INDONESIA

Public Private Partnership for Infrastructure Development

COUNTRY PAPER

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1. PREFACE

Indonesia is an agricultural nation that has long been known as an oporter of raw materials particularly foodstuffs and petroleum. Manufacturing, a secondary industry has also become an integral part of the Indonesian Economy. Since 1990, manufacturing has been one of the Indonesia's key industries, having been the largest contributor to the GDP of the year followed by agriculture.

Infrastructure development in Indonesia played a key role in creating growth and reducing poverty in the three decades before the 1997 crisis. From 1967 to 1997 the Indonesian economy grew by an average of 7% per annum and per capita income reached USS 1,100 in 1995, which was over 4 times the 1967 level and poverty declined in 1996 from 60% in 1965 to 11% of the population.

Despite the infrastructure significant role to the economic growth, since the economic crisis on 1997, the Government's capability to make adequate infrastructure halted due to budgetary constraints. It is impossible for the state budget to fund all the infrastructure that the country needs, without adversely and severely increasing our budget deficit and public sector borrowing. This economic circumstances condition dictate the need to resort to private sector participation, targeted mainly at injecting private finance into the infrastructure sector.

The Cabinet Indonesia Bersatu (The Indonesia United Cabinet) through Indonesia Infrastructure Summit 2005, commit that investing in decent roads, water supplies, energy, telecommunications and other basic infrastructure services is vital to sustain economic growth and improve people's standards of living. For that purpose, the government has built considerable momentum for infrastructure reform. . It has established a sound regulatory framework for private sector participation in line with international practices. It has adopted a risk management framework; amended the regulation on land acquisition; drafted and submitted to parliaments amendments to key transport laws, with provisions for greater public private partnerships; established separate regulatory bodies for toll roads, water and telecommunications. It has put in place regulations to allow for cost recovery in key sectors sharply reduced fuel oil subsidies, which were causing a major market distortion.

The purpose of this paper, and the detailed programme documents that issued in conjunction with it, is to convey a picture of Indonesia's infrastructure programmes, the development priorities they address and the means by which they will be achieved. The opportunities, which are opening up for cooperation in infrastructure projects and services will be sketched along with descriptions of the approaches and support given to companies realizing the potential investments that lie ahead.

2. OVERALL DEVELOPMENT OBJECTIVES

2.1.Guiding Principles for Development

Guiding a course of rapid development over such a long term requires both strong guiding principles as well as responsiveness to shifting currents in the world around us. In the light of the 1945 State Constitution (Undang-undang Dasar 1945) and the National Philosophy of Pancasila (Five Principles)[1],The National Medium Term Planning sets out three main agenda for the period of 2005-2009. The First agendais on the creation of a safe and peaceful Inodnesia. The second is on the establishment of a justice and democratic societies. The third is on improving the welfare of all citizens.

The first agenda focuses on issues on national security and conflict, including improving the capability of the security agencies to protect the community against crime and terrorism. The second agenda, on the consolidation of political and legal reforms, relates to the transformation of institutions and good governance, for example, on judicial and public sector reform, and improvement to the implementation of decentralization. The third agenda is on improving the welfare of the Indonesian people. While the economic program is a key to welfare improvement, the social program matters just as much to the present administration.

To put the agenda into implementation, the Government commit to maintain the following parameters

1. Maintain average annual growth 6.6% for the next 2005-2009. To support this commitment the Government has to provide at least US$. 80.1 billion on new infrastructure
2. The involvement of the private sector on infrastructure Development on the 85% of Rp. 4.100 trillion will be done
3. The alleviation of poverty from 16.6% (2004) to 8.2% (2009)
4. Maintain Monetary stability (stable inflation and exchange rates)

Tables below shown the Government main agenda based on National Development Planning Agency

[1] **Pancasila** (The Five Principles): 1. Belief in one and only God; 2. Just and civilised humanity; 3. The unity of Indonesia; 4. Democracy guided by the wisdom of deliberations among representatives; 5. Social justice for all Indonesian people.

