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Delivering Indonesia's infrastructure more effectively with real powers

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DELIVERING INDONESIA'S INFRASTRUCTURE MORE EFFECTIVELY WITH REAL POWERS

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ABSTRACT

Indonesia faces an ongoing infrastructure crisis, which is hampering economic growth and carries severe risks for the future. This is despite substantial efforts both to design and to implement numerous infrastructure projects, through public procurement and utilising the MP3EI Masterplan process and utilising Public Private Partnerships (PPP). Slippage in implementation of projects is very frequent. Funding arrangements, land acquisition processes and other authorisations are often hindered by inter-agency confusion and from slowness in carrying out the necessary processes. These inter-agency and bureaucratic difficulties are also exacerbated by the impact of decentralisation. Unless this situation is remedied, Indonesia will continue to suffer from high logistics costs, from increasing traffic congestion, from rolling black-outs and brown-outs in the electricity system and from slower economic growth than would otherwise be possible.

This paper argues that solving this problem requires effective co-ordination of a type that is not currently available in Indonesia. A properly empowered and supported agency needs to be established which has the authority, resources and capability to implement priority infrastructure projects. This has proven successful in a significant number of overseas countries, and agencies such as the Project Management Office in Queensland, Australia provide good examples of how such an approach can be made to succeed. Indonesia established the 'Policy Committee for the Acceleration of Infrastructure Provision (KKPPI)' in 2001 in response to the collapse of Indonesian infrastructure spending that followed the Asian financial crisis, and it still exists (although it is largely dormant). KKPPI needs to be revitalised, and given the authority and resources to solve the crisis. Indonesia has previously used specially established agencies to solve crises, an example being the 'Indonesian Bank Restructuring Authority (IBRA)'. In what follows, we explore the relevant history of both KKPPI and IBRA.

THE EFFECTS OF POOR INFRASTRUCTURE

Indonesia ranked 44th out of 139 economies in the World Economic Forum "Global Competitiveness Index" (GCI) 2010. Between 2005 and 2010, Indonesia improved its score on each of the 12 pillars measured by the GCI.[3] As a result of these positive dynamics, Indonesia's rank improved by 10 places, making it the most improved country among G20 countries over this period. Indonesia's macroeconomic management scores well (39th out of 139), as do its advances in education and the efficiency of the goods market.[4] The large size of the Indonesian market and Indonesia's rapidly growing middle class are highlighted as strengths.

However, the GCI 2011 review of Indonesia highlighted infrastructure as the major problem now facing the country:

> *"One of the most glaring shortcomings is the state of Indonesia's infrastructure (82nd). Despite notable improvements, its roads and railroads remain in poor condition, and the capacity of seaports remains limited. Energy infrastructure is of major concern, as well. The uptake of information and communication technologies also remains limited among businesses, as well as within the population at large. Mobile telephony is spreading fast, but Internet access, especially at high speed, remains the privilege of the very few[5]. As a result, Indonesia places 91st in the technological readiness pillar, its lowest ranking among the 12 pillars."*[6]

The latest GCI, for 2012-2103 shows a worrying deterioration in Indonesia's position. Indonesia's ranking slipped back to 46th in 2011-12 and 50th in 2012-13, despite an improvement in the macroeconomic environment.[7] The three most problematic factors for doing business in Indonesia were said by GCI respondents to be inefficient government bureaucracy, corruption, and inadequate supply of infrastructure.[8] Among infrastructure categories, poor roads, ports, air transport and electricity supply are highlighted.[9]

Logistics costs are perhaps the most worrying effect of Indonesia's poor infrastructure, as these directly affect the ability of Indonesia's industries to export, and also affect cost conditions domestically. In a recent study of logistics costs worldwide, the OECD estimated an average logistics cost for Indonesia of 14.08% of total sales value, with Jabotabek and Medan facing even higher costs, at 15.32% and 15.61% respectively. This compares with an average logistics cost of 4.88% in Japan. A recent OECD report notes that district and city roads, which account for nearly 80% of the network, are in bad condition, adding to the logistics costs to business.[10]

Indonesia has an impressive stock of human capital, and an improving education system. However, the use and protection of this human capital are also affected by poor infrastructure.[11] One particularly worrying aspect is the waste of human capital in unnecessary travel time and in road accidents. Both can be directly attributed to poor infrastructure. Many of Indonesia's workers have no choice but to travel to work by motorcycle or car, facing both severe congestion and the risk of accident. In a study published in 2011, the costs of poor infrastructure induced congestion were estimated for the CBD of Malioboro, Yogyakarta.[12] This found that motorcycle users faced an additional cost attributable to congestion of IDR 523 per trip. An earlier study found that the congestion cost for private car users was Indonesian Rupiah (IDR) 2701[13] per trip.[14]

THE FUNDING GAP

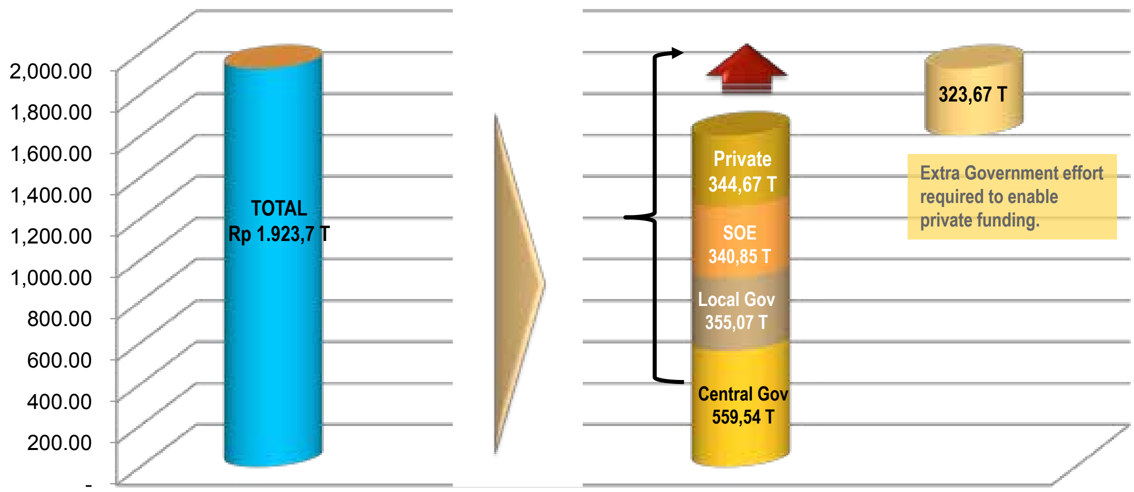
A 2011 report by BAPPENAS highlights how Indonesia's infrastructure investment fell from over 7% of GDP (about the same level as China, Thailand and Vietnam today) before the 1997 financial crisis, to under 4% of GDP today, with a particularly steep fall in energy sector investment.[15] The OECD also identified a serious funding gap, even to bring infrastructure spending up to 5% of GDP.[16] BAPPENAS have estimated an investment need of IDR 1,923.7 trillion for the period 2010-2014, and that in this period alone there is a funding gap of IDR 323.67 trillion, as shown in Figure 1.

