The Private Finance of Public Infrastructure : Indonesia PPP Outlook

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Abstract. Based on various motives, governments all over the world are looking increasingly to attract private finance to bridge public infrastructure gaps. It is believed that involving private finance will accelerate infrastructure provision, ease fiscal constraint, spur economic growth and reduce poverty gap. In Indonesia, bilateral and multilateral supports for PPP infrastructure development are continuously flowing, however, the progress is very slow and when the project lists were brought to market, transaction is very seldom occurred. Despite past negative experiences, the Government of Indonesia continuously streamlines and develops national PPP policy, guidelines and recently has established financial institutions to further support and guarantee private financing in infrastructure development. The purpose of this paper is to provide brief review on private sector participation in infrastructure development, to see the PPP market outlook and opportunities and to highlight obstacles that should have been tackled to accelerate its implementation. Finally, for more sustainable PPPs development in Indonesia, the future roadmap will be outlined. In the absence of championship and policy direction from the top level, maintaining project governance and management is simply impossible. Participation and partnership can only be successful if there is strong political leadership, robust and transparent assessment procedure, aided by expertise and entrepreneurial bureaucrats.

Keywords: *private finance, private finance initiative, public private partnership, value for money, public sector comparator, risks assessment*

1 Introduction

Since the 1997 Asian financial crisis Indonesia investment in infrastructure has now returned to the level of 3.2% of GDP. The recent positive and strong economic growth, though much been contributed by consumptions, nevertheless if continued, Indonesia is forecast to have the world's seventh largest economy by 2030, surpassing the UK and Germany according to a report by McKinsey Global Institute [1] and even the fourth largest in 2040 according to a Citibank report, trailing only China, India and the United States. If the 2014 election goes smoothly and if the backlog in many public infrastructures (brownfield and greenfield) were delivered timely, keeping pace with the recent continued population growth and increasing urbanization, Indonesia economy may even reach one of the top countries earlier in the quarter century.

Role of private finance is indeed very crucial to pursue the above-mentioned economic forecast, which has long been a very fashionable concept in infrastructure discourse in Indonesia. Starting from the Washington Consensus that advocates deregulation, trade liberalization and privatization, in 1991 the World Bank began offering loan TAP4I (Technical Assistance Project for Public & Private Provision of Infrastructure) to the Government of Indonesia, then this continues with PPITA (Private Provision of Infrastructure Technical Assistance), CIDA, JICA and recently IRSDP (Infrastructure Reform Sector Development Project) through the ADB loan. Total financing of hundreds of millions of dollars has been absorbed; the results are yet to be seen as executions were always hampered by various incomplete procedures and unpreparedness.

However, it is still strongly believed that involving private finance will accelerate infrastructure provision, ease fiscal constraint and spur economic growth. Having hit twice by financial crisis in 1998 and 2008, the infrastructure investment has not recovered to pre-crisis levels, though the nominal has been increasing up to 3.2% GDP[1].

The purpose of this paper is to provide a brief account on worldwide policy trend in managing private sector participation in infrastructure development, specifically for Indonesia is to see the PPP market outlook and opportunities and to highlight obstacles that should have been tackled to accelerate its implementation. Finally, for more sustainable PPPs development in Indonesia, the future roadmap will be outlined.

2 PFI , PPP and the Prerequisite

Although the recent infrastructure laws intended to end public monopolies and open the infrastructure market to private entities, only

[1] Rate of 4 to 5% GDP is regarded as moderate. In comparison to India and China, infrastructure financing is on the range of 7 to 9 % GDP.

[2] Competitive neutrality is about ensuring fair competition in PPP market. For example, the

certain market such as telecommunication grew rather rapidly, then power, waters and toll roads seems to develop rather slowly, while other sectors such as ports, airports and railways are even slower.

Revision of the 2010 Presidential Regulation on Negative Investment List is in progress, the amount of foreign ownership or share in infrastructures are planned to be more open in the future, including: the management and operation of ports, airports, land terminals and dry-docks.

Having revised Presidential Decree No. 67/2005 on PPPs twice (Presidential Decrees No. 13/2010 and No. 56/2011, respectively), regulating competitive tender as mandated by this decree remains political and draws controversy. Placing contestability first and foremost often delays and jeopardizes project delivery. Frequently, a number of PPP pre-qualification and tenders were repeated, because private parties' responses underwhelmed, or rather the information given in the "info memo" was unclear due to poor project preparation. None of "ready-to-offer" projects then come to a closing. If so further implementations always hampered, due to land acquisition, or licensing disputes between authority and subnational (local) government. Finally because of delay, the cost to realize the project continues to swell.

