REGIONAL THINK20 MEETING

Looking at the G20 Initiatives on Infrastructure Investment from a Developing Country's Perspectives: Indonesia

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Introduction

Indonesia has been one of the most celebrated champions of infrastructure investment when it comes to initiating infrastructure investment agenda at the regional and global fora, including the G20. Many times, it has been successful in its efforts to gain supports from other member countries, hence, placing infrastructure investment as a priority agenda in the respective regional and global fora. Indonesia's proposal to place infrastructure investment as one of the G20 priorities to support the weak global growth and global economic recovery from the 2008/2009 financial crisis is in line with Indonesia's dire needs of infrastructure investment.

Infrastructure investment has contributed around 2 per cent of the 6.2 per cent growth enjoyed by Indonesia last year. According to several studies conducted by international organizations, a similar contribution is also shared by many other emerging market and developing countries as well. However, Indonesia's infrastructure investment has struggled to return to the pre-1997/1998 crisis. In real terms, average infrastructure investment in 2010-2011 was about two third of what it was in 1995-1997.[2] The 3 per cent average infrastructure investment out of GDP in 2010-2011 is also well below most of regional countries, including China, Thailand, and Vietnam, which have moved towards the 7 per cent share.

Indonesia has proposed infrastructure investment to the G20 table not because it has been the most successful implementer of infrastructure development, but on the contrary, Indonesia needs helps from its regional and global partners to help continue the debate on infrastructure development going, learn lessons from other more successful countries, receive capacity buildings, and benefit from coordinated

[1] Draft: June 28, 2013
[2] Indonesia Economic Quarterly, March 2013, p. 38.

efforts to boost infrastructure worldwide. What needs to follow now is the implementation of the initiative, namely to realize these infrastructure development plans in the future in Indonesia. Otherwise, the infrastructure investment initiative that Indonesia brought to the G20 would be a wasteful “empty package”.

Against this background, it is worthy to look at Indonesia’s infrastructure development, challenges and prospects to realize its potential in improving its poor domestic infrastructure condition. The G20 should not only be about producing first-best solution to the global economic malaise or being successful in bringing a new agenda to the Leaders’ Declaration by negotiators, but it should also be concerned about its credibility and implementation on whatever agenda is being proposed.

This paper will focus on the implementation challenges of infrastructure development in Indonesia as a G20 member country.

Infrastructure Financing at the G20

Indonesia is one of the main pioneers in proposing infrastructure investment in the crisis context at the G20. At the G20 Summit in 2012, Indonesia proposed infrastructure investment through the financial and Sherpa channel, in the context of Framework of Strong, Sustainable, and Balanced Growth (FSSBG), instead of the Development Working Group only. The proposal focuses on the role of infrastructure in reducing global imbalances and lifting global growth. This can be achieved by recycling excess savings in some emerging countries to finance infrastructure instead of financing debts in advanced economies. Investing in infrastructure could also help efforts to reform fiscal policy mismanagement, especially in some developed countries.

These initiatives are reflected in the G20 outcomes:

1. The Los Cabos G20 Leaders Declaration 2012, Article 9 stated: "We ask Finance Ministers and Central Bank Governors to consider ways in which the G20 can foster investment in infrastructure and ensure the availability of sufficient funding for infrastructure projects, including Multilateral Development Banks’ (MDBs) financing and technical support."

2. The Washington G20 Communiqué Meeting of Finance Ministers and Central Bank Governors (April 2013), Article 11, stated: "We underscore the importance of long-term financing for investment, including in infrastructure, in enhancing economic growth and job creation. We are taking forward work on this issue, including through the adoption of the Terms of Reference of the new G20 Study Group,

with inputs envisaged from the World Bank Group, OECD, FSB, IMF, UN, UNCTAD, and from participating countries."

3. In February 2013, the G20 Ministers of Finance endorsed the establishment of a new "Study Group on financing for investment" to "determine a work plan for the G20, considering the role of private sector and official sources of long-term financing." It was officially set up in March 2013 and is co-chaired by Indonesia and Germany. The work program of the study group includes country-specific factors, capital markets, private sources of financing, official sources of financing and global financial regulatory reforms.