Our analysis of 477 crucial infrastructure projects covered by MP3EI identified that around 60% of the funding for these projects has been identified through mixed public/private funding (IDR 358 trillion), private funding (IDR 402 trillion), State Owned Enterprise (SOE) funding (IDR16 trillion) and funding via the state budget (APBN – IDR 121 trillion). However, this still leaves a potential funding gap for infrastructure of IDR 614 trillion.

Recently, policy focus has shifted to limiting the external debt faced by Indonesian public agencies and SOEs, which further highlights the need to attract private investment. However, such investment will not be forthcoming unless Indonesia can present projects which are commercially viable, and which have been prepared to a sufficient quality for private sector, and particularly for overseas, investors to find them attractive. This task will be a major part of the new agency's duties.

FIGURE 1

BAPPENAS Estimates of Infrastructure Funding Gap



A PREVIOUS RESPONSE TO CRISIS: THE CREATION OF KKPPI

After the Asian Financial Crisis of 1997/8, infrastructure spending in Indonesia fell steeply. By 2001, it was clear that a new approach was needed to 'kick-start' infrastructure development. A new Committee, the Policy Committee for The Acceleration of Infrastructure Provision (KKPPI) was established in June 2001.[17] The Co-ordinating Minister for Economic Affairs, with the Minister for National Development Planning as Executive Chairperson, chaired this Committee. Twelve key ministers and agency Chairmen were members,[18] and a First and Second Secretary were appointed.[19] The Committee reported directly to the President.

The duties allocated to KKPPI at its foundation included setting policies and strategies in the implementation of infrastructure development acceleration; coordinating the program and planning and monitoring the implementation of the policies for the acceleration of infrastructure provision; determining resolution of any issue/problem related to the acceleration of infrastructure provision, KKPPI was given substantial rights to seek information, and to carry out consultation.

In principle, such a Committee should have been very important and influential. It was created at a time of crisis to fix a difficult problem, and included all the key ministries and agencies that had authority to act. However, in practice it met infrequently[20] and there was little output from those meetings that were held. This may have been because the focus on co-ordination was not well enough defined, or because those involved in the Committee felt that such co-ordination could be achieved by other means. All the members of the Committee, of course, had substantial other duties and it may simply have been that they were unable to provide the time and energy needed to develop the Committee's activities.

An attempt to revitalise KKPPI was made in 2005, and greater powers were granted to it.[21] These included setting policies on public service obligation for infrastructure development and to provide recommendations to the President on the acceleration of infrastructure provision.[22] Presidential Regulation No. 42/2005 also provided that KKPPI should establish a secretariat and establish working units. One of the meetings of KKPPI after the granting of greater powers was held on 15th September 2006, chaired by the Vice President, Jusuf Kala. Some 15 further meetings were held up until a meeting on 9th April 2008, which reviewed co-operation between the government and business entities in infrastructure provision.

A number of the required units were established, from 2006 onwards, with budgets allocated from within the wider BAPPENAS budget. These included a unit for developing policies on Public Service Obligations; a unit for developing PPPs; a unit for developing communications; and a unit for developing Institutional and Human Resources Capacity. KKPPI was also charged with establishing a 'National Infrastructure Forum', reporting to the First Secretary. Executing units, working units and backup teams were also established to ensure adequate resources.

Again in principle, this development should have yielded positive results. However, apart from some consultation processes and a limited number of research papers, the output of KKPPI during the period 2006 to 2011 seems again to have been limited.[23] In 2011, Presidential Regulation No 12/2011 rescinded the authority to determine resolution of problems from KKPPI. The secretariat and the various units were disbanded. The secretariat of KKPPI is still domiciled in BAPPENAS, but we understand that there are currently no employees specifically assigned to the entity.

A MORE SUCCESSFUL EXAMPLE: IBRA

Following the Asian Financial Crisis of 1997/8, a number of Indonesian banks faced severe financial difficulties. A bank restructuring program was agreed, and the Bank of Indonesia handed over management of the relevant banks to a newly created agency, the Indonesian Bank Restructuring Agency (IBRA).[24] IBRA was established under Presidential Decree No. 27 of 1998, on 26th January.[25] IBRA consisted of a chairman, a vice chairman and maximum five deputies, with supporting staff. The chairman was appointed (and may be terminated) by the President, while the vice chairman and deputies were appointed by the Minister of Finance.

IBRA was given the task of closing, merging, taking over or recapitalising banks which the Bank of Indonesia transferred to it for management. It was expected to recover bad loans and sell assets in order to recover maximum value from the banks which needed to be closed. IBRA was expected to complete its tasks within five years, after which it was expected to be wound up.

IBRA's powers were substantial. It was authorised to take over and exercise all rights and authorities of shareholders, board of directors and board of commissioners of the bank; to control, manage, sell or transfer assets; to review, cancel, terminate or amend contracts; to sell or transfer the receivables of the bank and/or hand over the management of such receivables to another party, without the approval of the debtor customer; to transfer assets or management to a third party; to make a temporary equity participation; to seize land and/or buildings; and to seek redress for losses from the board of directors, board of commissioners and/or shareholders.

By February 1998, 54 banks (comprising 36.4% of the banking sector) were placed under IBRA supervision. These included four state-owned Banks (BAPINDO, Bank Bumi Daya, BDNI and Bank Exim) which together represented one-quarter of all liabilities. IBRA's task was made more difficult by the political upheaval and riots leading up to the change of president, and the steep depreciation of the Rupiah.[26] Deposit runs occurred frequently, including on Indonesia's largest bank, Bank Central Asia (BCA),[27] and credit lines to domestic banks were withdrawn. Nevertheless, by April IBRA took decisive action, taking over seven large banks, including Bank EXIM, and closing seven others. BCA was taken over on 29th May 1998, shareholders' rights were suspended and the management was changed. A major recapitalisation programme was launched in September 1998, and further banks (including Bank Niaga) were taken over when they failed to meet deadlines. IBRA successfully negotiated new performance contracts and memoranda of understanding. IBRA also took action against ten former owners of taken-over banks that were deemed to have violated their legal obligations.