The recent 2025 Master Plan for the Acceleration and Expansion of Indonesia's Economic Development (MP3EI) and the upcoming Five Year Development Plan (RPJMN-III 2015-2019) are heavily relies on private finance sources. From a recent RPJMN-III round table discussion it is estimated that government budget can only cover around 30% of US$ 489 billions total funding needs, the amount of which more than double the previous RPJMN-II 2009-2014. Another 30% estimated expected to be covered by the state-owned enterprises (SOEs) funds. Therefore, at least 40% funding gap expected to be contained by private finance, PPP or any other creative financing scheme. Of course, these will pose big challenge to all of infrastructure players in the country, as the achievement on past PPPs closing was meager.

Based on payment mechanism or revenue or stream, private finance of public infrastructure can be categorized in two types. First is the Private Finance Initiative (PFI), based on availability-based payment, private developers or service providers receive a unitary (annuity) charge from the government to recover the capital investment. In PFI private sectors take most of the risks, while public sector only takes demand risk. In UK, PFIs were getting momentums since the early 1990s, peaked in 2006 and start to decline in 2008 then was moribund in 2010. This is partly due to difficulties in raising finance during the 2008 crisis but mainly proof of value for money (VfM) become tighter, also the on-balance sheet asset requirement was reinforced with the adoption of IFRS in 2009, see Winch [2]. Being regarded as leading PPP market and implementer, a thorough review that relied more on evidence and submissions from a broad range of stakeholders are now under investigation in UK. Private Finance Initiative (PFI) has been challenged as providing government's giant credit card to the private entities. Having published "A New Approach to Public-Private Partnerships" HM Treasury [3], son of PFI (dubbed PF2) has recently been introduced. PF2 aims to reinvigorate the infrastructure sector while addressing criticisms on the ground that the previous scheme (PFI) did not deliver value for money in some projects, it involved a slow and expensive procurement process and employed insufficiently flexible contracts. This forward-looking PPP undertaking will most likely provide inspiration for other PPP units around the world in the coming years.

Performance Based Annuity Scheme (PBAS), comparable to PFI, is being envisaged to be adapted in Indonesia PPP. Basically it is similar to a regular Build Transfer Operate (BTO) but the concessionaire periodically earns sum of money from the government. The payment could be annually or semi-annually, given a requirement that the concessionaire delivers the complete asset and subject to random performance (operation and maintenance) check during the concession period. PBAS is potential to be enhanced to cover the social infrastructures such as hospitals, schools, universities and government building complex, the scope of which are urgent to be included too in the future PPP market.

Secondly, the PPP is a business relationship between a private-sector company and a government (public) agency for the purpose of completing a project that will serve the public. It is a method for enabling appropriate intervention by the government so as to ensure that private enterprises are able to earn reasonable returns through user pay principle, albeit leaving most risks are borne by private sector including the demand risk. The premise in PPP is that it must deliver value for money (efficiency gains) both for the public and the investor; risk transfer must be adequate also revenue and cost must be accurately identified and quantified. Figure 1 illustrates the value for money (VfM) concept, where PPP is less costly than that of public sector comparator (PSC) of traditional procurement, mainly due to innovation and transferable risk.

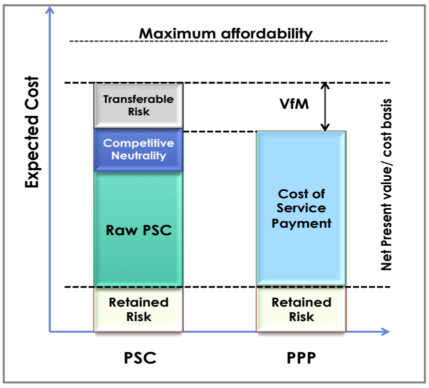

Figure 1 Value for Money

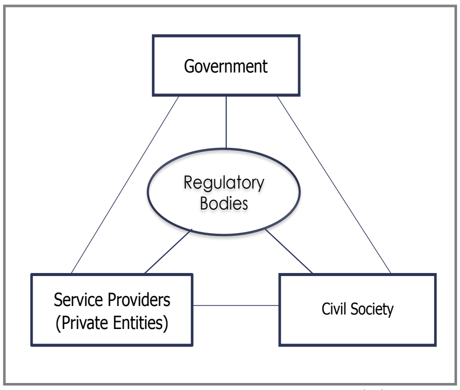

Figure 2 PPP Prerequisite

Having accounted the competitive neutrality[2] on public sector enterprises, VfM consists of a combination of cost savings, efficiency gains and risk transfer. Competitive neutrality does not apply to non-business, non-profit activities of government. PPP projects involve private funding and in terms of structure and viability, they need to be acceptable to financiers and debt holders. Apart from this, the financial strength of the operators is also critical as much of the risk during asset development stage rest with them.

