you talk a little bit about the role of private finance in water development? How do you see it now, where would you like to see it go?

It's very clear that private sector funding is going to be critical to the development of water systems in Indonesia, because there is such a huge amount of investment required. There are hundreds of potential project sponsors and owners of PDAMs, and the kabupaten-level governments constitute hundreds of different jurisdictions, and most of them don't have either the budget or the capacity to carry out a project effectively that would really help the people.

And in the meantime, Indonesia is very far behind in the development of water infrastructure. There is a World Bank study that rates access to improved water sources by population in ASEAN, and Indonesia is ranked second to last, even behind Laos and Myanmar, in terms of the percentage of the population that has access to an improved water source. So my first answer to the question is that in terms of the magnitude of the need and the administration of the build-out that is required, it's clear that there is going to have to be some private sector involvement in order to achieve our goals.

Functionally, in order to get a project done and financed in Indonesia, of course like any infrastructure developer I'd like to see a lot more depth in the debt markets, a lot more sources, a lot more willingness to finance really long term infrastructure. Right now it is very difficult to get local bank financing that's long enough term for water projects to repay the bank. So we need longer term funding, we need to figure out a way where longer term sources of capital such as pension funds and insurance companies can participate more in the development of infrastructure, because the returns are good and the reliability of repayment is good but the time period required is longer than banks are typically willing to go. And I can understand the reluctance of banks to lend long term, because most of their funding is short term in nature, so they have a mismatch if they lend long term. But there are a few funding sources such as pension funds and insurance companies that do have long term money, and right now there is not an effective channeling of long term money into this kind of project. So we are hoping that the market can deepen and that it will become more commonplace to get financing which is of the appropriate price and tenor to really build a water project in Indonesia.

So is there any way to encourage banks to take a longer term view, or achieve deeper debt markets?

Our role is to work out what financing is available and try to make it work as best we can. We have worked with SMI [PT Sarana Multi Infrastruktur, a shareholder of PT Indonesia Infrastructure Finance; PT IIF is a private enterprise launched by the Minister of Finance in 2010 to accelerate Indonesian infrastructure investment] for example, and that's very good funding source for infrastructure.

Can you talk about whether viability gap funding is needed in the water sector?

I can. I think the water sector is suffering somewhat from the same kind of subsidy mentality that we've seen with fuel prices. Which is to say, it's very safe and easy politically to just keep prices below costs. But it's not necessarily the best way to spend government resources to help the people. I think what we have to remember when we look at water tariffs is that the people who don't have water service at all end up paying more for their water than anybody on any water system in the entire country. So you have the richest people, the biggest houses, the biggest factories – they are paying the highest prices for their piped water from the system, and yet – the very poorest people are paying even more than that to develop their own solutions, by buying water in containers, filling buckets with water and boiling water that they get from unsanitary sources. All of these methods have a cost associated with them. We're very sympathetic to the medical issues that come from relying on water that is not provided through a municipal water system. Very quantifiably, it can be shown that the poorest people have to spend a lot of money to get water if they don't have a connection to a water system.

We think the best solution for helping these poor members of society is to have the tariff set at a level which is sufficient to cover the cost of producing the clean water, plus an additional amount which will create a capital base for expanding the system. And even if you do that, you can still charge poor people a very small amount, because we have a system of cross-subsidies which is used throughout the entire country, where the people who are most able to afford it pay a higher tariff, and the people who are the least able to afford it pay the lowest tariff.

Generally, the lowest tariff in a municipal water system is only Rp 1000 per cubic meter of water. You can continue to charge only Rp 1000 per cubic meter to poor people and still have a high enough overall tariff structure that you are actually recovering your cost and creating a pool of capital to allow for expansion of the system and investment. I think that's the way to go. And if a municipality or PDAM tells us they want to apply for a viability gap type of funding, we feel the municipality is not necessarily the area we would expect to require a subsidy in order to fund their water system.

There are areas in Indonesia where there is no industry, where virtually everybody is poor, and they should have water systems too – those areas may require government funding. I think some of the eastern islands, for example, are areas where there may not be enough money in the system to fund the development of a water system internally. But throughout of all Java and Bali, and probably most of Sumatra and Kalimantan and Sulawesi, there is actually enough money in the economy that the construction development of water systems can be funded internally without outside assistance, and the net effect on poor people in the economy will still be positive even though they fund those projects out of a higher tariff structure.

What do you think private investors like to see – what makes an investment attractive for you?

For us, we feel that the best solution to participating in a water sector that has limited financial capacity right now is for the private sector investor to have a direct customer relationship with the end users. So that's an important criterion for us. We feel that even though a particular PDAM may not be doing very well financially, if they have strong customers and a reasonable tariff structure we think that we can accept a bulk water kind of structure, where we don't necessarily bill the end users directly.

But in general we think that it is a big plus if we can get involved not only in the construction of the water treatment plant, but also in the rehabilitation and expansion of the piping network, and in addition the billing and customer service. If we can get involved in all of that, we feel that we could work even with the least solvent of the PDAMs. We don't necessarily see any reason why a PDAM would have to be operating profitably or have audited financial statements in order for us to work with them and share our expertise and get involved in every level of their business, as long as we have that direct relationship with the end users.

Is there any resistance to that at the Local Government or PDAM level?

