

## Investment

### UPGRADING INDONESIA'S INFRASTRUCTURE

- ▶ Infrastructure investment in Indonesia was seriously impaired by the 1997 Asian financial crisis. Indonesia plans to increase investment sharply through both public spending and private finance.
- ▶ The government recently announced a five year plan to invest over US\$ 400 billion in infrastructure, with the government providing 30%-40% of the capital.
- ▶ The governance of the public sector infrastructure process must be enhanced in order to ensure a prioritised, well developed pipeline of affordable projects that command broad based support and have a political champion.
- ▶ The capacity of the domestic financial system must be boosted in order to be able to provide substantial amounts of private financing in relevant forms for infrastructure investment.

#### What's the issue?

In the wake of the Asian financial crisis, infrastructure investment collapsed from around 9% of GDP in the mid-1990s to 2% in 2001. Despite a partial recovery to 4% in 2014, this remains relatively low in comparison with the levels of Asia's other high growth economies (6% to 7%). The new government has committed a significant part of the fiscal space created by the recent abolition of fuel subsidies to fund infrastructure investment. It also plans to increasingly use financial markets and private finance for infrastructure investment.

To enhance private participation in infrastructure, the new administration has mandated the Committee of Infrastructure Priorities Development Acceleration (KPPIP) to create a pipeline of projects following the public-private partnership (PPP) model. However, very few PPP projects have actually been realised to date. The committee mandate and the stakeholders are the right ones, but KPPIP is faced with a complex web of different entities with overlapping roles and responsibilities in the infrastructure space.

Steps are also being taken to create a more open and transparent investment regime and better institutions for infrastructure finance, such as transforming the state-owned financing firm PT SMI into an infrastructure bank. Yet, Indonesia still has a rather complex legal framework for investment, with several layers of regulations added in recent years. The co-existence of economy-wide regulations and sector-specific laws detailing modalities for private investment does not favour legibility for investors and procurement entities embarking on PPPs. Restrictions on

foreign participation remain relatively high in infrastructure sectors and few of these sectors are regulated by independent agencies, inhibiting investor interest. There is also no unified PPP law to date.

There is also strong interest by the government to find alternative sources for infrastructure financing through capital markets and non-bank financial institutions. A social security reform merging several separate public pension and insurance schemes is expected to provide an increase in retirement assets to be invested in capital markets. The assets will be managed by the national social security agency (BPJS). At the same time, a new unified regulatory body (OJK) will assume responsibility for banking, capital markets, institutional investors and other non-bank finance.

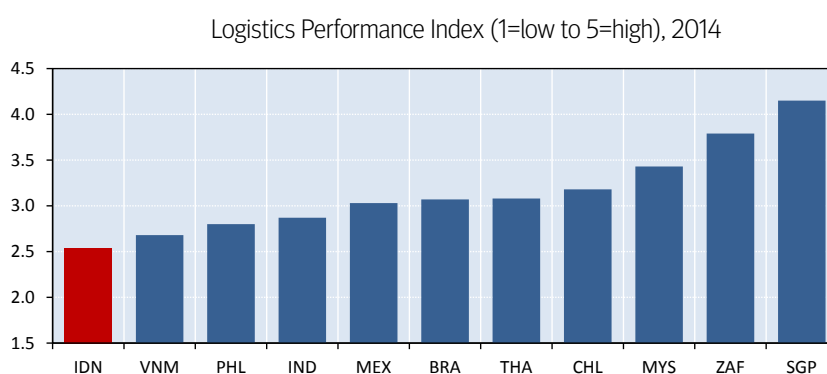
Indonesia lacks suitable long-term investment vehicles and capital markets are still developing. The corporate bond market is especially underdeveloped. Islamic finance is growing fast and could be a source for long-term investments with a "social component". Some suitable instruments, techniques and markets could be imported and modified to suit the Indonesian context, such as revenue bonds in the United States, social overhead capital bonds in Korea and infrastructure bonds in India and Brazil. Project bonds are an instrument currently being introduced in many countries that could be attractive to long-term investors.

## Why is this important for Indonesia?

The collapse of infrastructure during the Asian financial crisis left much of the population without sufficient access to basic facilities, including water and sanitation. The failure to maintain investment in the energy sector has resulted in widespread blackouts and load shedding. Congestion in major

cities has also become a major issue. Furthermore, growth of internationally competitive businesses has been inhibited by the lack of quality transport and logistics infrastructure (see Figure). This has impaired Indonesia's capacity to fully tap the potential of global value chains which would help to improve the trade balance and to create high quality jobs.

## » The quality of trade- and transport-related infrastructure is very low in Indonesia



Source: World Bank (2014), World Development Indicators.

## What should policymakers do?

- ▶ Follow through with plans to substantially lift public spending on infrastructure, particularly in transport and logistics.
- ▶ Strengthen infrastructure governance in order to unlock the project pipeline. Delineate institutional responsibilities, enhance technical skills and ensure coordination horizontally and vertically.
- ▶ Enhance the capacity of the domestic financial system to provide substantial amounts of financing for infrastructure investment, for example ensuring that the institutional savings generated by the social security reform are managed transparently and invested in the interest of final beneficiaries.
- ▶ Develop financial instruments, techniques and markets that are particularly relevant for long-term infrastructure finance, such as revenue bonds, social overhead capital bonds, infrastructure bonds and Islamic finance.



## Further reading

OECD (2014), *Southeast Asia Investment Policy Perspectives*, OECD Publishing. <http://www.oecd.org/daf/inv/investment-policy/Southeast-Asia-Investment-Policy-Perspectives-2014.pdf>

G20/OECD (2013), *High-Level Principles on Long-Term Investment Financing by Institutional Investors*. <http://www.oecd.org/finance/private-pensions/G20-OECD-Principles-LTI-Financing.pdf>

OECD (2012), *OECD Reviews of Regulatory Reform: Indonesia 2012*, OECD Publishing. [http://www.oecd-ilibrary.org/governance/oecd-reviews-of-regulatory-reform-indonesia-2012\\_9789264173637-en](http://www.oecd-ilibrary.org/governance/oecd-reviews-of-regulatory-reform-indonesia-2012_9789264173637-en)

OECD (2010), *OECD Investment Policy Reviews: Indonesia*, OECD Publishing. [http://www.oecd-ilibrary.org/finance-and-investment/oecd-investment-policy-reviews-indonesia-2010\\_9789264087019-en](http://www.oecd-ilibrary.org/finance-and-investment/oecd-investment-policy-reviews-indonesia-2010_9789264087019-en)