The Government Main Agenda: Macro Agenda for 2005-2009, sources Bappenas 2005

Macro Indicators	2005	2006	2007	2008	2009
Inflation, CPI (%)	7.0	5.5	5.0	4.0	3.0
Nom. Exchange Rate (Rp./US$)	8,900	8,800	8,800	8,700	8,700
GDP Growth by Expenditures (%)					
Economic Growth	5.5	6.1	6.7	7.2	7.6
Investment	14.6	17.8	16.3	14.3	12.8
Balance of Payment					
Current Account/GDP (%)	1.6	0.5	0.1	-0.2	-0.5
Foreign Reserves (US$ billion)	36.8	36.0	35.6	35.2	35.9
GDP/Capita (Rp. Thousand)	7,946	8,333	8,791	9,317	9,914
Fiscal Sustainability					
Budget Deficit/GDP (%)	-0.7	-0.6	-0.3	0.0	
Tax Revenue/GDP (%)	11.6	11.6	11.9	12.6	13.6
Debt Stock/GDP (%)	48.0	43.9	39.5	35.4	31.8
Open Unemployment					
% of Work Force	9.5	8.9	7.9	6.6	5.1

The Macro Economic indicators from after crisis up to 2005, shown that the economy is on a gradual but steady upward trend. After being hit hard by the crisis in 1998, the economy showed its resilient by growing steadily from 3-4% per annum in 2000-2003 to 4-5% per annum in 2004-2005. It is currently on a growth trajectory of 6% per annum. Based on table above, it is hope that in 2010 and beyond, growth will be about 7+% per annum. This condition will has two implications, from a supply perspective, a need for higher investment in Infrastructure to support enlargement of the Economy. Similarly, on the demand side, expansion of the economy will raise the commercial viability of infrastructure investment.

Policy Objectives

In accordance with these principles, our long term policy objectives are sustained economic growth supporting an overall rise and more equitable distribution of income and services. This will be achieved within a strict regime of sustainable use of natural resources and with a strong emphasis on preserving national and local identity, cultural integrity and treasured environmental legacies.

2.2. Long Term Development Objectives

A smooth transition into an industrial society is an integral element of these objectives. Within 25 years, the Government would hope to have developed to be on the same level, in terms of economic development and standard of living with any other of the newly industrialized countries. We would also hope to have addressed the problems of lifestyle change and accelerating technological cycles with solutions that are sensitive to human aspirations and social justice.

To accomplish these long term goals, the Government will continue the now well established pattern of gradually accelerating sustainable economic growth commensurate with maintaining monetary stability and limited price inflation. This growth must be based on building solid foundations in human resources, institutional strengthening; technological innovation and efficient infrastructure. Over the medium term, other key factors governing the rate of acceleration will continue to be the price of oil, the regional and world economic climate, and more particularly, the relative attractiveness of Indonesia as a base for further investment as well as our performance in rapidly bringing into production the new technologies in all facets of economic activity that new investments can bring.

Long term growth requirements dictate that we must continue to emphasize and perform well in the non oil export sectors, within a rapidly changing global trading climate, to maintain monetary stability without the need for major fiscal management adjustments. This is seen as a key aspect of maintaining a smooth and accelerating funds flow, through the government and private sector to economic investments and to enlarge poverty alleviation and environmental protection programmes in the face of rapidly increasing population pressures, particularly in urban and industrial areas.

In summary, the priority policy objectives that the infrastructure and related human resources programmes support are:

1. immediate poverty alleviation;
2. extending services, growth and wealth on an equitable basis throughout the community and the archipelago;
3. extending environmental protection and management activities;
4. enabling efficiency in on-going economic activities;
5. creating an attractive base for further investment; as well as
6. introducing, assimilating and further extending the application of new technologies.

All of this we believe, can only be achieved by a strong partnership between the community, government and the domestic and international private sectors. Our target is that a full 77% of on-going development will be by the private sector at the end of the 25 year period.We plan that this will be reflected by similar shift to a relatively high reliance on the private sector in infrastructure services.

3. STRATEGIES FOR INFRASTRUCTURE SUPPORT TO DEVELOPMENT OBJECTIVES

The strategies for infrastructure support to development can be directly observed in terms of their relationship to meeting the scale of surging demands for services through strategies in:

1. Domestic investment Priorities
2. Support of Regional Cooperation
4. Environmental Protection
5. Human Resources Development
6. Sector Investment Strategies and
7. Private Sector Support to the Sector Strategies

3.1 The Scale of Response Required

Infrastructure will continue to play a fundamental role in supporting or even leading development in Indonesia as, it will throughout the region and beyond. Our mission, in the infrastructure sectors is to ensure that within a regime of prudent fiscal and monetary management, the available resources are applied to provide infrastructure services and technologies that support economic growth.