Well, the government – both the Ministry of Public Works and Bappenas – have tried to encourage PDAMs not to pursue their own PPP investment structures unless they have first achieved a certain level of financial health and business effectiveness. That is not necessarily the right focus in my opinion, because I think that if you could go in into some of the areas where the solvency of the PDAM is still a problem currently, the private sector may actually be able to solve that problem instead of trying to solve it first before you try to get the private sector in.

So has that been your experience anywhere? Have you had a chance to test that?

To be honest, not really. Of course in any of our three projects where we are billing the end users, we can demonstrate that we are operating efficiently, and that the overall result for the government is good. But I think to actually go to a PDAM which is categorised as unhealthy by the central government, and working with them to develop a project, is something that has not been tried, and we are very much willing to try that.

There was a recent project proposed to private sector investors where the PDAM was not considered healthy – they had about 5 percent coverage in the kabupaten. They had only invested a small, small amount of money in the water system in the recent past. It was decided that the private sector investors should be invited to develop an area in the kabupaten that had no existing water coverage and no plan for the PDAM to ever build water coverage in that area. The consequence of that project, if it had gone forward, would have been for the least developed least needy portion of the kabupaten to have a good water system, while the rest of the kabupaten still had an inadequate water system. It was not of interest to investors, because there was not enough economic activity in that part of the kabupaten and the population was not densely enough located to make the construction of a water system economical. So that is an example where really we should be going into the PDAM service area and working directly with the PDAM to improve the service in the existing coverage area as a first step in developing the water system in that kabupaten.

Surely there are going to be times when the population density is never going to be attractive to the private sector in some areas of Indonesia?

I think that's true everywhere in the world, I think when you talk about municipal water systems, they are called "municipal" for a reason – that is because you don't normally have government-provided water sent to homes in agricultural and sparsely populated areas; it's just not the normal solution. We need to be sure that everybody has access to clean water, but we don't necessarily want to build a big water treatment plant and really long pipes to serve an area which is sparsely populated. But the priority I think is to focus on the more densely populated area because they are totally dependent on the government to provide them with access to clean water. I think one of the reasons the overall rating of Indonesia in providing access to clean water has actually gone down is because of urbanisation – because people who aren't being served by the government anyway moved from the countryside where they can make their own arrangements to the city where they are dependent on the government. So they go from the category of having access to clean water to not having access to clean water because of urbanisation. And it's very important for the government to focus on providing access to improved water to urban areas first. It also is a real environmental problem if people in urban areas make their own arrangements for clean water because typically they will build deep wells and there will become so many deep wells in an urban area, as we've seen in Jakarta, that the aquifer gets depleted – wells will have to get deeper and deeper and the land starts to sink because it is no longer being held up by a healthy aquifer. The ocean water starts to come into the aquifer and the wells become salinated. Health issues arise from using well water in urban areas that don't arise from the well water in rural areas – so you have not only a dependent population in urban areas, you also have the environmental imperative to provide a water system in urban areas.

Getting back to what makes an investment attractive for Acuatico – the opportunity to have a direct relationship with end-users is essential; how else would you characterise attractive opportunities?

What we are looking for in a government water concession is, number one, a reasonable tariff structure; and number two, adequate demand. In terms of adequate demand I touched on the notion that we are looking at relatively concentrated population areas, urban areas typically or industrial areas. And we are interested to see that we have a reasonable supply of raw water.

We have to have an overall business model that makes sense and the cost of delivering raw water has to be considered when we decide what tariff level is reasonable. In most areas of Indonesia we can build adequate water infrastructure using surface water, by which I mean rivers, or reservoirs in some cases. In Indonesia there a few areas that are too dry or where the demand is too high considering the number of rivers in the area, and in those areas we are starting to look at desalination. There is nothing wrong with desalination as an element of a potential project. What is important is the match between the tariff and cost, and if you desalinate you have a lot more cost.

Desalination is a really an expensive approach, isn't it?

Generally we are looking at rivers or reservoirs to supply the raw water requirements. But in some cases we can look to the ocean or a salinated aquifer to provide the raw water. You can start with sea water but then you need to have a higher tariff structure, much higher than even the cost of making other arrangements, in terms of having water trucked in for example, so that means you need to have a very special kind of user or conceivably you can have a subsidy – I might actually have a different opinion about subsidies if we wanted to build a water treatment system for example in Sumbawa or Sulawesi Tenggara, where the feeling is there is not enough prosperity to fund the water system locally and on top of that you've got a lack of raw water and you need to obtain it from the ocean in order to create clean water. I think we may be talking about putting the burden on the government in the form of subsidy or even having the government build the project without private sector participation.

But in general we are looking at desalination as a solution for industry and tourism where the raw water supply is simply not adequate. If the users are industrial or tourism, they normally can pay that higher price and it is justified by the importance of clean water.

Given the role that Acuatico plays, do you feel it's appropriate to suggest policies or priorities for the Indonesian Government?

Once I heard a talk by [an Indonesian head of an Indonesian firm] and he said it was his role to operate within the context of government policy and make his business work; we feel the same way. We don't spend a lot of time studying what we wish the policy would be changed to; we are not sure we know how exactly how to word or implement better policies. What we do is spend a lot of time analysing the policies that exist, so that we can create the best possible business opportunity with the best possible result to the consumers within the context of the regulatory environment. ■

The Role of the Private Sector in Developing Ports in Indonesia

Carmelita Hartoto is the President Director of PT Andhika Lines, a shipping company established in Indonesia in 1973. She is also the Chairperson of INSA (the Indonesian National Ship-owners Association). Currently, INSA counts about 1,300 ship-owners among its members. In addition to her activities at INSA, since 2013 Carmelita has also held the position of Vice Chairperson for Logistics and Treasurer of KADIN, the Indonesian Chamber of Commerce and Industry. She holds an MBA from Webster University in the UK.


