

Country case study: Indonesia

WHY READ THIS CASE STUDY?

- A** Indonesia has come a long way in toll road development. Projects stretch back some 30 years and over 1,000 km have been built. However, compared to other Asian countries, PPP development has been limited.
- B** The first major regulations and PPP initiatives in the late 1990s, were halted by the Asian crisis. The second round of PPP measures have been slow to take off even after the new PPP regulations were passed in 2005. So far only two toll roads have been offered under the PPP framework.
- C** Both of the toll roads mentioned above were ad hoc i.e. not identified, ranked or prioritized under any objective PPP analysis and both require substantial government support. The first toll road offered under PPP may be agreed this year (2008).
- D** Government has recognized that PPP in toll roads is essential but that many proposed highways, although economically viable are weak in financial terms. The government's regulations therefore provide for government support in a number of different ways depending on the type and characteristics of the project. PBC is proposed for a number of projects.
- E** There is a major need for a pipeline of suitable PPP projects tendered through the PPP framework and the development of a few successful highway projects through competitive PPP contracts, with continued strong support from the multilaterals and especially the World Bank and ADB.

Background to PPP in Indonesia

Pre-Asian crisis up to 1998

Indonesia's experience with the private sector and public infrastructure dates from the early 1990s. By the end of 1997 (start of the Asian financial crisis) it had attracted over USD 20 billion in investment, dominated by electricity (USD 10.2 billion), telecommunications (USD 8.4 billion) and transport-mainly highways (USD 2.1 billion). In some cases positive results were achieved while in others major difficulties were encountered.

In 1997, during the early part of the Asian crisis, the Government of Indonesia (GOI) through the Ministry of State Development Planning (Bappenas) reviewed PPP projects that had been committed by various Ministries and/or state-owned enterprises (SOE's).

In common with several other countries in the region, Indonesia focused on using the private sector to develop greenfield projects.

The Bappenas review concluded that structural reforms tended to lag behind (with little progress in pricing and subsidy reform), the regulatory framework was not sufficiently credible, and the issue of proper competition was not adequately addressed. Projects tended to be procured through a non-transparent unsolicited process, giving rise to poor governance (corruption, collusion and nepotism).

From this review, it was considered that an effective system must be in place to oversee the PPP program. It was decided to accelerate the establishment of a national policy by developing a cross-sector policy and regulatory framework for PPP.

Consequently, regulation Keppres 7/1998, (hereafter described as the 1998 PPP Regulations) on the Cooperation between the Government and Private Enterprise for the Development and/or Management of Infrastructure) was issued in 1998.

However, it should be noted that a Keppres is a decision or regulation issued by the President and does not over rule national laws or the constitution. Therefore where such regulations contradict or are in conflict with higher levels they cannot be applied.

The Keppres defined the GOI's policy on PPP and how to monitor such projects. Key policy objectives included expanded infrastructure investment and to receive greater value for money from PPP projects. It set out the broad principles transparency and competitive bidding and protection of the interests of the consumer and investor under which PPP projects were to be undertaken.

1998 PPP Regulation also assigned Bappenas the responsibility to produce a draft operational guidelines manual (OGM) for its implementation. Bappenas was thus charged to oversee and administer the PPP program, being responsible for monitoring its implementation for compliance with 1998 PPP Regulation, as well as identifying and prioritizing projects to be undertaken on a PPP basis. Moreover, approval from a Procurement Evaluation Team (An inter-ministerial body) was required before a PPP concession was awarded publicly.

During and Post Asian Crisis

The Bappenas guidelines, though drafted, were never used for all intent and purposes because of the Asian crisis, when most infrastructure development (and all PPP) was effectively at a standstill for 5-6 years.

Since its promulgation, the administrative machinery for the implementation of 1998 PPP Regulation has undergone significant changes and reform, especially with the establishment of the Committee for the Policy on the Acceleration of Infrastructure Development (KKPPI) in 2001.