Rapid demographic change, industrialization and the globalization of trade, along with poverty alleviation, are the dominant factors shaping demands for infrastructure. Urban growth is running at 5.2% per annum; and within 25 years the urban areas that now shelter 34% of the population must house an extra 79 millions, reaching an urban population of 143 million out of total of 258 million. In parallel with this family units are shrinking to perhaps half the average size of the last 25 years. Increasing wealth is bringing new home building and commuter patterns, and service level expectations are also rapidly rising. The acceleration of economic activities with 9% average industrial growth centred on the urban areas, fuelling trade, and with services growing at 6%, is rapidly increasing the per capita usage of almost all forms of urban infrastructure. The urban areas have become the engine houses dominating and leading economic growth.

Tourism areas also form concentrations of infrastructure demand. Arrivals now exceed 3.5 million and growth rates such as the 11.1% achieved in 1992 are expected to continue for some years, reaching over 13.5 million by 2020. is targeted to attract 6 - 6.5 million foreign tourists and around 84 million domestic tourists. Nineteen major pioneering and expansion areas are currently under development across the archipelago. The programmes for infrastructure that are presented here represent the beginnings, certainly not the whole of the growing response to this challenge.

3.2 Domestic Investment Priorities

The Government has long followed a policy of optimiing the allocation of investment capacity between sectors, regions and at the project level to achieve the perceived practical objectives at the nation's current phase of development. This realistic and cazutious approach has allowed basic infrastructure services to be extended across the community to enable social services and the growth of economic activities on an equitable basis. In the past this has sometimes necessitated restraint in the standard and extent of infrastructure investments that have potentially high economic benefits.

Focus on Local Fund due to the size of the infrastructure financing gap as has been estimated that from 2005 up to 2010 the infrastructure investment needs will be around 7 to 8% of GDP, this based on the assumption that Government will maintain the economic growth around 6.6% per annum, that means that investment cost will be around US$. 80.1 billion (Rp. 689.4 Trillion). This estimates does not include the cost of rehabilitation of damage infrastructure and operation and maintenance of existing infrastructure assets of new development of large scale infrastructure in gas and energy, sea ports, airports, water resources and irrigation facilities and toll Road. While based on the investment trend of the government out of 7 to 8% investment needs, only 3% of GDP can be fulfill through Government Budget allocation, the remaining 4 up to 5% rely on Private sector.

To achieve the national objective of sustained growth of 6% to 7%:

A. Infrastructure investments will be targeted to assist:

1. commerce and trade;
2. industrial and agribusiness production;
3. tourism.

National programming and market forces will both channel the investments to be more intense where comparative, complimentary and competitive advantages exist, or can be brought about in these sectors. The markets for services that infrastructure serves or promotes are therefore generally concentrated in, or connecting, larger urban areas or in special domestic and international development zones where particular advantages have been identified.

B. The national five year plans has been initially targeted to meet priority demands within the constraints of not exceeding the currently projected sustainable rates of

1. public investment;
2. international borrowing; and
3. growth without overheating of the economy.

These provide baseline targets which the Government and infrastructure industry adapt to market forces and economic performance.

To achieve the national objectives of Equity and promotion of Unity

a. Public funds will be reserved to invest in direct poverty alleviation programmes, such as village access roads, minimum power supplies, sanitation, and basic telephone links to progressively achieve complete coverage of the poorer communities in urban and rural areas across the nation.

b. To encourage efficiency and responsiveness to local needs, where practical, support will be provided to enable the private sector to provide affordable, market oriented, services. This is enabled through cross subsidy schemes such as utilised in water supply, in rural telephones and rural electrification. Some programmes, such as district roads will remain unattractive to the private sector except as contractors and these will continue to be driven by national economic and social development priority criteria.

3.3 Support of Regional Cooperation

Globalisation of world trade is re-shaping the locations of industrial development and directions of trade. This phenomena, and regional cooperation, are also bringing into the foreground development possibilities that draw on the combination of complimentary economic advantages of particular regions in cooperating countries. We must respond to each of these through infrastructure to catalyse development of special regions and to provide efficient inter urban and regional transport and communications.

The concentration of economic activities and burgeoning international and domestic trade through the urban centres all point towards the need for a sharp increase in intra and inter urban infrastructure investments to serve the profound shift in the demographic landscape, here and elsewhere in the region. Much of that investment will need to be concentrated on the 12 cities that already exceed one million and in total house 35 million persons. By 2020 over 93 million people will be concentrated in 23 cities of more than 1 million.
A second field of regional infrastructure cooperation, development of infrastructure specifically to support trade and investment is intended to focus on:

1. services to the primary industrial, commercial and trading centres;
2. linked infrastructure, such as in telecommunications, pipelines, transshipment terminals and supporting road networks; and
3. shared infrastructure, such as for navigation, satellite services and information highways; as well as support to trans-border or complimentary special development zones, and industries