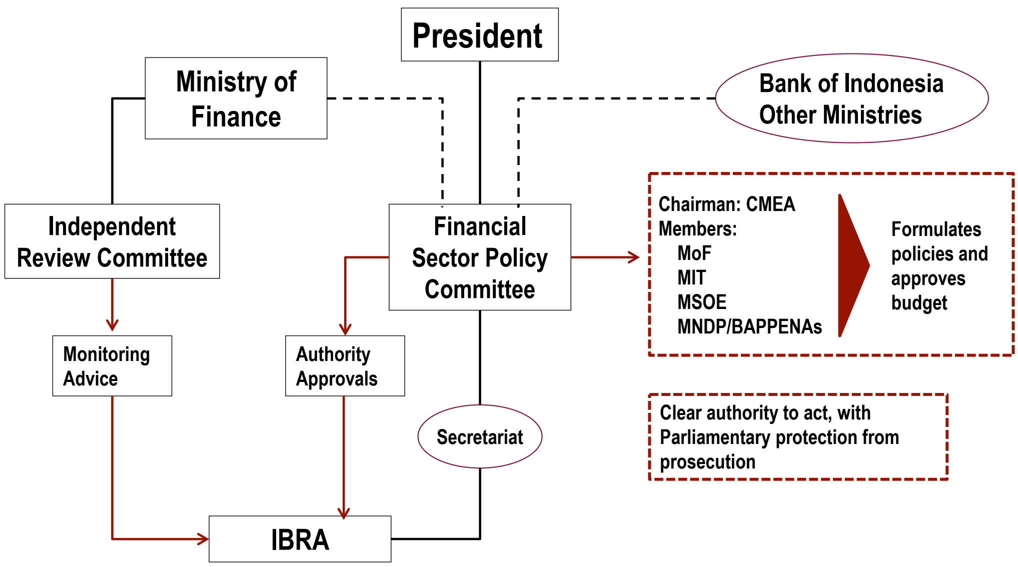
The IBRA experience shows that decisive action can be taken, quickly, by such an agency in Indonesia, and that this action will be supported when the crisis is perceived to be serious enough. So it is worth exploring how IBRA was structured, and how its governance arrangements conveyed sufficient authority. IBRA reported directly to the Minister of Finance, and was supervised by two committees, the Independent Review Committee (IRC, provided monitoring and advice) and the Financial Sector Policy Committee (FSPC, supervised IBRA and provided budgetary approval). IRC was also directly responsible to the Minister of Finance, and comprised two persons appointed by the government and three persons nominated by the International Monetary Fund, the World Bank, and the Asian Development Bank.[28] Figure 2 summarises IBRA's reporting arrangements.

FSPC had a more complicated structure and reporting arrangements. Its Chairman was the Co-ordinating Minister for Economic Affairs, and it reported directly to the President.[29] Members were the Minister of Finance; the Minister of Industry and Trade; the Minister of State-Owned Enterprise; and the Minister of National Development Planning/Head of BAPPENAS. The duties of the Committee were to formulate policies for bank and debt restructuring, optimise asset value and to approve the Annual Working Plan and Budget of IBRA.

There were some difficulties with the integrity of personnel appointed to IBRA, and there was a rapid turnover of Chairmen, with the following individuals

FIGURE 2

IBRA Reporting Arrangements



holding the post between 1998 and the disbanding of IBRA in 2004:

- Bambang Subianto, period 1998 up to March 1998
- Iwan Prawiranata, period March 1998 up to 22 June 1998
- Glen MS.Yusuf, period 22 June 1998 up to 12 January 2000
- Cacuk Sudarijanto, Period 12 January 2000 up to 6 November 2000
- Edwin Gerungan, period 6 November 2000 up to 25 June 2001
- I Putu Gde Ary Suta, period 25 June 2001 up to 19 April 2002
- Syafruddin Arsjad Temenggung, period 19 April 2002 up to 27 February 2004

One important part of IBRA's establishment was the protection of its executives from prosecution for any decision made by them. This permitted them to take difficult decisions despite political turmoil. However, this meant that it was difficult to prosecute if the individuals concerned turned out to be corrupt. In the event, although the public prosecutor made at least one arrest, and several of the above Chairmen were suspected of irregularities, no case was brought before the courts.

IBRA's role was always seen as short-term, and it was wound up in 2004. Its duties were to some extent taken over by PT Perusahaan Pengelola Aset, which is a state-owned enterprise, which was established on 27 February 2004 (based on Government Regulation No. 10 of 2004) with the objective to manage assets ex IBRA for and on behalf of Minister of Finance. The regulation is silent on the definition of assets for this purpose.

THE IMPACT OF DECENTRALISATION

The difficulties of infrastructure project implementation are exacerbated in Indonesia by the diffusion of authority across multiple levels of government. From 1998 onwards, Indonesia has transformed itself into one of the most democratic and decentralised countries in the world. Significant legislative authority has been devolved to around 1,000 local legislatures and executive officials. However, expertise and capacity at the local level is still being developed, and the resulting legal structures have added considerable complexity and uncertainty to Indonesia's legal system.

A recent OECD report summarised the situation as follows:

> *"local government's capacity, particularly in staffing and the allocation of funds, is still too limited and there is little accountability........ As the master plan identifies almost 400 infrastructure investment projects – in transport, energy, water and ICT infrastructure – to be completed by 2025, local government capacity to implement such projects needs to be bolstered..... Central government therefore needs to intervene to build local capacity, by increasing resources, training local government staff, and improving e-government tools."*[30]

The division of responsibility between the various levels of government was to some extent clarified by Law No. 32 of 2004,[31] which sets out the duties of provinces, regencies and municipalities. Central government retains responsibility for foreign policies; defence; security; judicial policies; national monetary and fiscal policies; and religious affairs. Both provincial and regency/municipal governments have responsibility for development and spatial planning, for provision of public facilities and infrastructure and for control of environmental impacts. Law no. 32 of 2004, clarified by Government Regulation no. 65 of 2005, does provide guidance on minimum service standards. In principle, these standards should guide regional and local governments in implementing infrastructure plans. Where minimum standards are not met, the central government does have power to impose penalties and sanctions, but there is no clear guideline for the central government, especially related line ministries, in imposing the penalties and sanction.

Where local laws conflict with central or provincial laws, it is left to the Indonesian Supreme Court to adjudicate. However, in "Regional Autonomy and Legal Disorder", Simon Butt argues that the intervention of the Supreme Court has typically focused on invalidating local laws which impose illegal taxation or user charges. Other local laws which may be damaging, he argues, are likely to escape review or be upheld by the Supreme Court without satisfactory explanation.[32]

The World Bank has recently highlighted the difficulties which decentralisation creates for the issue of road maintenance.[33] One of the main issues that they highlight is the lack of capacity and qualified human resources as most "experts" are still monopolized by central government rather than being distributed to local government during the decentralization process. Many local governments use up their infrastructure budget for building new infrastructure but fail to allocate enough money for maintenance because they don't see maintenance as a form of infrastructure investment. Regional government responsibilities are increasing, but they have no pool of skilled workers to hire to manage those responsibilities. The central government role in providing infrastructure is sinking, but without the ministries sharing their human resources to regional government, the ministries may become bloated and inefficient. Also, multiple small scale projects may not be able to capture economies of scale that larger projects can.

LEARNING FROM INTERNATIONAL EXPERIENCE

The effective implementation of major infrastructure projects is not easy. The need for each project has to be established and agreed, by all stakeholders and by the local community. Impacts, both on the economy and on the environment need to be assessed, with the design of the project adjusted to meet environmental concerns and the impact on existing stakeholders. Funding arrangements need to be developed, and relevant funding channels need to be authorised. Skilled and competent teams need to be assembled to construct the project, and materials need to be procured cost-effectively and in a timely manner. Regulatory, taxation and pricing arrangements need to be defined and agreed. Where non-government funding is required, especially if this is from overseas investors, the necessary due diligence and legal processes need to be undertaken. Service standards, building regulations and quality requirements all need to be defined and enforced.