KKPPI is an inter-ministerial committee chaired by the Coordinating Minister for Economic Affairs and was established in 2001. Its membership comprises 10 key infrastructure ministries and its main function is to accelerate infrastructure development and is tasked with policy and strategy formulation. Part of its task is to develop an effective PPP

framework (to replace 1998 PPP Regulation) that is consistent with policy, regulatory and institutional reforms that have occurred. Many of the principles featured in 1998 PPP Regulations and the draft operational guidelines, however, remain relevant to this day.

The secretariat of KKPPPI is managed by both the Deputy for the Coordination of Infrastructure and Regional Development (CMEA) as the First Secretary and the Deputy for Facilities and Infrastructure (Bappenas) as the Second Secretary. Such overlapping responsibilities is not unique but has probably reduced the effectiveness of the PPP laws and regulations.

The formulation of a PPP framework as one of the main tasks of KKPPPI, and it focuses on PPP implementation and developing a PSO framework. The definition of infrastructure in the regulations includes transportation, which in Indonesia is split between two ministries, Transport, for non road transport infrastructure and Public Works, for road infrastructure.

From the viewpoint of the private investor, government policy declared that PPP projects should entail:

- A Fair Rate of Return on Investment
- Transparent Procurement Procedures
- Predictable and reasonable performance standards

These, and orderly mechanisms for making adjustments to tariffs and settlement of complaints and disputes, are necessary. This requires that the Government create a legal and regulatory framework that will encourage the private sector – in exchange for an attractive and agreed rate of return - to assume and manage the risks of building, owning and operating infrastructure facilities throughout an agreed concession period, which may be 20 years or more.

This also means that tariff setting must be transparent, and the revenue earned by the investor should, in principle, be enough for full cost recovery. If this makes the costs of any services unaffordable for some disadvantaged users, government subsidies to close this gap must be properly quantified and targeted in order to make certain that the subsidies benefit only those recipients in need.

A demonstration of this commitment is shown in that two further presidential regulations were passed in 2005 including a major PPP regulation on Government Cooperation with Business Entity in the Provision of Infrastructure (replacing the 1998 PPP Regulations). A Policy Package on Infrastructure Provision was also announced by the Coordinating Minister of Economic Affairs in mid-February 2006.

The 2005 PPP Regulations provided the GOI's cross-sector regulatory framework for PPP. Issued in November 2005, it had four main objectives, i.e. to provide a credible regulatory framework; to ensure clarity and predictability of the rules of the game for infrastructure investment; to promote sustainable infrastructure provision; and to ensure accountable, competitive, fair and transparent PPP procurement.

The 2005 PPP Regulations had important features that were to be elucidated subsequently, namely:

- the general principles of Partnership (mutual needs, mutual support and mutual profitability);
- the importance of government due diligence (in preparing the social cost benefit analysis, capital cost scrutiny, environmental study, and choice of PPP modalities);
- commercial issues, including tariff setting and adjustment, risk management, and government support; and
- fair, transparent, competitive and accountable procurement of the PPP concessionaire.

Recent Developments 2007-

These two regulations were still not considered sufficient to create an effective PPP framework and amendments are under finalization. An Operational Guidelines Manual was prepared in 2006 to elucidate the regulations in significant detail.

While the 1995 regulations built on previous regulations, they had both structural and detailed limitations. At the detailed level, it suffered from not being fully complete (e.g. more detail was required on the consultation process), had contradictory sections (Conventional Public and PPP procurement mixed up) and its elucidation through Guidelines had no legal status.

However, it should be noted that technically the draft law would probably have been adequate, even if imperfect.

It is currently (June 2008) envisaged that the manual will soon be supplemented by these legislative, policy and institutional amendments - as explicitly indicated in the Policy Package - that will make the cross-sector PPP framework fully functional.

It is understood that revisions to the 2005 regulations will be finalized soon. However, issues remain to be finalized including several small but crucial proposed changes including;

- retendering in case of weak bidding
- unsolicited bids
- the role of SOEs in the PPP process

A PPP central unit is being established by KKPPI to assist users of the PPP Guidelines manual and to ensure compliance with the PPP Regulations. Legal decrees will further define the scope, function and organizational structure of the KKPPI secretariat, including the relationship of the PPP Centre to the network of PPP nodes to be established.