Courtesy of Carmelita Hartoto

PRAKARSA: How do you view the Government of Indonesia's role in developing infrastructure at ports? What should the new administration be doing?

CARMELITA HARTOTO: The Government should start by asking: what is the true meaning of maritime affairs? What is the scope? Does maritime affairs include fisheries? What about tourism? We would like to see the Government make building infrastructure at ports a priority. Since money is limited, it is important for them to establish priorities first. They also need to undertake the necessary planning to ensure that the port development is individualised – it must take into account how the needs of different regions vary. For example, what kind of capacity is needed in a particular region, now and in the future? What will the volume of goods be? The answers determine how deep the port needs to be. Further, the Government needs to ensure that the supporting infrastructure is provided. A port needs utilities – clean water, electricity, and for access it needs entry and exit roads to and from the port.

I hope that Jokowi will talk not only to ministries, academics, and port workers, but will also have substantial discussions with entrepreneurs. These are the people who really understand the day-to-day operations – not just the theory behind it.

What do you see as the most important measures to be taken to address Indonesia's infrastructure deficit?

Port development should, if possible, use funds from the APBN [State budget]. But private sector collaboration is part of the answer as well. And for PPPs, [Public Private Partnership], we do not always have to look at foreign investors. The domestic private sector is also ready and willing. I'm reminded of a friend of mine who recently switched from the shipping business to real estate because he saw more opportunity there. My point is that Indonesia's private investors are ready to move – they will take advantage when they see promising business opportunities.

APBN funds can focus on developing remote areas where there are poor villages and people, and ports are not commercially viable.

Does the source of investment make a difference in terms of operating efficiency?

The investor is not necessarily the same as the port operator. Different parties can do the construction and operation. What matters is that once the port is operating, the operations are efficient. And the private sector should be given the opportunity to invest in building ports.

There seem to be ongoing issues surrounding the authority of the central and the Local Governments.

Yes, that's true. There must be a separation of the functions of port regulator and operator. I don't think the Ministry of Transportation [MoT] is completely ready to address this yet. When they are, they can say: "This port can be taken over by the private sector. This one is not ready yet."

In theory the Shipping Law [Law no. 17/2008 on Shipping, which mandates that Indonesia must develop an "efficient, competitive and responsive port system"] should be resolving many of these issues. Is it working?

It is not yet entirely implemented. Shippers are following it, but has yet to be implemented on the Government side. That is what we need to have happen. We're dismayed by the way things stand now. For example, Local Governments have no authority to close or control shipping lanes, but MoT still has to deal with a lot of problems in the region. Usually they immediately handle the situation and try to resolve the problem.

Do State Owned Corporations (BUMN) obtain facilities in infrastructure that cannot be given to the private sector? If so, in order to be fair, what can be done to equalise the competition?

BUMNs should have to compete with the private sector. In the past they tended to restrict their line of business – for example, to cement. The BUMN would only transport cement and the rest of the cargo was transported by private entrepreneurs. But now it is the other way around – BUMNs are entering all kinds of businesses, and it is hard to compete with them. They never have to account for their investment. When they have losses, they get a capital injection. On the other hand, we [the private sector] die when we do not succeed.

So what can be done about this?

I am always screaming to the Government about this! Let's look at how it is done in China, as a benchmark. China used to give state-owned enterprises preferential treatment, but they realised it leads to inefficiency, so now they are enabling the private sector. Indonesia should take a lesson from that.

There are many studies undertaken by the World Bank and other institutions which conclude that the cost of transportation and logistics in Indonesia is very high. It is more expensive sending goods to Sumatera than to Europe. Why is that? Is the problem efficiency at the ports or something else?

The port efficiency problem has many dimensions. Document processing takes a long time. And rates are continuing to increase. This makes it hard to manage inventory. Let take onions, for example. We buy onions at Rp 50,000 per unit and we plan to sell them to the market at Rp 60,000. But during transit they were stored for too long and they spoiled. The real value has now become Rp 40,000. Obviously an entrepreneur can't do business under conditions like that.

And low productivity causes vessels to stay longer at the port. We sign Service Level Agreements that should guarantee service but in reality, service levels are low while costs are high. Equipment quality can also be an issue. Sometimes the regional ports use second-hand equipment. So there are many reasons why cargo shipping is taking much longer than it should.

What about the dock workers (TKBM)?

TKBM are also a big problem for us. They are managed by a kind of cooperative, and the number of people working there is very high. Fraud can occur – person A may have died, but someone is still collecting his wages. There should be an age limit for works, too. These are the kinds of issues that are causing low productivity, particularly at smaller ports. We must better utilise the labour force, and the Government needs to ensure that this happens. It is a tough problem because the solutions involve several ministries. The private sector can help too, by providing the needed training for workers.

What else can be done to minimise turn-around time?

Pelindo III is now building Teluk Lamongan. This port will entirely use computerised equipment. Probably in the whole world there are only a few new ports that using this system.

In your opinion, is it still necessary to build the Cilamaya port?

I think so, but I don't know whether the new government will build it or not.