Domestically, Indonesia has implemented some of its G20 commitments on infrastructure. As part of the G20 Mutual Assessment Process, Indonesia identified the issuance of Presidential Regulation No. 13, 2010 to strengthen government guarantees/ government finances for infrastructure as one of its structural reform priorities. Indonesia Infrastructure Finance was created. It is a private non-bank financial institution under Ministry of Finance with a focus on investing in commercially feasible infrastructure projects. The objective is to address a key gap in the institutional landscape for infrastructure development and finance in Indonesia. Moreover, it is expected to be a national repository of experience and skills related to development and financing of commercially viable projects in infrastructure, including through the Public Private Partnership (PPP). In the medium term, it plans to issue Rupiah denominated infrastructure project bonds. Indonesia has also set up Indonesia Guarantee Fund and Viability Financing Gap.

The G20 has brought some positive domestic reform pressures at home in the sense that it helps pressurize Indonesia to set up regulatory and institutional frameworks on infrastructure investment.

Infrastructure Financing at APEC

During Indonesia's APEC chairmanship this year, infrastructure financing is part of the major deliverables. This year, APEC leaders are set to endorse:

- APEC Framework on Connectivity
- APEC Multi Year Action Plan on Infrastructure Investment and Development.

APEC cooperation on infrastructure development and investment will take advantages of regional expertise, experience and funding sources, including from multilateral and regional development banks, and the private sector. Some of the public-private joint initiatives include:

1. Asia-Pacific Infrastructure Partnership (APIP), where private sector has worked with governments to boost capacity for the design, finance and implementation of economic infrastructure.
2. Asia Pacific Financial Forum, which will work to enhance the region's financial systems so that the private sector can help deliver new infrastructure and other regional investments, including social safety nets, health and other services. The forum will also work on a convergent approach so that financial sectors can facilitate regional economic integration. The forum's first meeting was held in April 2013.

Infrastructure Financing at ASEAN

Indonesia is also a member of ASEAN. At ASEAN, it has also established institutions to promote infrastructure financing. ASEAN also has:

1. ASEAN Master Plan on Connectivity (AMPC)
2. ASEAN Infrastructure Funds (AIF)
3. Asian Bond Initiatives as part of long-term financing for infrastructure

In ASEAN, we have established AIF which is a regional initiative participated by all ASEAN member countries (Myanmar is in the process of membership) and the ADB. The Fund's objective is to better match the need for infrastructure finance through facilitating not only sovereign funds but more importantly private investments for infrastructure development in the region.

AIF is also targeted to improve the utilization of the local currency bond markets to support infrastructure development as well as attracting more investment from sovereign wealth funds and private institutional investors such as pension funds and other long-term investors.

Indonesia wants to promote this initiative for upgrading it to a global scale, and through the G20.

The Need for Synergy Across Regional and Global Fora on Infrastructure Agenda

Infrastructure is a multi-faceted issue that cannot be tackled by any one regional or global institutions, however, synergy among regional and global institutions are necessary:

- ASEAN institutions have the advantages of looking at infrastructure from the development perspectives since most of ASEAN member countries are developing countries. ASEAN is also ready with a list of potential projects in the region.
- APEC has the advantage of looking at infrastructure from the regulatory perspectives and creating sound investment climate for the private sectors, particularly institutional investors.
- The G20 has the advantage of looking at infrastructure from the global financing, re-balancing, and financial stability perspective, including fiscal reforms.