Toll road sector and PPP

Historical Development

There can be said to be at least three periods for toll road development in Indonesia;

- **First period:** State development of toll roads under public financing, 1978-1990
- **Second period:** Toll road concessions 1990-2001 (Including Asian Crisis)
- **2001 onwards:** Reactivation of toll road concessions and the start of the development of the PPP framework proper

First Period

Indonesia's experience with toll roads began in 1978 when Indonesia's first toll road was financed by the Government and transferred to Jasa Marga as equity. Jasa Marga was then the only (state owned) company in the sector authorized to operate toll roads. The Jagorawi toll road with a total length of 59 km started operating in 1978 which connected Jakarta, Bogor and Ciawi.

The development of subsequent Jasa Marga toll roads in the first period was financed primarily by a combination of foreign loans (lent by the Government), and Rupiah bonds issued by Jasa Marga.

In earlier toll roads in Indonesia, there was an expectation that loans to toll road concessions would be backed up by Jasa Marga, and/or the government, and thus lenders' project appraisal was quite limited.

The first period of toll road development cannot be defined as development under PPP. At the end of 1980's, the government invited the private sector to take part in the development of the toll road network through types of Build, Operate and Transfer (BOT) schemes.

Second Period

After legal changes in 1987 and 1990, Jasa Marga, had the authority to cooperate with other parties and grant concessions for toll roads.

About a third of this network has been developed by private consortia, with Jasa Marga as a minority equity partner in each consortium.

Equity investment in private toll roads has been sourced exclusively from domestic investors, while debt has been financed by a mix of domestic bank lending and commercial paper, some of which was purchased by foreign buyers. Once the concessions are reformulated with proper public-private risk sharing, private financiers would need to take on more risks, namely commercial risks of toll road development and operation. Generally speaking, individual toll road project assets are considered riskier than a portfolio of diversified toll road assets (e.g., Jasa Marga corporate risk).

Third Period

This period is the current (post Asian crisis) period. This is characterised by two main types of toll road and PPP activities.

The Government is reactivating the toll road projects that stalled or were put on hold as a result of the crisis of 1988-2000. After 2001 the Ministry proposed proceeding quickly with toll road projects totalling 322 km. However private interest was limited and many 'non compliant with the new PPP regulations' bids were received in response to attempts to tender.

This period is also noted as a period of change including:

- Regulatory reform to support private sector involvement in Toll Roads;
- Some project transactions and progress, and
- Proposals for Toll Road Model Projects under the PPP regulations.

The PPP Background and the Transport Sector

Sector Organization for PPP

Under the 1998 PPP Regulations the scope of infrastructure includes toll-roads and bridges. This sector, regulated by separate law, is the responsibility of the relevant line ministry i.e. Public Works. As of 2005, the infrastructure sector laws include the (higher) Law no. 38/2004 on Roads that give mandates to the line ministries and the various PPP regulations under Presidential decrees.

This legal structure is the same across most line ministries, and thus, as there are many sector responsibilities for infrastructure development, effective coordination is essential. KKPPPI's role in this area is therefore critical. Therefore, KKPPPI developed a policy package for implementing PPP, consisting of policy, regulatory and institutional elements.

Each line ministry will also establish a PPP node or cell, which are designed to be fully coordinated with the center and each other. One of the node functions is to assist the PPP Centre to monitor compliance with the PPP Regulations with the aid of these PPP Guidelines.

A PPP network is necessary in Indonesia because PPP projects are implemented in a decentralized/line ministry manner and because Indonesia decided, probably correctly that each sector faces sufficiently different issues (compare toll roads to power stations) to warrant a sector basis, even though of course many issues such as competition, transparency and good project preparation are cross sectoral PPP requirements.

One aim of the PPP Centre and PPP nodes will be to ensure each PPP transaction, independently of the sector, goes through consistent quality control. Another is to address constraints to improve the PPP framework over time.

A ministerial decree in the Ministry of Finance (MOF) set up a risk management unit (RMU) to decide on and manage the provision of fiscal support to PPP infrastructure projects.

It should be noted that much of the work undertaken within GOI, including at various levels, such as Bappenas, CMEA, KKPPPI, Public Works, Transportation and other line ministries has been funded under technical assistance provided by WB and ADB under both substantial grants and loans.