What about the Port of Tanjung Priok? With the construction of Kalibaru will the capacity be sufficient?

My only concern is that ports cannot be built in one place only, while there is continuous growth. We should think far ahead. And in my opinion, actually we are already running significantly late in our development. Actually this is embarrassing, because JICA did a study four years ago on the Cilamaya port, and everyone expected it to be constructed. With the new government I do hope that there will be follow-up. While constructing, we should correct any shortcomings, but that doesn't mean we have to throw out all the work and planning that happened before. We will never advance if that's our way of thinking. I think that it's the same with the Australian government. A change in government does not mean that every single past plan will change, right?

We did a feasibility study on the construction of a new port in Makassar, but it seems that Pelindo IV has its own plans. The problem with using Pelindo IV is that there are no choices. Alternatively, project investors from anywhere could participate in building a world class port.

Competition leads to higher productivity and that means higher revenues. It was reported to me just now that there is a proposed 200 percent rate increase for tug boats; before that there was an increase of 800 percent. This comes from a subsidiary of Pelindo. I say, you cannot do it like that. Facing all this makes me truly sad.

Did our questions leave anything out that you wanted to add?

I think the most important thing is, the Government has to address the policy matters. ■

Are You on IndII's Mailing List?

If you are not currently receiving each quarterly edition of ***Prakarsa*** and you would like to subscribe, please send an e-mail to: enquiries@indii.co.id and we will add you to our mailing list for electronic distribution of ***Prakarsa*** and IndII's e-blasts. If you would like to receive a hard copy of ***Prakarsa***, please include your mailing address in your e-mail.

The Prakarsa Editorial Team

Carol Walker, Managing Editor <carol.walker@indii.co.id>
Eleonora Bergita, Senior Program Officer <eleonora.bergita@indii.co.id>
Pooja Punjabi, Communications Consultant <pooja.punjabi@indii.co.id>
Annetly Ngabito, Senior Communications Office <annetly.ngabito@indii.co.id>
David Ray, IndII Facility Director <david.ray@indii.co.id>
Jeff Bost, Deputy Facility Director <jeff.bost@indii.co.id>
Jim Coucouvinis, Technical Director – Water and Sanitation <jim.coucouvinis@indii.co.id>
John Lee, Technical Director – Transport <john.lee@indii.co.id>
Lynton Ulrich, Technical Director – Policy & Investment <lynton.ulrich@indii.co.id>

A Voice for the Private Sector in Infrastructure Development

Courtesy of Mark Rathbone

Based in Singapore, Mark Rathbone is PricewaterhouseCooper's [PwC] Asia Pacific Capital Projects & Infrastructure Leader. Mark has advised on a range of transactions across the Infrastructure, Project Finance and Public Private Partnership [PPP] market, including transactions in such sectors as energy (gas/oil storage), power and renewables, defence, health, accommodation, transport, and sports, including secondary market transactions and debt raising.

Mark advises on large infrastructure transactions that straddle the complex interface between public and private sectors. He has been integral to the development of project structures, tariff mechanisms, risk allocation and the related funding solutions for large infrastructure transactions, while also leading the development and negotiation of PPP, joint venture and concession type contracts.

He has led a broad range of projects including Hong Kong Zuhai Macau Bridge, debt and equity financing for oil storage terminals, Singapore's Sports Hub PPP, Brunei's Privatisation Masterplan, Ascot Racecourse Redevelopment, ITE College West PPP, Changi NEWater DBFO, Tuas Desalination, EPPO IPP Program, numerous IPP commercial reviews, toll road divestments, and the acquisition of a minority stake in a Chinese Port. Prior to joining the Singapore office, he was with the PwC Project Finance Group in UK, where he advised on a number of social infrastructure transactions in the defence and health sectors.

PRAKARSA: Indonesia has recently undergone a change in national leadership – what do you see as the key infrastructure priorities for the next government?

MARK RATHBONE: The new Indonesian administration has the opportunity to capitalise on Indonesia's recent economic growth and its rising influence across South East Asia. Indonesia is increasingly becoming a priority for infrastructure investors who recognise both its future growth potential and the current infrastructure deficit – it has an investment grade credit rating; a young, growing population; substantial natural resources and a low cost base with substantial needs for infrastructure investment across transport, utilities and social infrastructure. However, it would be very easy to miss the chance to capitalise on this potential growth dividend! I can list a few fundamentals that must be addressed in order to sustainably grow Indonesia's infrastructure stock:

Project preparation – ensuring that priority projects are effectively prepared to allow for procurement – attracting bidders and providing commercial structures that allow for private sector financing.

Viability Gap Financing – finalising the VGF legislation and implementing it effectively in the correct areas.

Consistency across government – forcing a consistent approach across central government as well as Local Governments [LGs], through strong leadership and robust planning.

Land acquisition – more effectively dealing with the land acquisition issues that continue to create issues.

Capacity – building capacity in both public and private sectors.

Government-related institutions – strengthening the institutions that are driving infrastructure development – for example, SMI [PT Sarana Multi Infrastruktur, a shareholder of PT Indonesia Infrastructure Finance] and IIGF [Indonesia Infrastructure Guarantee Fund].

Sector focus – it is important to focus on transport (roads, urban rail [Mass Rapid Transit etc.], and ports); water purification and distribution; power production and distribution; and healthcare (rural). However, it may make sense to close a few straightforward projects to build trust in the process before embarking on grand, complex schemes.