3.4 Environmental Protection

Environmental Protection is now a mandatory aspect of all private and government infrastructure projects. Environmental issues are governed by Law No. 23/1997 on the Management of the Environment and PP 27/1999. The Latter stipulates that the proponent of a project be required to submit an AMDAL proposal consisting of a KAANDAL (Term of Reference of Environmental Impact Assessment) an ANDAL (Environmental Impact Assessment), a RKL (mitigation plan) and a RPL (Monitoring Plan) to the appropriate environmental agency either Ministry of Environment or the Regional Bapedal. Once the AMDAL proposal is approved, the proponent then conducts and submits the ANDAL, RKL, and RPL on the basis of the KA-ANDAL. Final approach depends on the AMDAL being satisfactory and that there are no major adverse environmental impacts which can not be mitigated. The Whole process can lasts between six to eighteen months.

The key impacts of environmental protection on infrastructure investments and the industry are:

ON THE DEMANDS for infrastructure:

1. Sewerage and sewage treatment are becoming necessities for the denser city areas;
2. There is increasing pressure for mass transit systems to minimize further increases in vehicle traffic densities;
3. Solid waste disposal standards are being upgraded; requiring new investments in transport and sanitary disposal;
4. River basin clean-up and catchment protection projects are receiving higher priority; while Geothermal energy will be utilized wherever economic;
5. High efficiency gas and coal fired power generation is being preferred over oil;
6. Mini and micro hydro schemes and other alternate energy sources will be strongly supported for remote locations;
7. Absorbing excess private power production into the national grid;
8. The Government is being cautious on research into the possible future use of nuclear energy.

ON THE PROVISION of infrastructure:

1. Stringent scrutiny will be given to the planning and implementation of land acquisition and population relocation;
2. Emission and location restrictions for power generation and high voltage transmission will be firm;

Coastal developments now are required to demonstrate minimal impact and safeguards for viable mangrove and swamp ecosystems.

Human resources development is seen as essential to achieving equitable economic and social development on both the domestic and international plains. We see four focal points for human resources development in the infrastructure industry:

1. corporate and management
2. the professions
3. technical and skilled trades
4. cooperatives

For Corporate and Management

It is widely recognized that corporate management is rapidly becoming more professional in Indonesia. Indonesia’s chambers of commerce and business associations are becoming more active in sponsoring corporate excellence programmes. The Government is also sponsoring programmes to establish cooperative relations with similar associations overseas and at the company to company level. Some of the initiatives in this complex area are:

1. Cooperation within and between trade associations to improve business practices and links to peer groups in other countries;

2. Sponsorship by larger Indonesian companies of smaller companies to enhance corporate skills, access to finance, technologies, markets etc.;
3. Cooperation within the context of regional and bilateral arrangement to provide assistance and an improved business environment for small business;
4. Importing of a complete ?private sector' corporate culture and legal framework for the many large government owned companies that have been successful pioneers in almost every aspect of infrastructure and its financing;
5. Acceleration of the introduction of Quality Assurance to ISO 9000 and productivity improvements. This will be primarily driven through international and domestic market demands. It will also receive direct support through industry associations.

The government will take strong steps to encourage and enable a Quality Assurance culture to pervade the infrastructure industry. Significant progress has already been made in the energy and telecommunications sectors, initiatives are also gaining momentum in the other sectors. This will be applied to the public sector roles such as in planning and cooperation with the private sector as well as to contractors, suppliers and investors;

3.5 Human Resources Development

1. Introduction of incentives to contractors and investors who bring with them technology innovations to improve efficiency and service levels, provide training or promote R&D;
2. Preference and encouragement to international infrastructure investors and contracts that bring corporate capabilities to the Infrastructure industry by joint venturing or by long term direct investment presence.
3. Increased participation by Indonesian companies in the international infrastructure market place.

A number of companies have already been recognized as reaching an international standard in corporate capabilities. We believe many more will within the next few years and that they will be solid industry partners for their peers internationally.

For the Professions

Access to professional training in Indonesia is relatively broad based for a developing country. This is evidenced by the large number of engineers graduating, the large proportion of them coming from lower income groups and remote villages as well as the unusually high proportion of women graduates. Accordingly the emphasis now is on increasing the quality and practicality. We are focusing on engineering skills at entry level to industry; and particularly on the continuing updating of skills and management capabilities in parallel with career progression.