These requirements have long been recognised in numerous countries, which have had considerable success in establishing agencies of the kind we describe. The pioneer of private sector investment in infrastructure, the UK, for example has now concentrated responsibility into a single agency, the Infrastructure Agency.

International examples show how the leadership role of the infrastructure body can also enhance the effectiveness of line ministries, and achieve co-ordination across funding agencies. Case studies show that close and meaningful community engagement, facilitated by the infrastructure agency, can lead to major design and delivery changes that are welcomed by local communities and improve implementation. Careful management of local and environmental impacts assists project delivery by achieving consensus among stakeholders. Many countries (e.g. UK) also have sophisticated public enquiry processes which have proved effective in refining infrastructure plans.

A number of international initiatives to improve connectivity in which Indonesia participates are also relevant. These include efforts to improve maritime co-operation, and various fora which aim to share knowledge and experience about infrastructure development.[34] In 2010, ASEAN adopted the Master Plan on ASEAN Connectivity (MPAC).[35] This includes fifteen priority projects to transform the ASEAN region, including facilitating a single market and production base and to create an economic community by 2015. There is a current focus on rail connectivity in the countries with land borders, especially Malaysia and Thailand,[36] and on ICT connectivity.[37]

Of course, Indonesia is a special case and has its own specific circumstances, not least a very dispersed geography and the decentralisation of legislative and regulatory authority. However, what works, and doesn't work, in other countries does at least provide a starting point from which Indonesia may learn. In particular, in Section 7, we highlight the parallels between Indonesia's current situation and that faced by Queensland in 2004, to which the establishment of the Queensland Project Management Office (PMO) provided a very effective response.

WHY AN EFFECTIVE INFRASTRUCTURE AGENCY IS CRUCIAL TO INDONESIA'S FUTURE

Infrastructure spending has great potential to provide a spur to economic growth. Countries such as China have used infrastructure spending to provide the basis for creating a modern, efficient, economy, and in so doing have also reduced poverty significantly. Infrastructure spending creates jobs and economic activity during the construction phase, but also creates much larger benefits in the short, medium and long term. OECD figures suggest that, in the short-run, a dollar spent on infrastructure construction produces roughly double the initial spending in ultimate economic output.[38] Over a twenty year period, generalized 'infrastructure investment' can generate accumulated $3.21 of economic activity per $1.00 spent, which in the US yields $0.96 in additional tax revenues.[39] A study of Sydney's toll roads estimated that they will increase Gross State Product by 0.89% or A$3.4 billion by 2020, and create an additional 4,000 jobs.[40] The Sydney study also estimated travel time benefits of 20%, travel time savings of 19% and accident reduction benefits of 41%.

There is little doubt that additional infrastructure spending is both needed and beneficial for Indonesia. This is recognised by the government, and forms the basis of the impressive plans for infrastructure development contained in the MP3EI Masterplan and in the plans of the major ministries and SOEs. However, when it comes to implementing these plans, Indonesia continues to run into difficulties.

Recently, for example, Jakarta faced severe floods which paralysed the CBD and caused several fatalities. To a large extent these floods were predictable, and flooding of this kind is indeed a regular feature of Jakarta life. This was recognised in 2008, when the government enacted the Presidential Regulation Number 54 of 2008 on Spatial Planning for the Jakarta, Bogor, Depok, Tangerang, Bekasi, Puncak and Cianjur Area ("Jabodetabekpuncur Areas"). This set out a number of actions, which, if implemented, would arguably have reduced the destruction created by the recent floods. The actions included rehabilitation of forest and water catchment areas; management (penataan) of river borders; normalization of river areas; development of dams and normalization of lakes; construction of flood management systems; and construction of drainage infrastructure.

However, these admirable objectives were mostly not implemented, for three main reasons. First, the budgeting system prohibited the regional government from carrying out projects which extend for a period exceeding the tenure of the Governor. Second, relevant authorities, especially Bogor Municipality/Regency Government and West Java Provincial Government, did not have the relevant budgets allocated to them. And third, land procurement for normalisation of the rivers ran into difficulties.

A further example is provided by the chronic under-investment in Indonesian port facilities. Until the creation of 2008 Shipping Law (No. 17/2008), Indonesian Ports were regulated by the 1992 Shipping Law (No. 21/1992). Pelindo I through IV acted as both regulatory authority and operator of ports within their assigned regions, giving them monopoly power. Companies that wanted to invest in port construction and operation had to obtain a concession from Pelindos or enter into a joint venture with Pelindos. Pelindos also had regulatory power over private ports, which they used to prevent competition with their own ports. They were also separated into regions, which were also not allowed to compete with each other. Private ports were not allowed to accommodate third party cargoes.

Taken as a whole, this situation led to a substantial disincentive for either private sector or indeed the Perlindos to engage in the necessary investment. Even though the 2008 law seeks to redress some of the problems, uncertainties and poor implementation have prolonged the transition period beyond the May 2011 deadline and further discouraged private sector investments. The 2008 law also contains elements which continue to reinforce the Perlindos position, for example the requirement that port authorities be wholly staffed with civil servants from Ministry of Transportation.[41]

In our work assisting KP3EI in implementing the MP3EI Masterplan, we have examined a number of other key infrastructure projects which are experiencing 'bottlenecks'. These bottlenecks are delaying the implementation and funding of projects which are desperately needed to improve living conditions and economic competitiveness. The bottlenecks include uncertainties over the regulations relating to land acquisition; slowness in the issuance of necessary permits, often by local authority officials; changes to policy which delay or prevent previously agreed funding arrangements; lack of capacity and understanding at the local level of required procedures; and inter-agency confusion.

A SUCCESSFUL EXAMPLE: QUEENSLAND PROJECT MANAGEMENT OFFICE

Queensland is the third largest state in Australia, with a population of 4.1 million, of which two thirds live in South-East Queensland (SEQ). Because of worldwide, and particularly Chinese, demand for resources, Queensland has been growing rapidly, with an annual GDP growth rate of 4.75% (compared with 2.2% for Australia as a whole). This has put enormous pressure on Queensland's infrastructure. Because of the resources boom, and a vibrant tourism industry, SEQ is the fastest growing urban region in Australia, with an additional 1200 people/week living there. In 2003 Brisbane was the cheapest Australia capital city to live in, but by 2008 it became the most expensive.

SEQ consists of 18 local governments including Brisbane and the Gold Coast, with a current population close to 3 million which is expected to double by 2026. SEQ experienced increased demand for schools, hospitals, transportation and other services. By 2005, massive infrastructure and public services bottlenecks had built up. Consecutive Treasurers since 1998 had opted for a 'surplus budget' as the mantra of state finances, and basic infrastructure provisions such as new schools, hospitals and transportation were not funded.

In 2005 the Queensland Government released a 20 year infrastructure plan for SEQ, the South East Queensland Infrastructure Plan (SEQIP), which identified 440 projects at an estimated cost of A$55 billion, which was revised in 2007 to A$66 billion, in 2009 to A$107 billion, and in 2010 to A$131 billion. Large projects were designed to be jointly funded by government and the private sector as PPPs. The Queensland Project Management Office (PMO) was established, under the Treasurer and the Coordinator General (CG), to manage the process.