Infrastructure Investment in Indonesia

Indonesia is in a dire need of infrastructure. "Indonesia's poor connectivity is hampering its international competitiveness. One of the reasons is low quality of infrastructure, particularly visible in ports and roads."[3]

> "According to the Global Competitiveness Index 2009-2010, Indonesia's infrastructure ranks very low, particularly its ports and roads. The index places Indonesia in 94th place out of 133 countries in these terms. The Global Enabling Trade Report (2009) also ranks Indonesia in the low range, in 79th place out of 121 countries for infrastructure networks, far below Malaysia and Thailand, which occupied the 29th and 40th position respectively."[4]

"Poor quality of logistics service providers also discourages competitiveness."[5]

> "The Logistics Performance Indicator report (2009) ranks Indonesia lower than most other nations in Southeast Asia in terms of the quality of service providers. Indicators determining this include the ease of arranging shipments; the competence of private service providers such as freight forwarders, warehousing, maritime, air, rail and road transport; and the ability to track and trace a container to its final destination. Disturbingly, Indonesia's performance in terms of these indicators has worsened since the previous report in 2007. It

[3] World Bank, Connecting Indonesia. A Framework for Action. June 2010, p.5.
[4] World Bank, Connecting Indonesia, p.6.
[5] World Bank, Connecting Indonesia, p.7.

now ranks 36 places lower in terms of the ease of arranging shipments, 42 positions lower in terms of logistics competence and 47 places lower in terms of tracking and tracing availability. Although the decline in Indonesia's position is partly due to the relative improvements achieved by countries, most of the reduction is due to lower scores given by the respondents of the survey, who are logistics professionals worldwide."[6]

As an illustration of Indonesia's poor connectivity and logistics service providers, Box 1 is presented below:

Box 1: Examples of the implications of Indonesia's poor connectivity

- The price of a bag of cement in certain parts of Papua is 20 times that in Java. The price of a gallon of water in Medan is double that in Jakarta. Oranges from China are cheaper than oranges from Pontianak (Kalimatan). High domestic transport costs are the main reason.
- 70% of differences in rice prices across provinces can be explained by the degree of remoteness, which in turn is a reflection of poor logistics and inadequate transport infrastructure (World Bank 2010).
- Availability and prices of basic commodities fluctuate widely in remote areas. For instance, gasoline prices in Di Kisar island are three times higher in rainy season than in dry season.
- High quality products with great potential, such a shrimps from eastern Indonesia, cannot be commercially processed in Java, and commodities, like pineapples, are canned abroad because it is cheaper to transport them to Malaysia than to ship them to Java.
- Indonesia's manufacturing sector is poorly integrated into international production networks because of unreliable transport and high logistics costs.
- The costs of bringing a container from Jakarta's main industrial sites are double that in Malaysia and Thailand.
- Some ten percent of Indonesian exports leave ports too late and consequently do not reach the regional transshipment ports on time. Ships destined for local destinations are frequently delayed.
- In some export sectors, such as cocoa, rubber and coffee, more than 40% of total logistics and transport costs come from pre-shipment and inland transportation expenses in Indonesia before international shipment.
- Approximately 70% of freight in Indonesia is transported by trucks. The majority of the trucks on the road in

[6] World Bank, Connecting Indonesia, p.7.

Indonesia are old and poorly maintained.

- A truck making a round-trip from Bandung to Jakarta may spend up to 75% of its time parked due to customs processes, warehouse delays, and lift-on and lift-off queues.
- Trade and transport logistics are still mainly 'paper-based systems', which increases logistics costs in addition to illegal fees.
- Different national and regional authorities continue to issue laws and regulations without clear assessment of their impact on trade flows and logistics costs.

Sources: World Bank Trade Logistics Roundtables 2009-2010

Indonesia has recognized this urging issue. It has increased its budget spent on capital expenditure in recent years and enacted policies and institutional frameworks related to infrastructure development.

