Position Paper

Sector Working Group on
Infrastructure

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Infrastructure Review

1. Introduction

An impediment to future investment in Indonesia is the concern over poor infrastructure, which has further deteriorated over the past few years, such that industry in general is facing higher costs of doing business. Significant delays in sea, road and rail transportation are increasingly common. Road transport is more costly than anywhere else in Asia.

Investment into transport infrastructure is key to sustainable economic development. Other than the transport of raw materials, industrial cargo of higher value is mostly containerized, moving by truck, rail or water, and this requires specialized infrastructure. For sustainable investments in manufacturing and value-adding to goods, investors are carefully scrutinizing the operating legal framework, labour relations, the reliability of supplied energy and the prevailing transport situation.

So far, Indonesia has had a fragmented approach to infrastructure development. Current lack of port development in the main seaports of Jakarta, Surabaya and Belawan prevents larger vessels from calling directly, which creates additional costs in necessary transshipping activities. This is compounded by the extremely slow pace of construction of hinterland connections and facilities and often inefficient domestic shipping arrangements. Much investment and development is needed in the previously largely neglected provinces, which need considerable investment in road expansion, rail where appropriate, and smooth links to new or upgraded port facilities.

2. Airports and Airlines

There is ongoing development of key airports with Makassar being provided with a new airport in 2008, one underway for Medan and upgrading and expansion of the airport important international tourist destination of Bali about to occur. Planning is also well in hand for a further international airport to be located in West Java province as well as further expansion at Indonesia's main Soekarno-Hatta airport, which already carries some 40 million passengers per annum, well beyond originally envisaged, with double digit growth recorded for most of the past decade.

Domestic air travel, along with some regional linkages, has continued to be the main reason for rapid growth. Tariffs remain artificially low at medium to small domestic airports. Garuda, the national carrier, has moved over the past 3 years from a deficit operation to being a well-run and profitable one, and is expected to so continue and expand accordingly. The largest private carrier, Lion Air, is in the process of greatly expanding its fleet of 737s, and has taken delivery of the first tranche of an order of 173 new aircraft. There are now 54 registered airlines, which have been categorized according to air safety considerations. Safety and security remain key concerns.

3. Railways

Little further real development has occurred over the past decade in this sector. It remains as one requiring very large levels of investment for upgrading some of the existing rail track as well as for new lines, particularly to provide commuter access for large urban communities, especially Jakarta. Some early work has been undertaken on reinstating the line between Lhoksamuewe and Banda Aceh in northern Sumatra as a first step towards re-linking Medan with Banda Aceh, a route abandoned in the 1970s.

While the principle of a new rail link to Soekarno-Hatta airport is still planned little practical progress has been made in the past year or so, although this has been designated a project to be undertaken under Public Private Partnership (PPP) arrangements. Law 23/2007 lays out a framework for private sector participation, allowing companies to compete against the state-owned railway company, PTKAI. Projects being discussed include the upgrading of stations, rolling stock and suburban commuter lines, and the issue of separating track from train operations.

Plans are evolving for pushing ahead with the MRT and monorail, but the pace of development is slow; the investment required is large and is yet to emerge. Much of this work is appropriate to PPP, as are proposals for the development of commodity (primarily coal) lines in Kalimantan and Sumatra. Without significant local government interest and financial involvement it will be difficult to attract private funding.

3. Seaports and Shipping

A new shipping law, law 17/2008, appeared in mid-2008 with government expecting this to be gradually implemented over the ensuing 3 years. Industry has commented, however, that certain directives will take considerably longer to be implemented, e. g. with respect to cabotage, in an attempt to increase the domestic shipping involvement for in-country cargoes, but overall the law is viewed as taking steps in the right direction. However, the issue of fully developing cabotage is more complicated because of sources of investment and the need to replace much of an aging fleet, much of this over 20 years old.

Many national and sub-national ports require to be upgraded, and some regional governments are pursuing plans to build new port facilities independent of central government.

Port handling processes, lift on/lift off in inter-island ports need to be improved in order to give more certain lead times and avoidance of over long queuing at ports. Importation of raw materials and goods are delayed posing uncertainty in production of goods, all of which plays a negative part in the cost of doing business by increasing costs to manufacturers and prices to consumers. Further container capacity is urgently replied in several locations.

The decision has been taken to expand the country's main port at Tanjung Priok, Jakarta, a US$2 billion investment, especially to cope with a rapidly expanding container market. The feasibility study for this in order to optimize the layout and design is currently underway. This is a necessary immediate activity, since it will take at least 10 years to develop a much-needed new port for western Java, where 50% of the country's industry is located and continues to grow rapidly.

4. Roads

While most public focus is on the development of the toll road programme, there is a very large backlog in the upgrading and expansion of the national and sub-national road programme. The total road length across the country is in the order of 440,000 km and it is estimated that this needs to be at least doubled in order to optimize regional development. Pushing ahead with this programme is vital if the untapped growth potential of the country is to be realized, but many plans in the past few years have been delayed or badly implemented. While building national road links has commonly been supported by aid financing, most if not all of the sub-national programme is normally financed through national budget. In the meantime, the growth in motor vehicle and motorcycle sales without attention to network expansion is causing over-stress on the road network, especially in Jakarta and increasingly in other main urban locations.