SEQIP consisted of 440 projects including roads, hospitals, schools, recycled water treatment plants, prison etc thus a solid pipeline creating certainty of investment. The historic 10 year budget provided certainty that the projects would be implemented, thus enabling the private sector to increase resources. PPP schemes varied from BOT for tunnels, to PBAS schemes for hospitals and prisons etc. Transactions Management was considered as a key requirement for all infrastructure projects seeking investors. Most PPP models were developed in consultation with investors to ensure market acceptability based on the project fundamentals. Projects were only allowed to go to tender after a fully costed Business Case was approved, and the risk sharing framework developed by PMO was considered one of the best for both protecting the government and attracting serious investors.

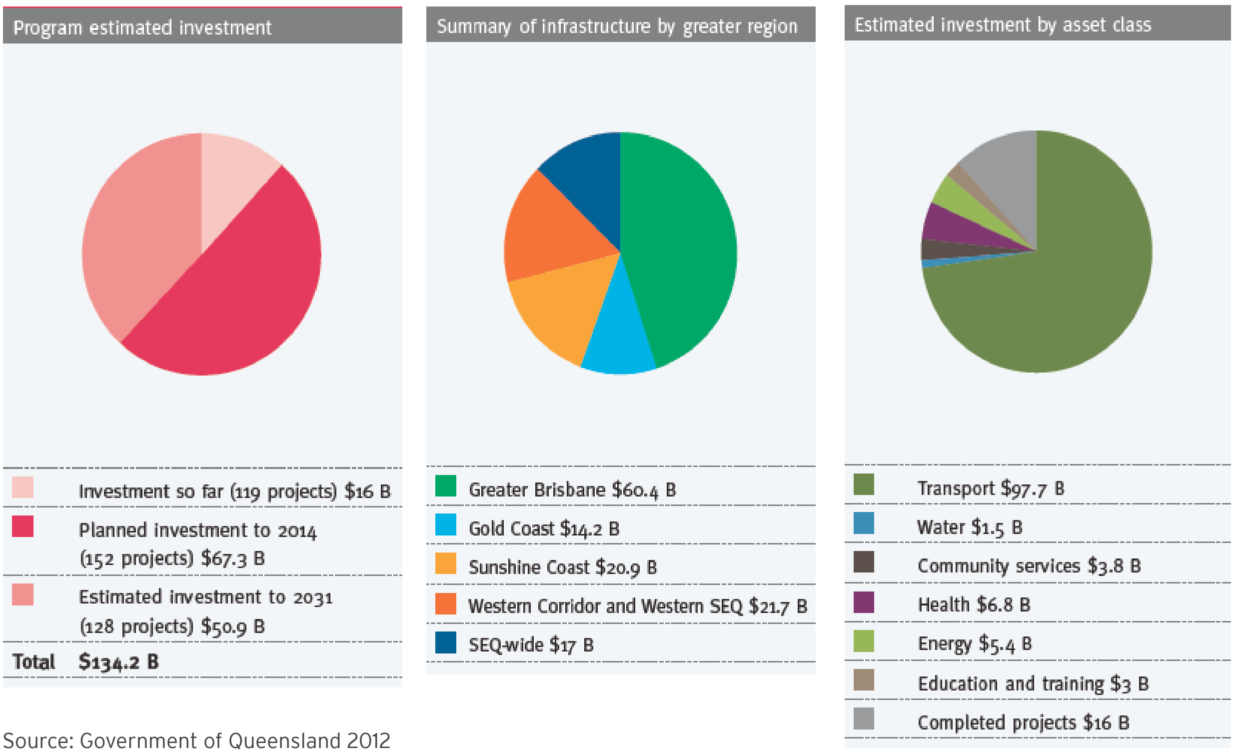
PMO's internal resources were cost effective. The PMO was resourced by 6 private sector Consultants (including Raj Kannan, one of the authors) working with 6 government servants all with the government department badges. PMO was empowered to hire consultants and advisers as needed to deliver projects. The historically impotent PPP Centre under Department of State Development was moved to the Treasury to give it the fiscal muscle that was lacking. PMO later moved to under a newly created Department of Infrastructure Delivery under the Treasurer with project priority oversight by the CG.

Among the most progressive powers created by the CG for the delivery of SEQIP projects was the agreement by the 18 local governments within South east Queensland to agree that their usual planning and approval powers for the 440 projects were novated to the CG and this enabled smoother implementation. The PMO was also given considerable implementation powers in ensuring that the line ministries understood that any slippage in their own milestones to deliver key projects without a compelling reason may result in the PMO taking the delivery of the said delayed project.

Overall, the evidence shows that Queensland achieved unprecedented development of infrastructure led by the PMO, which was itself a partnership between the private sector and government officers. By the end of 2007, two years after the establishment of the Program Management Office 160 SEQIP Projects were completed (most within 18 months) with an investment of A$3.3 billion. Two major PPP transactions achieved closure in 14 months from business case development, an Australian record. Figure 3 summarises what the PMO achieved in the five years from 2005 to 2010.

FIGURE 3

Achievements of Queensland Project Management Office by 2010



Source: Government of Queensland 2012

ESTABLISHING THE REVITALISED KKPPI

As we have discussed above, Indonesia faces severe problems with infrastructure project implementation. Despite ambitious plans, and the good intentions of the various agencies involved in the process, the actual development of key infrastructure is lamentably slow.

All of the above requires clarity of purpose which is often lacking in Indonesia. Too frequently, aspects of project implementation are carried out by one agency without sufficient regard for the other requirements of the project. Issues which involve multiple agencies can take a long time to resolve as meetings, letters and other interactions are required, and the process needs to be fitted into already heavy work schedules. A strong and empowered agency has the potential to solve this problem, provided that the stakeholders both in government and in the wider community accept its mandate. Empowerment of such an agency requires the bringing together of legal, fiscal, executing and monitoring powers. At the moment, these powers are diffused across the Parliament, the Supreme Court, the Ministry of Finance, BAPPENAS, the Line Ministries, and local and provincial governments.

Coordination between ministries is especially slow because when a report (or feasibility study, etc) is passed from one ministry to another ministry for review, it can take months before the other ministry starts reviewing it. In the land acquisition law, the procedure is clearly stated and the maximum amount of days to do each procedure is prescribed. Something similar would be helpful to ensure prompt actions by ministries when reviewing projects of National importance. But without this type of law, an empowered agency that are unlikely to keep to the project schedule by an agency with strong powers of intervention.