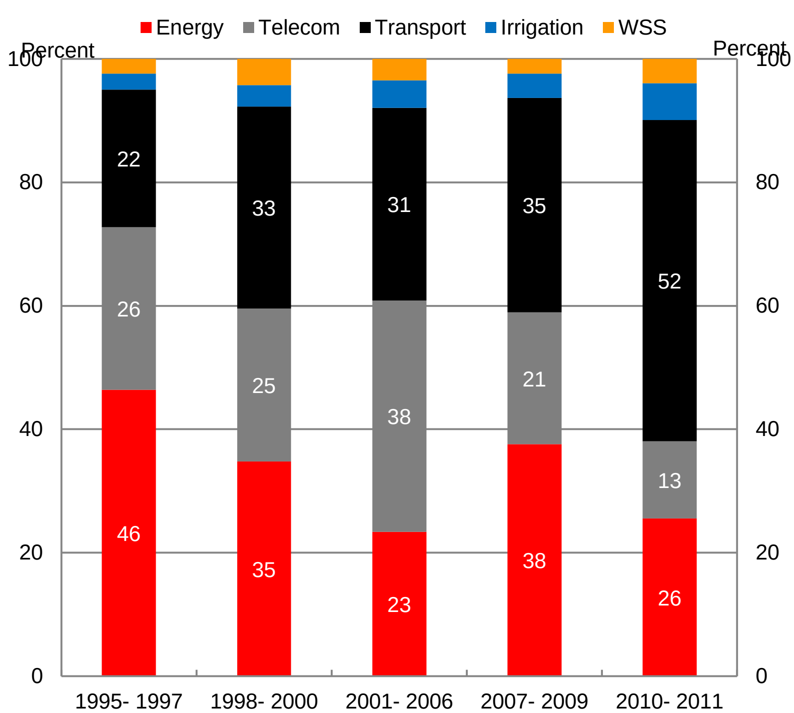
Currently, Indonesia has Master Plan on the Acceleration and Expansion of Indonesia's Economic Development (MP3EI): A visionary project on infrastructure and connectivity valued at around US$468 billion between 2011 and 2025. However, Indonesia's MP3EI relies too much on private sector financing. Private sector is expected to contribute about 51 per cent of the whole projects. This is very high in comparison to other regional and global countries. This is in addition to the heavy reliance on private sector investment for its current medium term development plan (RPJMN), in which the private sector was targeted to contribute more than 70 percent of US$ 150 billion investment needs identified in the RPJMN. Some observers think that MP3EI is politically driven, opening corridors in all major islands in order to win the heart of people (or votes) all around Indonesia. Some analysts even consider it as a dream or a prayer.

Indonesia's main infrastructure problem is not (only) financing but domestic structural, institutional and regulatory issues (some may say a lack of political commitment). Vertical and horizontal fragmentations within the government are identified as major issues in implementing infrastructure development. Regulatory barriers, including land acquisition bill, protected services sectors, unequal treatment of private sectors against state-owned enterprises (SOEs looking for profitable projects), those that are related to PPP including guarantee fund, viability financing gap (not yet fully operational) are also major infrastructure issues.

Infrastructure projects, especially roads, have become political commodities. For example, at the local level, there are some evidence that after local leaders are directly elected by constituents, the number of paved roads increased but the number of passable roads decreased, indicating that quantity of roads come at the cost of quality of roads.[7] Moreover, it was shown that building better roads increased electability of local leaders.

The story above fits with the empirical data on the ground. The World Bank study on infrastructure investment has shown that the transport sector, particularly roads, has accounted for an increasing share of infrastructure investment.[8] Its share of total infrastructure investment has gone up from 20 per cent in 1995-1997 to more than half in 2010-2011. (See Figure 1)

Figure 1: Share of Total Infrastructure Investment, Per Cent



Source: Indonesia Economic Quarterly, March 2013, Figure 56, p. 41.

[7] Kuncoro, Ari, Vid Adrison, Ifa Isfandiarni, “Varieties of Governance of Public Goods Delivery in Indonesia: The Case of Roads after Decentralization and Local Democratization,” Working Paper in Economics and Business, Volume III No.1/2013, January 2013 (Source: http://econ.fe.ui.ac.id/uploads/201301.pdf)

[8] Indonesia Economic Quarterly, March 2013, p.41.