Therefore many reports, guidelines and draft laws and regulations have been produced by advisors with GOI support but still the progress on PPP is limited especially in roads and the transport sector overall.

There may be some explicit reasons for this including the Asian crisis which went on longer in Indonesia than all other Asian countries, political upheavals, financial crises, inadequate laws (discussed below), overlapping responsibilities in government, institutional weaknesses and capacity, and other causes. However, the continual improvement of laws and drafting reports on the problems in itself has not been sufficient, even though the laws and guidelines are quite sophisticated and conform to good to best practice.

The most important starting point is highest level commitment to enforce PPP development through best practice methods i.e. transparent, competitive and professional procedures that lead to at least a few appropriate projects being implemented, irrespective of constraints. In that regard many of the model projects were not model in the sense of being ready, risk minimizing and suitable, or selected through any proper process such as multi criteria analysis. Many selected PPP projects (not only toll roads) were quite difficult, involving SOEs and requiring substantial subsidies e.g. the toll road model project, Solo Kertosono, requires a subsidy of about USD 300m.

Guidelines for PPP

While the GOI spent considerable resources on preparing guidelines for PPP implementation based on the 2005 law, the status of the Guidelines was uncertain given that they were not referred to in the law and that Guidelines could not legally overcome the confusion in the law itself. It is now proposed that the essence of the PPP guidelines will be included as annexes to the revised regulations.

Regulation: Sector Regulator and Re-alignment of the Four Primary Functions

A sector regulator is important because one of its functions is to ensure a level playing field. In toll roads the agency has two roles regulation and contracting agency. For this reason, PPP is likely to be less attractive relative to other sectors from the point of view of the private sector because independence is compromised, there is less transparency and more potential conflicts of interest.

Thus, to create a level playing field, the four functions (The four functions are policy making (the responsibility of the line ministry), regulatory, contracting and operator) need to be re-aligned. The objective of at least aiming for a functionally independent

regulator is important because part of its role is to ensure compliance with the "rules of the PPP game" in Indonesia.

In toll roads progress has been made in regulation but there is no independent regulator and also the regulatory agency still has conflicting functions, so more progress is considered needed.

PPP Implementation and Local Government

Local autonomy allows the local government to organize and implement their own PPP projects subject to direction from the local parliament. The 2005 PPP Regulations applies also to PPP at the local level. It is envisaged that any local regulation issued by a local parliament would be in accordance with The 2005 PPP Regulations and the Guidelines.

Another pertinent issue concerns local fiscal support for PPP projects at the local level. Clarity is essential in the application of PPP regulations at the local level, if local government wishes to implement more PPP projects.

The reform process

Government Regulation on Toll Roads, No. 15/2005,

The New Government Regulation No. 15/2005 on Toll Roads reformed the legal framework and potentially paved the way for greater PPPs in highways. The sector has been unbundled by splitting off the regulatory functions from its main State Owned Enterprise, Jasa Marga, calling for the establishment of a new regulatory body, ending Jasa Marga's monopoly on toll road development; and allowing fully private investors to bid for new Build Operate Transfer or concession projects in competition with Jasa Marga.

The Indonesia Toll Road Authority (BPJT) was established in June 2005. Its responsibilities include developing business plans and feasibility studies for toll road projects; conducting bidding, facilitating land acquisition, and recommending tariffs for such projects; and supervising implementation of toll road concessions.

The 2005 PPP Regulations.

As already discussed above, the introduction of this Regulation in 2005 should have provided greater certainty to private investors by clearly defining the rules of the game within the government's policy framework.

Presidential Decree on Land Acquisition No. 36/2006.

In 2006 the government-amended regulation on land acquisition was adopted. This brought government policy on land acquisition closer to internationally accepted principles especially on involuntary resettlement.

The Ministry also issued a decree on tariffs.

The decree enables toll road tariffs to be set on the basis of the bidding process. At the same time, tariffs for existing toll roads were increased very substantially to ensure

financial sustainability of their operation. To complete the legal framework, the Ministry issued a series of implementing regulations.