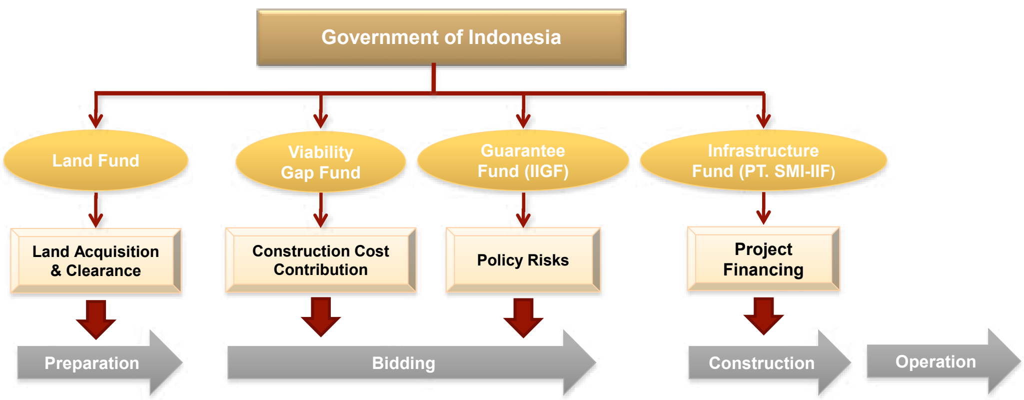
There is also a lack of centralized planning - each ministry has its own planning, which often results in a confusion of responsibilities. As an example, there is no clear guidance for some toll roads about which section is going to be made a toll road (under BPJT) or non-toll road (under Bina Marga). This creates potential for conflict between BPJT and Bina Marga about which institution should do the project preparation. An empowered agency could take the responsibility of making an infrastructure masterplan for the country and have the authority to divide work between institutions.

In addition to these institutional problems, there is a lack of capacity and understanding among relevant staff at various levels of government. In a recent study, Bustmaan & Ramayandi explored the problems faced by government officers in facilitating PPPs in Indonesia.[42] They identified lack of clear policy in conforming to international standards; lack of skills for identifying, analysing, and developing PPP projects; the long and unfamiliar procurement process; lack of coordination; high transaction costs; and lack of effective capacity building as major problems. They recommended the setting up a dedicated PPP unit with policy, project and technical advisory, facilitation and capacity building capabilities.

KP3EI was established to assist the President in implementing the MP3EI Masterplan. It was charged with prioritising infrastructure projects, with remaining bottlenecks on key projects and with establishing connectivity between projects. Much progress has been made on all these fronts, a process with which Kannan and Morris have assisted. A set of 40 prioritised projects has been defined, connectivity requirements have been established and the debottlenecking efforts have solved problems in some key areas. However, KP3EI was set up purely as an advisory body with limited budgets and resources. It does not have the capability and resources

FIGURE 4.

Institutional Support for Infrastructure in Indonesia



Source: Establishing Dedicated PPP Unit within the Ministry of Finance, MoF, 5th February 2013 to implement major projects, nor does it have the authority to compel stakeholders or other government agencies to comply with necessary procedures. All it can do is explain problems clearly, facilitate meetings between other stakeholders and make suggestions about innovative solutions to solve bottlenecks.

There has been considerable discussion about what the best basis might be for a properly empowered agency. The starting point has been agreed to be a revitalised KKPPI, in close relationship with the Ministry of Finance. We believe that this is the correct decision, and that KKPPI has considerably more chance of becoming effective now than it had in 2001. In part this is because institutional support for infrastructure is already much improved, as shown in figure 4.

Indonesia has already established a Land Fund, a Viability Gap Fund (VGF), the Indonesia Infrastructure Guarantee Fund (IIGF), supported the establishment of of non-bank Infrastructure Funders - one wholly owned by the Ministry of Finance (PT SMI) and the other partly owned by the Ministry of Finance (PT IIF) and a Geothermal Fund (under the Government Investment Agency called PIP). In addition, the Ministry of Finance is also currently establishing a PPP unit directly under its purview to increase the role of the fiscal agency to provide the increased confidence required by the infrastructure investors that the PPP concession agreements signed by the line ministries do in fact have the support of the fiscal agency. This has been one of the most glaring gaps in the government's efforts to deliver infrastructure projects since the existing PPP Directorate under the National Planning Agency (Bappenas) lacks the fiscal power that most PPP Units have in countries where PPP projects have successfully been delivered – such as Australia, India, South Africa and United Kingdom etc.

As mentioned earlier, the government has also established a state owned infrastructure guarantee provider called Indonesia Infrastructure Guarantee Fund (IIGF). IIGF, wholly owned by the Ministry of Finance is mandated to:

(1) improve the creditworthiness of the PPP infrastructure projects by giving guarantees against infrastructure risks,

(2) improve the governance and the transparency of the guarantee process to the infrastructure PPP Projects related to the government actions or inactions,

(3) facilitate deal flow for Contracting Agencies (ministries, state-owned enterprises, local government) by providing guarantees to well-structured PPP projects, as well as,

(4) ring-fence government contingent liability and minimize sudden shock to government budget.[43]

Essentially, IIGF assumes the role as the State guarantee provider to the private sector for various PPP projects related risks, which may lead to financial losses to the PPP infrastructure projects, such as delays in the issuance of permits and licenses, delays or failure by the line ministries to abide by the tariff adjustment clauses stated in the concession agreements, changes to the government regulations that impact only one particular concessionaire, failure to integrate the network/facilities and other common risks related to PPP schemes. While it is still early days, IIGF has hit the ground running and has played a key role in the successful awarding of a $4billion power project to international bidders where its has provided the so called "first loss guarantee' against the performance of the State electricity utility company.

These new institutions and financial support schemes – namely the land fund, the viability gap fund, Geothermal Fund, IIGF, PT SMI and PT IIF - are collectively designed to act and function as effective partners of KKPPI in the delivery of infrastructure projects in the near future.

Over and above these partnerships, to make the revitalised KKPPI effective, it will require at a minimum a well specified strategic plan and road map, and the authority to act quickly and effectively, with appropriate protection for managers (as was granted to the managers of IBRA). Proper budgets will be needed to enable KKPPI to hire well-qualified staff and external consultants. KKPPI must have a clear mandate, with measurable targets and performance indicators.

It will need active support from all the major stakeholders, including the President, Ministry of Finance, BAPPENAS, Ministries, Provincial and Local Governments. There needs to be commitment to support KKPPI's funding initiatives, as well as well-orchestrated public dissemination of objectives and purpose, to achieve wide support from the community. This will also require transparency and accountability, including regular public reporting and scrutiny by Parliament.

KKPPI must be granted the authority to determine solutions to remove barriers to investment, strong support from the President, Parliament, regulators and the courts. KKPPI will need an effective governance structure, like the Committees which guided IBRA. We suggest that it acts as secretariat to, and is guided by, a Committee ("The Committee") consisting of MoF (who will provide guidance on VGF issues and interface with the new MoF PPP unit), BPN (for land issues), CMEA (for economic priority issues), BAPPENAS (for planning and PPP issues), IIGF (for government guarantee issues for PPP projects) and MPW, MOT, PLN and other GCAs on a project by project basis.

KKPPI should be fully funded (by MoF) and the head of KKPPI should have similar rank as a Minister. It should have the mandate and authority to take over the coordination of the delivery of key projects identified by The Committee, including the right to mobilise various government agencies and private sector consultants to undertake feasibility studies, develop tenders and select winners and monitor implementation of the selected projects. KKPPI will gain its 'rights and authority' to coordinate the delivery of the selected projects both via the strength of the Presidential Decree as well as through recognised role as a true Coordinator.