That's an ambitious list of items to address. How do you see things breaking down, in terms of what should be done in the short term and what is longer term?

In the short term, what's required is basic legislation on VGF and land acquisition; better project structuring; eliminate approval blockages by simplifying process; project prioritisation to address economic growth barriers; engage effectively with other governments regionally and with multi-lateral institutions.

Over the medium term, build transactional capacity in government, improve on commercial structures, and try to use globally recognised precedents. Build stakeholder support across government and encourage private sector participation through effective risk allocation.

And for the long term, what is required is to introduce measures to boost capital markets; develop stronger institutions that drive infrastructure procurement; continue the focus on capacity building and talent retention programs; open parts of the economy to international expertise and investment; reduce administrative burden of company set up; and address transparency and vested interest issues at different levels of government (centrally and locally).

You can see this approach illustrated in a PwC diagram [see Figure 1].

Figure 1: Approach to Addressing the Infrastructure Gap

Source: PricewaterhouseCoopers

From the perspective of privately financed infrastructure, are there any gaps or inconsistencies in the regulatory environment that you think deserve particular attention?

A lot has been said about new legislation to allow for effective land acquisition and VGF support. Efforts have been made to create institutions that are supposed to support infrastructure procurement and development – the IIGF, for example. However, how many PPP projects have closed utilising this legislation? VGF is limited in extent and so can only be used on certain projects. And the amount of Government subsidy is capped for each project as a percentage of project cost. The much-promised land acquisition legislation seems to lack teeth and does not seem to have been used.

Projects need to have more done to prepare them effectively – using the right expertise and precedent to ensure projects are well structured.

Mega projects seem to be a focus area – Jakarta Dam Wall, SHIA Airport Link, Trans Sumatra Road. These are multi-billion dollar projects that have substantial complexities. Why not start with a few simple projects that create confidence and allow for quick wins? Look at sectors that have huge public need and great social as well as economic benefit – water provision; flood protection in Jakarta (clearing drainage channels at a basic level). Subsidies should be directed towards these efforts to allow for financial close.

Vested interests, corruption and the local-versus-central government issue need to be addressed. Alignment between central government and LGs needs to be encouraged while clear, transparent procurement processes must be implemented to address issues around transparency.

Individuals who understand infrastructure procurement and have a track record of successfully bringing deals to market and closing them should be put into positions where they can push forward with good procurement practices. A clear set of processes need to be communicated to the market with a clear set of criteria and stages that must be followed. Key individuals need to be identified as the ones responsible for driving a particular project, sector or location with strong, robust KPIs [Key Performance Indicators]. Failure to close projects should lead to replacement.

Here is a useful analysis that contrasts mature infrastructure markets with immature ones [see Figure 2]. These are the criteria that should be followed.

Figure 2: Moving from Undeveloped to Developed Infrastructure Markets

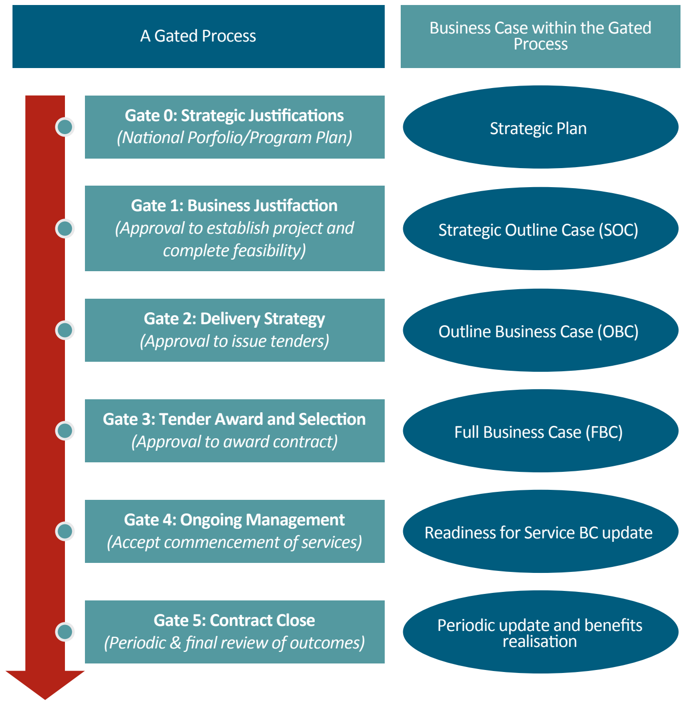
Undeveloped or unsuccessful use of private finance	**Part 1: Laying the Foundation** *Requirements for private finance*	**Part 2: Building the Structure** *Developing the market for private finance*	**Part 3: Planning for the Future** *The way forward for private finance*	**Developed or successful use of private finance**
Market Characteristics				**Market Characteristics**
• Lackof political and public support • Underdeveloped procurement policy • Ad hoc approach to market • Infrastucture propositions not commercially viable; thus unable to attract private finance solution • Reliance on attracting foreign investment and investors • Lack of transaction capacity and know-how • Failure to recognise the wider benefits and risk transfer that can be achieved by involving private finance • Uncompetitive private finance proposals	• Create political, legal and financial environments that are conducive to private finance (*Texas P3 roads, Lekki Toll Road, Highway 407*) • Involve all stakeholders, including public users, in the development and planning phases • Develop objective financial forecasts and practical debt repayment schedules (*Cross City Tunnel, Mexico toll roads*) • Analyse tradeoffs among commercial, contractual and financing approaches (*Chicago Skyway, Chilean PPP Program*) • Determine the meaning and impact of failure and establish how to mitigate and manage such risks (*Delhi International Airport*)	• Attract private finance with a program of prioritised investment opportunities (*India's PPPs, Portuguese SCUT roads program*) • Identify what is commercially achievable (*Port of Miami Tunnel*) • Increase collaboration between public and private parties (*Florida I-595, Seagirt Marine Terminal, Australia's Future Fund, Canada Line*) • Build and sustain transaction capacity (*PPP Canada, Partnerships BC*) • Leverage the financing and transactional skills of multirateral Institutions (*Doraleh Port*)	• Sustain the involvement of existing sources of private finance (*UK Treasury Infrastructure Finance Unit, TIFIA funding*) • Stimulate long-term capital markets • Respond to changes in the infrastructure finance offering as investor appetite, sectoral and geographic focus change • Explore the development of new sources of private finance (*Viability Gap Funding, BRIS Connections*) • Propose new ways to increase the involvement of private finance in the infrastructure sector (*IFC Crisis Facility*)	• Strong and transparent political and legal frameworks • Established program of opportunities • Close collaboration between public and private parties • Strong support from all stakeholders • Continuous innovation in procurement approaches • Developed local or regional financial capacity • Ability to attract new sources of finance markets • Improved transaction capacity and ability to sustain it