Moreover, much of the increase has been mainly driven by sub-national road investment. The length of district's road has increased by one third between 2001 and 2009 from 287,577 km in 2001 to 384,810 in 2009. However, the same study reported a number of efficiency concerns to this spending from "insufficient level of operation and maintenance spending, institutional fragmentation leading to new road investment that does not lie within an integrated transportation network, and sub-standard design and road quality."[9] Due to institutional issues related to decentralization (autonomous districts), vertical and horizontal fragmentation within the government, regulatory barriers, etc., it is not surprising that in contrast to sub-national road building, toll road development (that often needs to cross district boundaries) has been below (about a third of) the targeted increase.[10]

Inefficient fossil fuel subsidies have left little space in the government budget. Despite Indonesia's dilapidated physical infrastructure, almost 30 per cent of the 2013 national budget is spent on poorly targeted energy subsidies, but only about 12 per cent is spent on infrastructure and 5 per cent on social expenditure. Subsidizing fossil fuel also degrades the environment and discourages innovations of renewable energy, and is a drain to Indonesia's Balance of Payment. Only recently (in June 2013), did the government finally reduce fossil fuel subsidies and revise its 2013 national budget.

PPP scheme is still weak and viability project is an issue: Currently, Indonesia only has one viable project under the PPP scheme, namely the Central Java Power Plant, which has been procured and is now at the stage of financial close. However, this does not guarantee that this project is going to be built soon, because according to some sources, the average delay between the signing of a contract and the implementation of a project is about seven years.

Other PPP projects are still under either the project-readiness stage, financial viability study stage supported by Viability Gap Fund (VGF) or transaction stage. These projects include drinking water project in Umbulan, East Java, drinking water project in Bandar City, Lampung, Soekarno-Hatta Airport railway project, and coal railway project in Central Kalimantan. There are also non-PPP public infrastructure projects, mostly electricity project in order to meet the government commitment to complete the second stage of 10.000 MW or the Fast Track Programme II (FTP II).

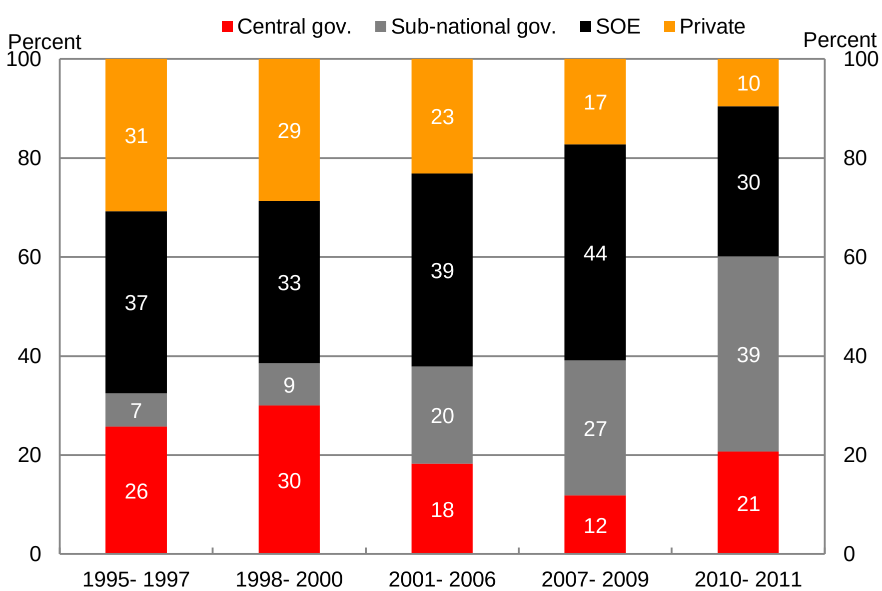
One of the reasons for lacking viable projects is that the government lacks the capacity to develop projects with acceptable Rates of Return on Investment (ROI). So, even projects with high economic

[9] Indonesia Economic Quarterly, March 2013, p.41.
[10] Indonesia Economic Quarterly, March 2013, p.41.

returns are not perceived as commercially viable as they are not carefully developed and structured. Limited human and financial resources devoted to project development to make projects become commercially viable are parts of the problem. There is also a wide risk-perception gap between private and public sector that needs to be corrected.

There have been some compositional changes in Indonesia's infrastructure investment since 1997-1998 crisis. The most notably is the decline in the share of private sector investment on infrastructure. The World Bank study on infrastructure investment has noted that the contribution of the private sector to total infrastructure investment in Indonesia has shrunk to only 10 per cent in 2010-2011 from almost one-third in 1996-1997.[11] (See Figure 2)

Figure 2: Share of Total Infrastructure Investment, Per Cent



Source: Indonesia Economic Quarterly, March 2013, Figure 53, p.40.