KKPPI should also play a key role in education and capacity building for regional government, standardization of SOP and quality, relocating central "experts" to lead regional government's infrastructure team, and / or providing outsourcing options for regional government. A possibility is the establishment of province wide infrastructure maintenance programs that regional government can opt into, so they don't need to manage their own program and hence suffer from economies of scale. Initiatives of this kind would enhance substantially the ability of regional government to perform.

To succeed, KKPPI will need to interact effectively with existing agencies, all of which have a crucial role to play. KKPPI will in all instances defer to the GCA's right as the project owner and will work with the GCA purely in the interest of ensuring the project is delivered on time. GCA's should appreciate KKPPI's financial strength to fund the project preparation and transaction management, in close coordination with the relevant agencies like IIGF and PT SMI for example. KKPPI will have the financial resources to appoint consultants and advisers to prepare the projects for tender as well as coordinate the provision of RMU's VGF (if appropriate) and IIGF's guarantee (if appropriate).

The PPP Directorate of BAPPENAS will continue to perform its functions to select projects for inclusion in the BAPPENAS Blue Book. There will be no change to their functions. However, for projects that are selected by The Committee as priority, KKPPI will coordinate delivery. There will be no interference to the functions of Indonesia Infrastructure Guarantee Fund (PT. PII), rather KKPPI will simply coordinate and ensure any bottlenecks in the selected projects are removed in a speedy fashion. In projects that PT. Sarana Multi Infrastruktur (PT. SMI) are transacting for and on behalf of the priority projects, KKPPI will monitor the progress and where needed it will assist and coordinate removal of bottlenecks. KP3EI agency will continue with its role in the implementation of MP3EI, although its connectivity role may be transferred to KKPPI.

To summarise, it is crucial that KKPPI have financial strength, the power to appoint external resources to prepare and deliver projects and the legal ability to take over project delivery. There have been too many examples in the past where agencies have been established with a strategic and forward looking intent only to be reduced to a non-functional entity simply because they lack the financial strength and ability to fund the required works. In Indonesia (unlike most countries), who pay for the cost of the project preparation is a constant issue with no clear and efficient solution in sight. Unfortunately most projects are not even ready for the private sector to consider – they lack the basic business case of why the private sector should do the project and how will they recover their investments. This is the component that most crucially needs funding. GCAs often start a project and then due to changes in priority or due to lack of funds delay the delivery of these projects. If GCAs miss a milestone then the right of KKPPI to take over the delivery process should be automatic.

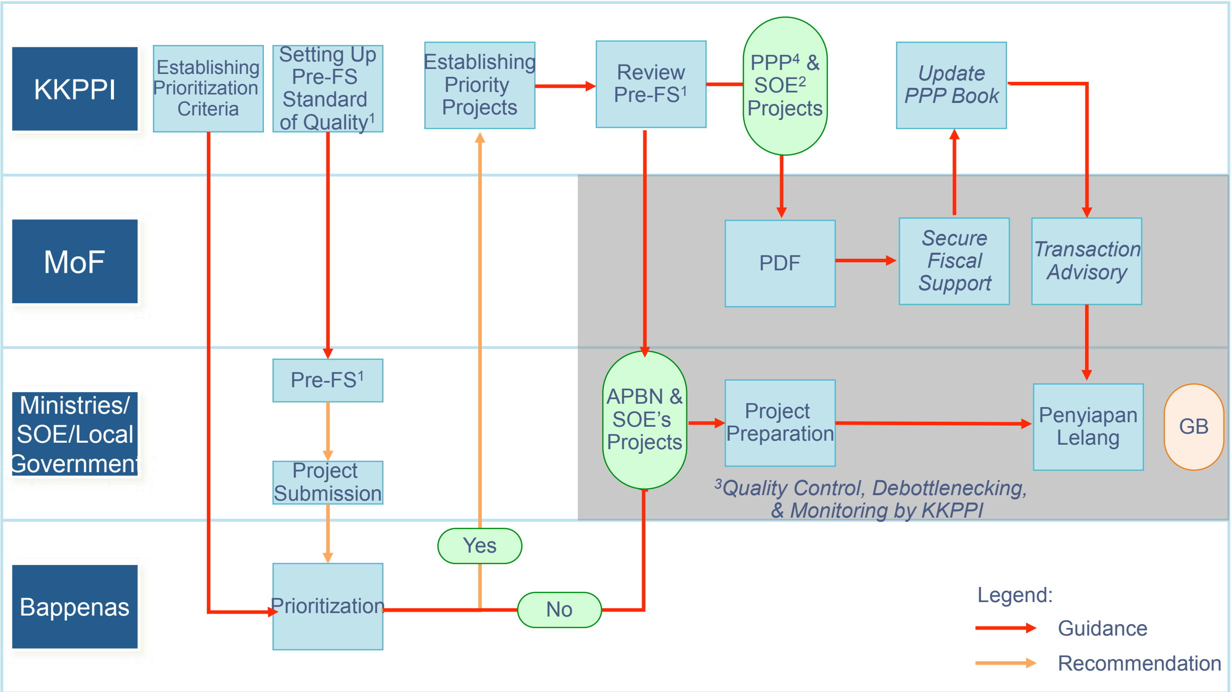
Considerable preparatory work is needed to further define how KKPPI should be structured, and how its governance arrangements should be refined.

To conclude, we have also sought to define how KKPPI should interact with other agencies during the evolution of each project, a process that is summarised in Figure 5.

KKPPI will play an essential role in establishing prioritisation criteria, in setting standards, and in establishing priority projects. The Committee will have the final say on which projects are selected. KKPPI's implementation role will include the review of PPP and SOE projects prior to submission to MoF for funding approval. KKPPI will also play a role in each revision of the PPP Blue Book.

FIGURE 5

KKPPI's role in the development of priority projects



CONCLUSION

Indonesia has made significant improvements to institutional structures. The Land Fund, VGF, IIGF, PT SMI, IIF and KP3EI are all making valuable contributions. However, more needs to be done. Co-ordination is still not strong enough, and authority and responsibility are too dispersed. GCA's do not exhibit enough urgency, and decentralisation has complicated authority structures. Decentralisation has added complexity, uncertainty and increased challenges of co-ordination. International experience shows that a dedicated infrastructure agency can play a crucial role. China, Australia and UK, along with other countries, show what can be achieved. Queensland PMO provides valuable insight from which Indonesia can learn as it establishes an effective infrastructure agency.

KKPPI was supposed to be such an agency, in response to the collapse in infrastructure spending. A revitalised and strengthened KKPPI could be more effective now, provided it is established well. It would act as a close collaborator with MoF, GCA's etc, but would not supplant the roles of other agencies. KKPPI should also act as the clearing house for funding of priority projects, in a similar way to Infrastructure Australia, for example; KKPPI must have more than it had previously; greater support from other agencies, financial strength, the power to appoint external resources, the legal ability to take over project delivery when other agencies miss deadlines – something similar to the PMO in Queensland.

Assuming that the political process agrees, the establishment, empowerment and resourcing of KKPPI along the lines suggested in this paper, and that the other agencies and governments at all levels work with KKPPI on a constructive basis, we believe that KKPPI can make a big difference to the effectiveness of infrastructure development in Indonesia.