Land Acquisition Fund

The Government has now established a revolving land fund, by setting up a General services Agency, which will, to same extent; help ensure that land is acquired before a project is put out for tender. The BPJT (Indonesian Toll Road Authority) will act as a Land Banking which will facilitate and manage the land acquisition process and the seeding funds for the land banking has been prepared by the Government.

Government Support and the Risk Management Framework

Government Support is to be provided by the Government to projects that meet the requirements of the 2005 PPP Regulations. Government support is based on both these regulation and the principles of management and financial risk control under either the Minister of Finance or a Regional Finance Unit in the event the Government support is to be provided by Regional Government.

In 2006, the Minister of Finance issued a legal Guideline for Controlling and Managing Risks of Infrastructure Provision. Types of the risks covered, include Political, Project Performance and Demand Risks. It would appear that if a toll road project needs government financial support it must follow the PPP regulations.

Highway Program/Projects

Status of the Current Toll Road Program

- In operation: 4 links, 51.6 km
- Construction Stage: 7 links, 114.55 km
- Concession Agreement signed: 16 links, 641.14 km
- Finalization of Concession Agreement, 3 links, 104.72 km
- At Tender stage: 4 links, 61.94 km
- At the prequalification stage, 2 links, 117.12 km

Total on-going Toll Road Projects consist of 36 links around 1,151 Km whose total cost is approximately Rp. 91,824 Billion (About USD 82.6 billion). At the same time the Government is now preparing 18 toll road links for tender, around 683 km and approximately will cost around Rp. 37,926 billion (about USD 3.8 Billion).

Model PPP Projects

The government also proposed two toll road projects to be designated 'model' projects. That meant in theory that they would be developed in strict accordance with the 2005 PPP regulations. These two projects are namely:

- 1 Medan-KualaNamu-Tebingtinggi (The proposed project will provide a direct and vital access to the proposed Medan New Airport Project. However, the estimated Financial IRR is only around 9% and this far below the 18-19% target rate)

- ② Solo-Mantingan-Ngawi-Kertosono (Part of the Trans Java Toll Road Project). The Financial IRR is around 14 %.

There is need for government support for these two projects, and the government reviewed the case for providing government financial support rationalizing incentives and subsidies, increasing competition and moving to more market-based tariffs.

However, at the same time, subsidy is now more acceptable for PPP schemes, and the government now, preparing the tendering out of the Jakarta port access Toll Road, as part of the Jakarta Outer Ring Road (JORR). Due to its low financial viability, the Government will build the Project under JBIC funding, and later on will put into tender to the private sector through Operation and Maintenance Schemes (including possibly PBC) which will support its PPP initiatives.

Maintenance of National Roads and Funding

The total national road network is approximately 36,600 km; 50% of the total National Road Network is in good condition, 31% is in fair condition, while the rest around 20% is in poor condition.

Efforts have also been made to improve the road network partly through strengthening the procurement process with innovative approaches including Performance Based Maintenance Contracts which will be put into practice through a Pilot Project, proposed for 2008.

The Government is also said to fully support the principle of a Road Fund mechanism.

Key sector developments and Issues facing toll road development

The Government of Indonesia has implemented a number of significant reforms, which have affected or been directed at the toll road sector, the objectives of which included:

- ① Introduction of automatic tariff adjustment mechanisms;
- ② Accommodation of using the existing toll road assets to help finance new toll road sections; and
- ③ Land policy reforms to enable timely acquisition of land.
- ④ They have also tried to separate policy, planning and regulatory functions from toll road operations.

Substantial debate and focus has been put to how to attract new private capital to develop the toll road framework, and the World Bank has been assisting the GOI to reorganize the institutional and regulatory framework for toll road development through technical assistance.

Some key issues facing investors in the toll road sector continue to be:

Regulatory framework: There was general consensus among stakeholders that toll road reform was needed and should involve the separation of policy, regulatory and contracting functions. Some progress was made but the body created still combined regulation and contracting.

Tariff setting and other regulatory risks: Tolls have been set by Presidential Decree and had not been revised over a decade prior to the recent average increase of 25%. The introduction of automatic tariff adjustment mechanism has now been made, using appropriately structured formula to attract private investors and enable them to project revenues. It is still not clear how this will work in practice. Implications of decentralization: In a decentralized environment it is important that all legal and regulatory issues are clarified.