[11] Indonesia Economic Quarterly, March 2013, p.40.

The study contends that the trend "likely partly reflects the regulatory and institutional challenges that Indonesia is facing in attracting PPP."[12]

Meanwhile, government investment in infrastructure has been driven by sub-national government spending, which is not surprising following the big-bang fiscal decentralization in 2001. The sharp fall in energy (63 per cent between 1995-1997 and 2010-2011) and the telecommunication sector (by 69 per cent for the same period) accounts for the entire 30 per cent fall in total real infrastructure investment since the crisis period.

Summary

The abovementioned issues in infrastructure development have shown that the potential for Indonesia benefiting from regional and global fora is enormous. External push and pressures to reform will be needed to help the reforms domestically from outside. The G20 must recognize these challenges that Indonesia and maybe many other emerging countries are facing although at the government-to-government level, Indonesia does not bring these domestic structural issues on infrastructure explicitly at the G20. The initiative is usually brought up at the government-to-government level from the perspectives of crisis and global growth, financing and the impact of global financial regulatory reform on long-term financing.

However, at APEC, domestic regulatory issues have more space to be discussed through good regulatory reform practices, APEC Workstreams on infrastructure Investment and Development, and other sub-APEC fora on structure reforms, such as APEC New Strategy on Structural Reforms. Indonesia can also use other regional fora such as ASEAN and OECD Regulatory Reform Review to discuss and help implement domestic structural reforms.

The need to build synergy among these regional and global fora is necessary and not an option.

The G20 also has different arms to divide work labors in a cooperative and coordinated manner. For example, the financial channel can focus on the long-term financing issues of infrastructure in the context of crisis, fiscal reforms, and global economic growth (or FSSBG). The Think20 can discuss about regulatory and implementation issues of infrastructure, the C20 can discuss about the demand-side issues of infrastructure and the B20 can focus on PPP and other challenges for private sector to invest in

[12] Indonesia Economic Quarterly, March 2013, p.40.

infrastructure. Every aspect of infrastructure, from the supply to demand side issues, from financing to regulatory issues, needs to be addressed accordingly.

How can the G20 do to help member countries and beyond experiencing similar issues like Indonesia?

The G20 can encourage higher-level coordination between different governmental agencies and ministries, such as coordination among the Ministry of Transportation, the Ministry of Public Works, and the Ministry of Development Planning Agency as well as the Ministry of Finance. Monitoring scheme and reform-minded champions are keys to achieve milestones. Stronger coordination among central and local governments is also the key for implementation. Local governments need to be engaged more. This should be recognized and coordinated accordingly.

The G20 should recognize that services are inputs to productivity. Regulatory reforms related to services sectors, including in air, land, maritime transportation, railways, toll road, telecommunication, financial, logistics, power, oil and gas, water resources, water supply, etc., are often needed to successfully implement infrastructure projects. Key regulatory uncertainties such as land, investment and trade restrictions also need to be resolved. The G20 can draw lessons from APEC who has done a lot of works on Good Regulatory Practices.

The G20 should encourage equal treatments of private sectors and state-owned enterprises, and development on institutions to support infrastructure investment should move towards more independent regulators. Competition should also be encouraged.

The G20 should support the establishment of institutions that would support the implementation of PPP, especially for countries that rely heavily on private sectors in financing infrastructure development, including guarantee funds, viability financing gap, etc..

The G20 should encourage local currency bonds to prevent currency mismatches. It should be recognized that external financing in the form of foreign currencies can cause currency mismatches. Maturity mismatches can also be culprits of long-term infrastructure investment. More generally, the G20 should support regional, local and sub-national bonds to help finance infrastructure development, especially in the Asian region with excess savings.

Lastly, the G20 could draw lessons from the AIF and start thinking to upgrading it to the global scale.

More than anything else, the G20 needs to maintain its credibility. Only by focusing on implementation challenges, such as infrastructure investment in Indonesia, can the G20 maintain its credibility and be a real global champion of its own initiatives.