Source: PricewaterhouseCoopers

So if the legal framework is improved, what happens next to make the environment more conducive to foreign and domestic investment?

Indonesia needs basic legislation with teeth – effective VGF and land acquisition legislation as a starting point. The project process needs to be formalised and communicated – here is an example [see Figure 3].

Figure 3: A Formal Project Process



Source: PricewaterhouseCoopers

People – the ones responsible for projects and programs – need to be held accountable for failure. If blockages are occurring at specific stages in the process or within parts of Government, address reasons for this in a timely manner or get rid of the individuals creating those blockages if there is no reason for a project to be held up.

Restrictions on foreign direct investment and the employment of foreigners are blocks that need to be dealt with immediately. A more open economy will improve perception, build capacity, and likely allow for more efficient processes, because precedent from other countries can be utilised within Indonesia. There is no need to reinvent the wheel when it comes to infrastructure procurement – many countries have very successful infrastructure procurement programs, using different tools and commercial structures.

Do you think LGs are part of the problem or solution?

Both – there needs to be more alignment between local and central government. LGs are needed to push local programs, but they can create blocks if the LGs or local leaders do not believe the particular project is a priority for their region.

There should be a clear strategic focus and a whole-of-government approach to the development of Indonesia's infrastructure program. PwC recently published a great document with World Economic Forum that discussed the development of strategic infrastructure – it has become very widely recognised that the scale of the global infrastructure deficit requires a very strategic approach to pipeline development and procurement.

You mentioned that LGs can create blocks. It's true, it is often said that decentralisation is an impediment to improved infrastructure delivery. What can be done to ensure a more positive role for LGs?

LGs need to be part of the institutional set up driving infrastructure. For example, have LG teams that interface with central government/SMI, etc. LGs must have some influence over the priorities within their districts. They must be enfranchised in central government infrastructure programming.

Moving from LGs to another important institution: Do State Owned Enterprises [SOEs] enjoy privileges not afforded to the private sector in the infrastructure sector? If so what could be done to level the playing field?

I believe they do – in any economy. This is more so the case in areas or sectors where the SOE has a monopoly or acts in a monopolistic way. This can act as a barrier to private sector activity in the specific sector. So if a government is looking to improve performance, encourage investment and grow its infrastructure stock, this should be addressed.

Encouraging private sector participation though PPP is one way of addressing this. For certain SOEs, corporatisation that can then lead onto privatisation is another option.

Much of the narrative regarding infrastructure problems seems to be dominated by the government perspective. Does the private sector have a voice in improving the policy, planning and delivery of infrastructure services?

We would expect this to be the case when we look at inherently governmental infrastructure – for example, roads, rail and light rail networks, ports, airports, power plants and other utilities, water purification and distribution, public hospitals and public education. Government drives the procurement of these assets and so it is the responsibility of Government to create an environment in which these assets can be procured.

You do not see similar issues in Indonesia when it comes to the private sector developing real estate (malls, offices or condominiums), or a corporate entity developing its mining rights. As an illustration, 33.1 percent of Indonesia's GDP was spent on capital asset investment in 2012; only 3.2 percent of GDP was spent on infrastructure[1] – the remainder was spent on private sector capital assets – factories, mines, real estate! The private sector has offered substantial levels of feedback and narrative to government that should inform reform and the Government's approach to infrastructure development – the private sector does want to invest in inherently governmental infrastructure in Indonesia – but the risk allocation must be fair, the returns equitable, and the processes fair.

A final point to make – the Indonesian Government does not have the capital necessary to spend on the infrastructure it requires in order to continue growing. A substantial amount of infrastructure financing will necessarily come from the private sector.

In conclusion, the private sector does have a voice and must have a voice in the delivery of infrastructure in Indonesia. PPP requires government and the private sector working together with common objectives to deliver needed infrastructure and services to a tax-paying public.

What can you tell us about the current infrastructure-related activities of PwC in Indonesia?