The government has programmed to complete 887 km of new toll road, especially in connection with the trans-Java network, before 2014, but little has happened in the past 2 years apart from the opening of some small sections such as JORR W1 on the Jakarta outer ring road. While the law is present to take a more proactive stance on land acquisition, there has been a reluctance to use it and many projects are mired in lack of progress in this area. A revolving fund to facilitate land purchase has helped in a few instances, but the overall scope of activity required in this area remains large. In the meantime the cost of land continues to escalate and that of construction materials – and thence construction – has also increased, sometimes adversely affecting returns on investment.

Some 13 key undeveloped toll road sections lie in the purview of existing concessionaires; the government is pushing to have these constructed and, since most of the concessionaires would seem to have insufficient funding to proceed, the government is advising the concessionaires to bring in new funding partners. Some sections are now becoming critical towards supporting the burgeoning industrial expansion in Java.

The transport of goods around the country is the most expensive in Asia by a significant margin. Apart from the additional time taken to transport goods, hauliers are subject to a high level of both legal and illegal charges, some of this arising from conflicts in the clauses of national and local government regulations; resolution of this issue is a priority and actions can be facilitated at local government level.

The city jurisdiction of Jakarta has planned several projects with the aim of trying to improve the chronic traffic congestion in the city, but is hampered by little apparent planning coupled with no or poor implementation; the situation is now at crisis level and is hurting confidence among both local and foreign businesses.

Investment in all levels of road development is crucial.

5. Water and Sanitation

Overall, little progress, except through intervention of ongoing multilateral or bilateral aid projects, has been made in the water and sanitation sector over the past few years, and the projected investment requirement of US$20 billion over period to 2015 remains. Of this target, approximately half is expected to come from the state budget, 18% from multilateral or bilateral aid programmes, and the balance through private sector financing. The government is promoting PPP programmes in this and other infrastructure areas, but work is still required at different levels of bureaucracy to present clear regulatory instructions. Following regionalization in1999, unlike other areas of infrastructure, the responsibility for the management and development of this sector was divested to the regions except where cross- boundary jurisdictions exist.

The country is well-blessed with rainfall in most locations, but less than 1% is harnessed for use. Of that captured, some 89% of water supply is directed towards agriculture and the balance to domestic, municipal or industrial use. With rapid population growth, urbanization and increasing industrialization of Java, in particular, the supply-demand cycle is steadily changing and offers considerable planning challenges ahead. The loss of paddy will mean investment attention to locations off the main Java production base as well as towards more efficient farming practices.

While there are ongoing works targeted towards improving sanitation in rural areas, the overall programme across the nation as a whole is well behind goals set out in the Millennium Development Goals in 2000. While failing to meet these targets is a recognized global problem and there are many countries with a poorer standard of progress, much remains to be done.

Most water supply is handled through public sector water companies (PDAMs), of which there are more than 300, although many rural areas are not supported in this manner. These companies were in a poor condition prior to the 1997 Asian Economic Crisis, with most thereafter in technically bankrupt; over the past decade a consequence of this has seen a serious decline in operational and maintenance activities. Attempts have been and are being made to rationalize and regularize this, but much yet remains to be done in resolving managerial, upgrading standards and knowledge, as well as increasing investment.

6. Electricity

The aftermath of the 1997 Asian Economic Crisis left the expansion of national power supply in a critical condition. A target Crash Programme of 10,000 MW was projected in 1996/7, especially for the key Java-Bali grid. Arrangements were made with Chinese companies, because of their financially competitive and growing manufacturing base, to take a leading role in delivering this, but for various reasons this has not been followed through properly and the programme is well behind. More recently, arrangements with traditional vendors are progressing through the IPP programme. A second 10,000 MW crash programme was launched in 2008 with a wider national window and focus on a significant proportion of supply to come from renewable sources, especially geothermal. Recently one significant geothermal power project was awarded to a new international player and others are due to proceed in the near future. However, little progress has been made towards the development of the country's many hydro projects, and there is growing realization of the limited input that can be supplied by other forms of renewable energy, even where appropriate, without a measure of subsidized support.

A major constraint to rapid development of new generation capacity remains outwith the control of PLN or the government. These are global in nature because world power demand is large, meaning that plant and equipment manufacturers have full order books, and there is a continuing lack of *bona fide* contractors. This has contributed, along with the negative effect on the price of construction materials from higher oil prices, to higher construction costs, despite the temporary relief after the downturn in economic activity following the 2008 world economic crisis.

A recent major overhaul in the management of PLN has seen some encouragement towards renewable energy initiatives, but little progress will be made unless realistic global-level tariffs are set. Renewable solutions make particular sense for the many locations of the country off Java needing focused power solutions independent of grid networks and the replacement of old diesel generators. The global increase in the price of oil has only exacerbated the need, and the annual cost to the economy of running old generating sets is large, in the order of US$1 billion. The government has also to address the significant distortion caused to the economy (loss of budget to development) through provision of subsidies, an action recently postponed by the legislature.