ENDNOTES

1. Raj Kannan, Founder and Managing Director of Tusk Advisory Pte Ltd (Tusk), a leading infrastructure strategy and investment advisory firm with a significant presence in Indonesia. He is currently the lead international advisor to the Indonesian Coordinating Ministry of Economic Affairs in the implementation of MP3EI and was formerly a private sector member of the Queenslandís Program Management Office (PMO) for the delivery of ìSouth East Queensland Infrastructure Plan and Program SEQIP 2006 ñ 2026.

2. Nicholas Morris is a Director of Tusk, and he is the Team Leader for a technical assistance supporting the KP3EI Secretariat, which has been mandated to oversee the rollout of projects in MP3EI.

3. These are quality of private and public institutions; infrastructure; macroeconomic environment; health and primary education; goods market efficiency; labour market efficiency; financial market development; technological readiness; market size; business sophistication; and innovation.

4. However, bureaucratic problems are highlighted: Indonesia ranks 121st poorest out of the 139 countries in the number of days it takes to start a business, and 89th in the burden of customs procedures.

5. Indonesia ranks only 107th out of 139 countries for Internet users, and 102nd for Internet bandwidth.

6. The Indonesia Competitiveness Report 2011: Sustaining the Growth Momentum, Thierry Geiger, World Economic Forum, June 2011.

7. Indonesia was ranked 25th in the 2012-13 GCI.

8. The Global Competitiveness Report 2012ñ2013, Professor Klaus Schwab and Professor Xavier Sala-i-MartÌn, World Economic Forum 2013, P200.

9. Indonesia ranks 90th, 104th, 89th and 93rd out of 144 countries for these infrastructures.

10. Structural Policy Country Notes: Indonesia, In Structural Policy Challenges For Southeast Asian Countries, Southeast Asian Economic Outlook 2013: With Perspectives on China And India, OECD 2013.

11. CGI also highlights the health situation, where Indonesia ranked 99th out of 139 countries in 2010.

12. G. Sugiyanto, S. Malkhamah, A. Munawar, H. Sutomo, Estimation of congestion cost of motorcycles users in Malioboro, Yogyakarta, Indonesia, International Journal of Civil & Environmental Engineering IJCEE-IJENS Vol: 11 No: 01, February 2011.

13. US$1=IDR 10,000 approximately

14. G. Sugiyanto, S. Malkhamah, A. Munawar, H. Sutomo, Estimation of congestion cost of motorcycles users in Malioboro, Yogyakarta, Civil Engineering Dimension, vol. 12, no. 2, pp. 92-97, September 2010.

15. Infrastructure Development Strategy In Indonesia, Ministry of National Development Planning / National Development Planning Agency (BAPPENAS), January 2011.

16. The OECD estimates suggested a funding gap of IDR 324 Trillion in the period 2010 to 2014.

17. Under Presidential Decree No. 81 of 2001.

18. Minister of Home Affairs; Minister of Finance; Minister of Energy and Mineral Resources; Minister of Public Works; Minister of Transportation; Minister of Communication and Information Technology; Minister of State-Owned Enterprises; Minister of Forestry; Minister of Environment; Cabinet Secretary; Chairman of the Investment Coordinating Board; and Chairman of the National Land Agency.

19. The Deputy Coordinating Minister for Economic Affairs in Coordinating Region Infrastructure and Development; and the Deputy Minister for National Development Planning/Chairperson of the National Development Planning Agency in Facility and Infrastructure, respectively.

20. Information on how often KKPPI met between 2001 and 2005 has proven difficult to obtain, as relevant records seem to have been mislaid.

21. Under Presidential Decree No. 42 of 2005.

22. Including in respect of the implementation of Presidential Decree No. 15 of 2002 on Revocation of Presidential Decree No. 39 of 1997 on Postponement/Reviewing of Government, State-Owned Enterprises, and Private Projects which Related with Government/ State-Owned Enterprises in Infrastructure Sector.

23.Identifying the output of KKPPI in this period has also proved difficult, as the disbanding of the secretariat in 2011 seems to have co-incided with the loss of most of the relevant documents and records.

24. Also known as Badan Penyehatan Perbankan Nasional (BPPN).

25. With its establishment further defined by Government Regulation No. 17 of 1999 on IBRA as amended several times, most recently by Government Regulation No. 47 of 2001.

26. Political difficulties also led to the head of IBRA being replaced.

27. 30% of BCAís shares were held by President Suhartoís children.

28. IRC was established under Presidential Decree No. 90 of 1999.

29. FSPC was established under Presidential Decree No 177 of 1999.

30. Structural Policy Country Notes: Indonesia, In Structural Policy Challenges For Southeast Asian Countries, Southeast Asian Economic Outlook 2013: With Perspectives On China And Indiaí, OECD 2013.

31. Further clarified by Government Regulation No. 38 of 2007 on Distribution of Authority between Central Government, Province Government and Regency/Municipality Government.

32.Regional Autonomy and Legal Disorder: The Proliferation of Local Laws in Indonesia, Simon Butt, Sydney Law Review, Vol 32:176-191, 2010.

33.Averting an Infrastructure Crisis: A Framework for Policy and Actioní, World Bank Jakarta, 2004.

34.A helpful summary of these initiatives may be found in Ted Osius and C. Raja Mohan, Enhancing India-ASEAN Connectivityí, Centre for Strategic and International Studies, June 2013, especially Chapters 2 and 3.

35.See Sanchita Basu Das, Enhancing ASEAN's Connectivity, Institute of Southeast Asian Studies, 2013.

36. Through the Connectivity through railí initiative, see http://www.asean.org/news/asean-secretariat-news/item/asean-forum-pushes-for-increased-rail-capacity-in-the-region

37. See for example The Master Plan on ASEAN Connectivityí, Dr. Somsak Pipoppinyo, Director of Finance, Industry and Infrastructure Directorate, presented at ASEAN Secretariat ASEAN CIO Forum, 19 ñ 20 April 2012, Bangkok, Thailand, http://www.aseancioforum.com/LinkClick.aspx?fileticket=8DpYLdaCgqw%3D&tabid=210&mid=655.

38. Figures provided by Dr Alo Ghosh, ìEconomics of Public Private Partnerships: Theory, Practice, What Works, What Doesnít, October 2012.

39. The Economic Impact and Financing of Infrastructure Spending 2012, Isabelle Cohen, Thomas Freiling and Eric Robinson, Thomas Jefferson Program in Public Policy, Williamsburg, Virginia. The study utilises the Bureau of Economic Analysisís Input Output Accounts, for the years 1998 through 2009.

40. The economic contribution of Sydneyís toll roads to NSW and Australiaí, Ernst and Young report for Transurban, 2008.

41. Who have long pre-existing relationships with Perlindos.

42. Ramayandi, Arief & Bustaman, Arief (2011), An Evaluation on Institution of Public Private Partnership (PPP) in Indonesia. In H. Handra, et.al, eds (2012).

43. As per the IIGF website.

RAJ KANNAN

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Nicholas Morris is a Director of Tusk and has over 30 years experience in advising governments and corporations in major infrastructure programs and projects with particular focus on energy sector including geothermal.

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