PwC has a strong team of Capital Projects & Infrastructure [CP&I] advisors within Indonesia – our team has experience across the transport sector (roads, rail, ports and airports), utilities, including power and water and of course social infrastructure – for example, hospital procurement. Our team also works closely with private sector clients who are looking to invest in different asset classes across the economy, whether inherently governmental infrastructure like transport projects, or more private sector-focused opportunities in real estate, mining, manufacturing or oil and gas.

PwC are investing heavily in our own capability in Indonesia by building on our team's capacity and experience. Our team is led by Pak Rizal Satar and Julian Smith. Pak Rizal has been an institution in Indonesia's infrastructure story over many years, while Julian is our Global Transport and Logistics Leader who recently relocated to Jakarta to boost our credentials in the local market. The local team is supported by PwC's Global CP&I team which comprises approximately 800 professionals who are dedicated to advising clients on large scale infrastructure projects globally.

So you are in a good position to comment on the dynamics of public and private roles in investment. In Indonesia, PPPs have been spoken about for many years, but there has been little successful implementation. What needs to be done to encourage sustainable use of these delivery modalities?

I have touched on a number of key areas that need to be addressed to allow for effective PPP programs to be developed. Many countries, both developed and developing utilise PPP which is clearly an important tool for infrastructure development – especially when there is limited government capital available to spend. PPP is an absolute necessity for Indonesia if its infrastructure plans are to be successfully implemented.

PPP will only be attractive to investors if the risks are not unreasonable. What should the government be doing to ensure that the risks assigned to the private sector in large infrastructure projects are manageable?

Follow the basic principles that govern this – allocate risk to the party that is best placed to manage the risk. Thereafter, recognise that investors in infrastructure require a return that is commensurate with the risks being taken! There is a very substantial amount of precedent globally that could be used to define the basic principles that should be applied on all projects in Indonesia. This is not rocket science, and should be one of the easier parts to get right at a basic level. For more complex risks, for example, revenue risk, more thought and analysis are needed – but again, there is so much material available that one does not need to reinvent the wheel!

Risk analysis, quantification, allocation and subsequent mitigation are key parts of any project – both during a project's procurement process, and also after the financial close during construction, commissioning and operations. PwC has developed very robust processes to support the development of effective risk structures or allocation on infrastructure projects which can be used to structure commercially bankable projects.

PPPs have been focused to date on the delivery of economic infrastructure. Should PPP be considered for the delivery of social infrastructure?

I do not see how else Indonesia can provide the necessary healthcare, housing and education that its population needs, and that citizens will soon demand as they grow in wealth. It is "normal" that emerging markets address economic infrastructure needs at earlier stages in their development cycles – this is the infrastructure that drives economic growth. However, social infrastructure is needed both at this stage and also as economies progress from emerging market status into more developed status. A good starting point may be to look at examples of how one can implement focused programs in these sectors that are not "grand mega schemes" but that show real social benefit.

Social Infrastructure PPP has been around for many years – the UK pioneered this through its Private Finance Initiative program in healthcare, education and housing. PPP in social infrastructure is now being widely used in North and South America, Southern Africa, the Middle East, India, Japan, South Korea, Singapore, Australia and New Zealand. There is an enormous amount of precedent, project examples and alternative structures that can be used to build these programs.

However, a very fundamental part of social infrastructure PPP is the role of government as either an investor or payer. This would require fundamental changes to be made to current VGF proposals.

Do you support the use of Viability Gap funding? Why has it taken so long to develop?

VGF is a necessity for most infrastructure programs – large scale transport projects almost always require government support in some way – whether it be tariff subsidy or contribution to up front capital costs; social infrastructure requires it too.

Why has it taken so long – I have no idea. VGF is not an altogether new concept. Government contributes to the cost of its infrastructure all over the world in different ways so there are many examples as to how this can be done and how legislation can be created to affect this! Lack of will power, lack of leadership, vested interests, lack of willingness to change could all be reasons as to why it has taken so long.

Indonesia is a middle-income country and has considerable domestic resources. How can these resources be better mobilised and channeled into infrastructure projects?

Better planning; more effective processes; improved communication; focus on key priorities not vote winning or mega projects; ease business set up costs; encourage FDI; stop leakage of capital on big schemes.

Can local finance markets intermediate between surplus savings and investment?

Yes – one would hope that they can. At a basic level, by allocating pension savings to central infrastructure investment; allocating tax revenues to infrastructure projects; accessing high net worth families and private corporates that appear to have substantial capital that they do not invest in public infrastructure.

Local banks should look at ways of strengthening and deepening capital markets so that infrastructure projects can tap more effectively into these sources of financing.

Does the mismatch of liability/asset tenures create difficulties for the finance sector to participate in long term project financing? What could be done to ease the situation? Perhaps better use of pension monies, municipal bonds, etc.?

Of course – infrastructure is long term, and most projects do not have the revenue base to be able to support short tenor debt repayment profiles offered by local financial markets. Therefore longer tenor/term financing is important. Bond solutions are an option as is pension money. However, bond solutions require structure and certainty and are often less easy to close than bank debt solutions – as such, project bonds may be challenging in Indonesia unless the government stands behind these.

