

Improving Infrastructure Development in Indonesia

- Offer infrastructure projects with enough consideration on the following aspects: rational portion between SOEs and private sector, exposure of State-Owned Enterprises to fair competition, the need for latest technology and innovation, and variation and uniqueness of sectors and regions.
- Create effective, efficient, and simple institutional system in conducting KPBU, formulate a standard for implementing VfM to compare the option of KPBU scheme with other schemes, and to arrange a mechanism if an SOE/ROE (BUMN/BUMD) acts as business entity in KPBU project.
- Prepare better for the offering of infrastructure projects. Project Development Facility (PDF) is needed so that government can have a strong argument about the scheme it wants. Therefore, government will have a clear guideline, with regard to the scheme, pricing, fiscal support, etc., during the negotiation process with private sector.
- Provide a significant breakthrough to solve land acquisition problems, for example by restricting the amount and time for filing lawsuits on the determined compensation fee, providing a logical reference for market price that doesn't follow the speculators schemes, specifying percentage of marginal increase in the property value as non-material compensation as a solution for high demand from the land owners and the high value/price of the land itself.
- Adopt performance-based asset management system, for example by assigning a single agency for design, development, operation, and maintenance of a certain asset, and periodically conducting evaluation and remuneration based on their performance of asset management.

Indonesia Has Infrastructure Deficit

The development of infrastructure is one of the most important requirements of socio-economic development. Poor infrastructure is a major hindering factor for Indonesia to realize the potential of economic growth by 7-8% every year.

The recent condition of Indonesia showed a large infrastructure deficit, both in terms of availability and quantity. For example, in the last 20 years, only 200 km of highways were constructed and the national road capacity only grew by 1-2% per year. Meanwhile, meeting the needs of year 2030 requires construction of at least 500 km of highways per year, and 5% increase per year in the national roads capacity. This is still not yet taking into account the physical damage currently observed in a lot of established infrastructure.

Issues on Infrastructure Development in Indonesia

There are at least 4 key aspects in the development of infrastructure causing this deficit: (a) the involvement (or lack thereof) of private sector, (b) funding, (c) the provision or acquisition of land, and (d) the management of infrastructure assets.

Two key issues may have hindered private participation in infrastructure development. *First*, the lack of good profit- and risk-sharing mechanism between the government and the private sector makes the private sector reluctant to participate in an infrastructure project. *Second*, the lack of effective strategies to attract private participation. This may be caused by the direct appointment of State-Owned Enterprises (SOEs) to build large-scale and key infrastructure projects. Infrastructure projects offered to the private non-SOEs are often unattractive and require a lot of structural adjustments in order to be viable.

The second problem is associated with **the financing scheme, which does not support the sustainable development of infrastructure**. Funding an infrastructure project consists of two main stages: the construction costs (financing) and the costs of operation and maintenance (OM/funding). However, construction of infrastructure projects in Indonesia often only takes into account construction costs and pays less attention to the sustainability of the project and the maintenance costs after the project is over. This does not apply to Cooperation of Government with Business Entities (KPBU) projects only.

Presidential Regulation No 38/2015 provided a more progressive approach. Yet, there are still uncertainties with regard to: **a) procedure to determine the procurement scheme**. KPBU projects are determined by the Person in Charge of Cooperation Project (PJPK) based on the compatibility with the planning and Value-for-Money (VfM) analysis. However, there is no requirement to create a comparison between traditional scheme with KPBU scheme, for instance with Public Sector Comparator (PSC) method or any other method. As a result, in some cases KPBU may not be the best possible scheme for a particular project, relative to other schemes. **b) State-Owned or Regionally-Owned Enterprises (BUMN or BUMD) could act as Person in Charge for Cooperation Project (PJPK) (public sector), and as Business Entity (private sector)**. This may create uncertainties if not immediately addressed by the implementing regulation; **c) institutional aspect has yet to be decisively addressed**: what is the role of KPPI, will there be any sort of PPP Center, how to deal with PPP Centers that are found in both Ministry of Finance and Bappenas, and how is its implementation in the regions?

The third problem is related to the **high costs and lengthy time required for land acquisition**. Many infrastructure projects have been delayed for years due to this problem. It would significantly increase the cost of the project as time goes by, as there will be a rise in prices for construction materials/inputs, disruption to supplies, overhead costs accrued without any productive activities, and the possibility of the technology used being left behind because of the long delay. Now Presidential Regulation No 28/2015 has delegated responsibilities of land provision to PJPK (government), which is a major improvement. However, the challenge will lie in ensuring the speed and efficiency of its execution, given the fact that current government projects are still heavily constrained by land acquisitions.

Although there has been regulation in place, such as the Presidential Decree No. 71 in 2012, land acquisition is still very difficult to be effectively carried out due to several reasons. The key hindering factor is the lack of decisive law enforcement from the government, with regard to the execution of land acquisition for public uses. The landowner's frequent debates on issues such as the compensation scheme and the market-price for the land, often delay the planned infrastructure project.

Fourth, there is a **poor management of infrastructure assets**. In-depth discussions regarding asset management schemes, especially in maintenance and renewal, have not been present in current public discourse on infrastructure policy. As a result, the process of budgeting, planning, and investment decision-making are being done without careful calculations with regard to the long-term maintenance of infrastructure assets.

Poor management of Indonesia's infrastructure is reflected by the high depreciation rate of infrastructure, and by the rapid rate at which physical damages of infrastructure occur. One example is found in water utility infrastructure management, in which more than 40% of PDAM's asset per year suffer from degradation. As a result, the total depreciation value exceed the amount of new investment in the same period. As another example, roads are damaged only within 2-3 years after it is built, resulting in significant additional costs for the government and road users. Contrastingly, with better management, the roads can last 10-15 years before needing repair.

Several things cause poor asset management. *First* is the lack of effective incentive structure in the management of infrastructure. Often, one party undertakes infrastructure development, while another party does the maintenance and renewal of infrastructure. This condition might potentially produce moral hazard. *Second*, there is a lack of accountability and clear responsibility for the condition, usage and the performance of infrastructure assets. There are still frequent lack of clarity, as to which institution is supposed to be responsible for conducting maintenance on an infrastructure asset. It is further exacerbated by the absence of proper reward-and-punishment mechanism to encourage better management of infrastructure assets.