Land acquisition: Many toll road concessions failed to start construction due to the difficulty of acquiring land in a timely manner, as there was no enforceable legal framework to expropriate land for public services (such as roads) and to agree on land acquisition prices. This has been addressed in principle and remains to be seen as to success.

Coherent transport development plan: In addition to the creation of a national toll road agency, there is need for the country and regions to formulate a credible transparent process for the implementation of a coherent transport plan covering both toll and non-tolled roads and different transport modalities, to allow private investors to assess and forecast traffic demand for toll roads in a meaningful manner. Some coordinated plans have been prepared but more remains to be done.

The European Business Chamber of Commerce in Indonesia said that the country's infrastructure program is realistic, but suggests that the government not only focus on providing legal certainty but also on expediting implementation.

"One of the reasons why the first Infrastructure Summit was unsuccessful was because the legal framework did not exist and has suggested that while providing the necessary legal framework was imperative for attracting investors, building up program-implementation capacity would be the future key to success.

The government held its first infrastructure summit in 2005, offering a total of 91 projects worth USD 22.5 billion. Only nine deals were clinched, however. During the Summit of 2006, the government put 10 "model" projects (including 2 toll roads) worth USD 4.4 billion on the table. In addition, it is also offering 101 other potential projects worth about USD 14.7 billion.

EuroCham is helping the Ministry of Finance with capacity-building because implementation is key. Therefore, it says that the government has to train people, who can work in teams and are aware of what global best practice is.

Consistent regulations and security have always been the key problems. Investors want to be here for the long haul and they want to be able to forecast their profits. Thus, they require consistent regulations and long-term security for their projects. He added that the ten projects being offered at the conference were all quite realistic".

Conclusions and Lessons Learned

Indonesia has come a long way in toll road development. Projects stretch back some 30 years and over 1,000 km have been built. Indonesia has spent much resources and time in developing its PPP framework but with limited success so far. While the overall

PPP concept seems reasonably well understood among the senior staff in government, effective implementation remains a problem. Therefore, in the toll road sector, real PPP based projects remain elusive.

The legacy of direct government involvement in toll roads through Jasa Marga and in the other transport sectors through other SOEs may dominate thinking. The tendency is for projects that could conceivably be good candidates for PPP are passed on to the SOE. While some progress has been achieved in the toll road sector to convert Jasa Marga into a corporatized entity that will bid for projects in competition against or as a partner with private companies, this has not yet been seen in practice.

With much more funding available from both public and private sources, but still insufficient from public sources the need is to develop a proper program of toll roads and prioritize them into those most appropriate for public funding and those most suitable for PPPs.

The main problems faced in project selection, preparation and execution are:

- Business-to-business (B2B) versus the PPP approach. B2B implies direct SOE to private concessionaire contract without reference to PPP regulations;
- Changes or adjustments of priority in response to unforeseen policy decisions by the Government;
- The roles of the PPP Central Unit and the PPP nodes in PP project development remain unclear;
- The need for PPP regulations and guidelines focused on local governments
- The minimum requirements in terms of completeness for pre-feasibility or feasibility study for both solicited and unsolicited PPP projects:
- The breadth and depth of the environmental impact assessment (AMDAL) to enable the contracting agency to estimate the cost of mitigating adverse environmental impacts of a PPP project;
- The importance of incorporating risk management procedures and good practice in the PPP Guidelines and the need to revise the former to include both direct and contingent government support as well as support for and/or from the local government;
- Coverage of the entire spectrum of PPP modalities: the need to select for each project the modality relevant to Indonesia's conditions;
- Market sounding with private sector is needed; to help prepare bankable projects;
- Tendering procedures at the fine detail level cause problems e.g;
 - Extended bid conference or pre-bid negotiations
 - Discussion of tender variations
 - Finalizing contract agreements
 - Avoiding too many loop backs in the prequalification or tendering process in the case of less than three applications/bids
 - Identification of negotiable and non-negotiable items of the contract agreement

Important aspects not adequately dealt with in the 2005 PPP Regulations are:

- the definition of a contracting agency,