Local pension money – yes, this could be used to invest in infrastructure as an asset class. International pension money (Ontario Teachers, Aussie Super funds etc.) that invest heavily in infrastructure are not investing directly into projects in Indonesia or other emerging markets because the risk is too great (I am referring here to these institutions taking direct project risk exposure as a shareholder in a particular infrastructure asset). In order to attract this capital, one must address some basic fundamentals around legislative frameworks, transparency, ease of investment, security of investment, etc.

In order to improve a project's ability to attract longer term financing to deals – better project structures, more secure revenue streams, strong Government support for project/programs, use precedent contracts/risk allocation to reduce perception of increased risk, Government project support (guarantees etc).

What role can international finance play to promote Indonesian infrastructure?

They bring experience in structuring and lending to infrastructure, liquidity depth, and capacity to lend longer term. They have the capability to assess and drive programs, and they have people who have done it before. ■

Letters to Prakarsa

More Thoughts on Developing Roads

TO THE EDITOR: Thanks for an excellent ***Prakarsa*** on roads [issue 19, October 2014]. Back in October 2011 I also congratulated IndII on a good edition on roads, and this one shows just how great a contribution IndII has made on this subject over the years.

I would like to add some comments on matters that are related to some of the issues you covered in that edition.

The Director General made a good contribution[1], pointing out the need to look at other modes of transportation, including a mention of BRT [Bus Rapid Transit]. When preparing commentary to DKI Jakarta in the UNEP [United Nations Environment Program] mid-term report on the Jakarta BRT, David Antell (now deceased) and I proposed a simple principle for DKI road design: design for pedestrians first, then public transport, then private transport. It was a simple formulation, and like so many other simple formulations has largely been ignored.

But the growth of use of motorbikes and the huge accident rate that was well presented in that edition of ***Prakarsa*** suggest that there would be benefit if more attention was given to specific provisions for motorbikes. I am very impressed by the success of the Bali toll road bike lanes, and continually see where special provisions would help move the traffic along.

It is good seeing again the emphasis on budget efficiency, but I am a little surprised that the excellent work by IndII promoting multiyear MTEF-[Midterm Economic Framework]-based planning did not rate a mention. Strategic planning is mentioned, but there is a sense of endorsement of the Indonesian concept of strategic planning (based on Law no. 25/2004) which is anything but strategic planning. One salutes the way in which the Ministry of Public Works generally, and the Directorate General of Highways in particular, have managed to use this bad planning law to produce some good planning, but wouldn't it be good if good planning and budgeting was the norm?

For just a minor example, wouldn't it be far better if multiyear contracting was the norm? As it is, especially in regional governments, maintenance periods are not managed properly because the supervising consultants do not have a contract to supervise the maintenance period.

I think you understate the importance of your proposed institutional changes, by saying they "may be needed". They are clearly needed, and I support your proposal.

Your proposal on conditional grants is most interesting, and the implications much broader than just roads, as they cut across all sectors. I think there is room for both factoring it into DAK [*Dana Alokasi Khusus* – special allocation funds], and for Road Funds. As the amendment to the law on fiscal balance that defines DAK is still being discussed, I think it would be good to raise this matter in discussions.

Again, congratulations on a good presentation.

Owen Podger
Professional Associate
University of Canberra
Institute for Governance & Policy Analysis

Outcomes:
Recommendations Shape Plans for Bus Reform

Jakarta citizens, in particular women and people with disability, face formidable problems related to public transport, including congestion, safety concerns, and accessibility issues. With support from the Australian Government-funded Indonesia Infrastructure Initiative (IndII), the Jakarta Transport Agency (Dishub) held a workshop on gender and disabilities in November 2014 in order to discuss these issues and make recommendations. In addition to Dishub officials, the event was attended by various stakeholders concerned with transport and/or gender and disability issues, including the Jakarta Police, TransJakarta, Kartunet (an on-line community for youth with disability), the National Women's Commission (Komnas Perempuan), and Jakarta Barriers Free Tourism. A film and leaflet produced through the efforts of IndII, illuminating how women and persons with disability experience Jakarta transport, were shared and received accolades. Attendess recommended that groups representing women and persons with disability be included in the planning, implementation and evaluation of infrastructure development, and that facilities be designed to meet universally accepted accessibility and safety standards. These recommendations have since been incorporated in IndII's design of a pilot project for reforming Jakarta's non-BRT (Bus Rapid Transit) bus system.

To read more about this and other IndII activities, view the Activity Updates on our website at: http://www.indii.co.id/publications.php?id_cat=57

In our Next Issue:
Sanitation Public Diplomacy

In mid-2013, IndII began planning an outreach program to enhance the effectiveness of several of its sanitation programs (Australian-Indonesian Infrastructure Grants for Sanitation, city sewerage, and the sanitation hibah). A conventional sanitation outreach approach (stressing hand-washing and other hygiene-related behavior change) was initially considered, but soon set aside as not suitable for reasons of scale, duplication of effort, and alignment with IndII activities and messaging. Instead, IndII undertook a small but ambitious program focused on sanitation-related public diplomacy – reinforcing the value of the Australian-Indonesian partnership, supporting Local Governments in their own communities, spreading the word about the importance not just of sanitation but sanitation *infrastructure*, and even touching upon the effectiveness of output-based aid. The program, carried out in eight Local Governments starting in September 2014 and winding to a close during mid-2015, has employed a range of tactics and produced human interest stories, an innovative toolkit of ideas for future outreach/public diplomacy programming, and worthwhile lessons learned. Highlights of the program, and its implications for future planning, will be the focus of the July 2015 ***Prakarsa***.