The bottom line is, VfM can be accomplished only when a PPP delivers high-quality services at a lower cost than the government (PSC) could provide. Nevertheless, all too often governments pursue PPPs for reasons other than efficiency gains. Efficiency gains as the basic argument in PPP

[2] Competitive neutrality is about ensuring fair competition in PPP market. For example, the presence of State-owned enterprises (SOEs) vis-à-vis pure private enterprises in a PPP bidding, they do not always compete on equal terms. It is the goal of competitive neutrality policy to offset the inequalities where appropriate. The inequalities of concern may arise from differences in tax treatment, differences in the need to provide a return on investment, etc. State Government of Victoria, Australia, for example, establishes Victorian Competitive and Efficiency Committee (VCEC) to oversee this issue.

application seems to be much less important in the emerging countries like Indonesia. Therefore priority to seek private capital, in some cases, is pursued whatever the cost borne to the customers.

By tradition most public infrastructures were delivered solely by government funded fully by public money or tax, then service providers such as contractors were selected through competitive tender[3], see Figure 2. In contrast to fully public funding, Public-Private Partnership will demand a very unique environment: good public and corporate governance, accountability and transparency. Ideally (independent) regulatory bodies are required to balance the interests of the stakeholders. To ensure good quality PPP is delivered to the public, the prerequisites include: clean government, private entities or providers are capable and professional, civil society mature and finally the PPP market to some degree are already competitive.

Indonesia PPP market is not yet contestable, because innovation and efficiency are rare. It was often found that qualified bidders are lacking and competition is simply not in place. Such factual economic environement then pose a very fundamental question: whether private finance of public infrastructure can still demonstrate value for money compared to the public sector procurement? Furthermore, the use of PPPs raises very complex issues and choices, while solutions are often case-by-case and project specific, as stated in Lubis [4].

Within the current regulation, unsolicited proposal from private sectors may also be submitted to the government so long it is fully funded by the initiatior. However, the object of concern must not be listed in the PPP book or any other master plan, and private sector should bear all the burdens of development costs, capital investment also all risks associated with the project. To the best of our knowledge only toll road in Bali, which was opened to public last year, was successful in this regards. Many unsolicited proposals like the monorails in some cities, the progress has not been seen, although highly unlikely, as evidenced by the prolonged delay in the completion of the monorail in Jakarta.

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[3] Worth noting that during Dutch colonization, Indonesia railways asset were built by private finance, then they were nationalized soon after the independence.

3 Ambiguity in Legal and Institutional Set Up

At least there are three institutional issues to be resolved in the future. Firstly, the current PPP procedure which is governed by Presidential Regulation number 56/2011 is no longer convincing, therefore needs to be upgraded. To ensure consistency in PPP policy and to convince the potential private partners, it is desirable to upgrade the hierarchy up to a Law or Act level. An ad-hoc arrangement such as the memorandums of understanding (MoU) on facility coordination and PPP acceleration in infrastructure issued two years ago amongst the Finance Ministry, the National Development Planning Board (Bappenas) and the Investment Coordinating Board (BKPM), as the taste of the pudding is in the eating, in reality such inter-agency coordination was easily drafted than done. Cycle of PPP projects from planning to operation and until the assets are handed back to the state may effectively exceeds the period of one or two governments or presidential office terms. Neighboring countries such as the Philippines and Thailand continue to improve the legal and institutional framework of their PPP undertaking. Malaysia is far ahead in front other ASEAN countries. Consequently, this is a very tough job for the upcoming new government to accomplish, because there are a lot of overlapping legal and regulations that need to be amended.

Secondly is related to a function of regulatory bodies. Formerly, the roles of government Ministries or Directorate Generals are responsible for all kind of regulatory functions. But according to the new infrastructure laws, for examples, the Toll Road Regulatory Body (BPJT) and Port Authority although they are not acting as independent regulatory bodies, they do act as an economic regulator and contracting agency or landlord in their respective sectors. However, in rail sector neither economic regulator nor asset manager is mentioned in the railway law. In the absence of (independent) regulatory agency, two essential regulatory tasks – price control for (natural) monopoly and safeguarding competitive climate – are difficult to be fairly imposed to all service providers. Urgently, for PPPs to be effective, ownership of state-owned assets need to be settled and recorded accordingly either on the GCA's balance sheet or asset manager's or SOEs'.

Sometimes, when a project is dropped from the list of PPP tender, justifications are often weak and inherently political. A direct appointment to SOEs or private entities through Presidential Decree, such as Port Kalibaru was viewed as against the market-oriented policies as mandated in the infrastructure laws. The competitive neutrality policy is not yet known in Indonesia PPP. The role and involvement of SOEs in PPP tenders varies across sectors. In electricity, for example, PT PLN played a role as government contracting agency (GCA) in the recent Central Java power plant tender. Other SOEs, such as the Toll-Road Corporation (PT Jasa Marga) and Railway Corporation (PT Kereta Api) are positioned purely as service provider i.e. operational functions. In the recent Port Kalibaru development, IPC (PT Pelindo II) functions as a landlord, in in which busines-to-business dealt with other private entities are directly managed by IPC -- future port development deals should have not been like this. In the future role of Port Authority and SOEs (Pelindo) should be re-organized so as to follow mandate stated in the Law no. 17 /2008 on Shipping.

To date, the position of public institutions as regulatory (Safety, Health, Environment) and reposition of landlord or GCA as (independent) economic regulators are yet to be settled. Likewise, SOEs function solely as service providers as mandated by infrastructure laws need to be settled too. In case a vertical restructuring of the business is envisaged, such as in rail sector, asset ownership and management issues all need to be clarified prior to formation of a new asset and partnership.

Finally is related to the functions of PPP agency in providing centralized knowledge and a process for approving and implementing large-scale PPP programs. Now, the PPP Center is attached to Central Planning Agency (Bappenas) and is under developing. The recent ambivalence whether to go for public spending, PPP funding and or SOE funding as witnessed repeatedly needs to be ended by establishing a dedicated PPP Center, professionally run and separated from routine administration. The PPP Center conducts a proper value assessment during the PPP preparatory stage prior to tendering stage. The center should conduct the PPP cycle in transparent, competitive and equitable manner to reach the right and best price of infrastructure services to the communities. The Center is best placed directly under the office of the President, alternatively it may be placed closer to the office of the Ministry of Finance, where fiscal policies are taken care of. In the PPP Center experts are pooled, at the same time the PPP nodes in the ministries and sub-national governments can access them and ask for advice.

4 Developing Value Assessment Method

As part of developing a standardized PPP value assessment amongst ASEAN countries, Lubis & Majid [5] proposed a complete framework that can be adapted depending on the PPP maturity level in particular country. The flow of project preparation up to the tendering stage are basically managed under two phases of decision i.e. decision to invest and choice of procurement. For non-PFI (PPP) projects, it is recommended that subsequent to evaluation on absolute affordability and financial sustainability and is subjected to Cost-Benefit Analysis (CBA). This is for a simple reason that the projects have implications on larger audience. There are clear benefits and costs to the society at large.

For PFI projects, they are actually an extension of services purchased by the Government in the normal course of business. Instead of those services being procured or generated internally, private companies now provide them. Examples of these include school, hospital, prison and administrative complex. Hence, what really matter for these projects is the affordability of the Government to bear the financial commitment and whether PPP can give VfM. This is why having satisfied absolute affordability test it will continue directly to relative affordability test, which is the choice of procurement options.

The foregoing recommended assessment was not for immediate implementation, howerever, the proposed framework can be used as a guidance to plan a further PPP work program to develop the required list of supporting information and skill requirement, especially within the Government's PPP unit, refer to Lubis & Majid [5] for more detailed explanation.

5 Conclusion and Recommendation

Having managed private finance for public infrastructure for more than twenty years with all positive and negative experience, it is expected that in the upcoming new term of government all remaining regulatory, institutional and inter-agency difficulties can be resolved to speed up PPP/PFI project implementation. The role of central government nevertheless is very crucial to carry on completing and enforcing governance and international best practice. The missing link between the the huge demand of private finance for public infrastructure and the availability of capital in the market are blocked by improper value assessment start from the very beginning of PPP/PFI projects preparation, more specifically due to unsatisfying assessment on risk-reward ratio to investors.

In contrast to traditional procurement, PPP scheme demand a totally different set of mind, therefore all PPP cycle activities from planning, preparation, tender and closing should be managed exclusively in a PPP center of excellence directly under presidential office and out of the existing routine line ministries. The center should conduct the PPP process in transparent, competitive and equitable manner to reach the right and best price of infrastructure services to the communities. The existing PPP Center is now attached to Central Planning Agency (Bappenas) and is now under developing. To be strong and productive, a pool of permanent experts and supporting consultants should back up the unit. The center and its experts should also be accessible to subnational governments. The competitive neutrality policy should eventually be introduced when competitive environment and the PPP market are getting mature.

Until now social infrastructure such as hospital and medical care equipment, schools or campus and the facilities, and government offices all have not been included in the PPP scope. These types of infrastructures, particularly health services and medical equipment are urgently needed by the mass population below the middle income class, and are suitably financed through availability payments (PBAS) with or without user charges. Finally, as cycle of PPP projects from planning to operation, and to end of life may last beyond administrative and presidential office terms, in a longer run Indonesia would need a PPP Law.

As for universities and academic communities, challenges in PPP implementation require them to develop the core competence in infrastructure planning and management, also in legal and finance. The competitive neutrality policy should eventually be introduced when competitive environment and the PPP market are getting mature. Moreover, the faculties need to work inter-disciplinary in conducting research on this challenging issue in order to accumulate empirical knowledge of certain elements in the PPP project management, and offer courses and trainings to help disseminate them nation-wide.

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