The current initiatives are in:

1. Establishing strong working relationships with professional institutes both in and outside of the country, through this it is planned to cooperate in establishing vigorous professional education, accreditation and practice standards;

2. Promotion of the use of advanced technical and commercial information services by the professions;
3. Tightening links between educational services to the professions, accreditation and continuing professional upgrading; emphasizing adding management awareness and skills to technical knowledge;
4. Continuing sponsorship of domestic and international professional / management seminars and training;
5. Wider cooperation with other countries and the private sector;
6. sponsorship of programmes to instil Quality Assurance and Productivity as essential aspects of professionalism.

For Technical and Skilled Trades

The skill levels in the infrastructure related trades and technical fields in Indonesia vary widely between companies and across the country.
We believe that rapid technological adaptation demands that the cutting face for introducing new skills will be through private sector investments. External private and public training agencies will generally provide wider access to training for basic and advanced skills that already have markets.

Under this approach the government will continue to provide direct training assistance for personnel to reach at least threshold levels for entry into trades and technical vocations. Companies and individuals will be motivated to go beyond that through commercial and quality assurance incentives. Already large numbers of companies are responding with internal training. We see the opportunity for much more training to be provided, particularly to small and medium businesses by public and private training organizations on a commercial basis or with industry association and government support.

For Cooperatives

Indonesia has a long record of government support to community cooperatives operating over a wide range of light industries. Over recent years this has been complemented by the ?big brother' scheme of support from large companies. The impact on infrastructure industry capacity remains small, however, this programme will remain as a useful tool for introducing simple component manufacture and business skills, particularly to more remote communities.

3.6 Sector Investment Strategies

The principle thrust of development in each sector addresses the above profile of the demand for infrastructure services.

Transport

The Blue Print (Cetak Biru Pembangunan Perhubungan 2000-2024) defines the long term policy for four transportation subsectors (Airport, seaport, railways and land transport). The vision is to accomplish reliable and competitive transport services and to create a favourable environment for PSP in the provision of transport infrastructure and services. There are 4 missions stated in the blue print. The first mission at least to maintain the existing level of transportation services, as the level had been declining since the crisis. The second is to reform institutions and enforce regulations. It seems that the Ministry of Transportation also recognizes that the current institutional arrangement should be. The third mission is to improve accessibility. Intermodal transportation planning and programming between the various directorates general. The last mission is to improve transport operation and quality of service

Telecommunications

The earlier phase of the Telecommunications programmes will be to provide Plain Ordinary Telephone Services coverage and reliability of service across the nation using existing terrestrial microwave, fibre optic, submarine cable and satellite technologies. Even so, as Indonesia rapidly moves into the use of digital technologies and communications satellites, he range and functionality of value added services will be rapidly increased to enable industry, the dynamic urban commercial concentrations, and neighbouring countries to share in utilizing emerging technologies in enhanced communications and information services. dynamic urban commercial concentrations, and neighbouring countries to share in utilizing emerging technologies in enhanced communications and information services.

The telecommunication sector is considered to be the most developed sector in Indonesia. It experienced tremendous growth, particularly in mobile subscription with an average annual increase of 77% over the past decade. Another is the growing competion among players that led to substansial new investments in infrastructure. Over the past decade, reforms have brought about increased private sector participation. It includes the partial selling of Indonesia's two main operators i.e. Telkom and Indosat through a listing on certain stock markets and the consent to private companies to provide mobile, internet and other value added services. The current policy framework is derived from the sector blue print formulated in 1999 and contained in Law 36/1999 on Telecommunication. The main policy elements in telecommunication sector are: (i) to encourage competition; (ii) To separate the regulatory function from the operator function; (iii) No discrimination based on ownership i.e. a more level of playing field; (iv) costs reflected tariff; (v) Simple, transparent, fair and rapid licensing mechanism; (vi) an open interconnection scheme for network operation; (vii) Universal Service Provision; (viii) Equal access for customers to choose telecommunication network according to their requirements; (ix) a neutral technical standard based on international regulation and (x) consumer protection.

Energy

Government of Indonesia is trying to maximize the upstream sector, GOI is trying to maximize the country's foreign exchange earnings from the export of tradable energy resources, such as oil, gas and coal. Another integral part of government policy is to ensure sufficient energy to support economic growth. The present energy sector policy framework consists of a number of strands, on the supply side the government aims to (i) increase availability of different types of energy; (ii) conserve energy resources and (iii) progress toward economic pricing, bearing in mind equity considerations . While on the demand side the government airms to (i) increase efficiency in energy usage; (ii) develop greater diversification in energy usage. There are also supporting elements to the overall policy: (i) to increase infrastructure development to increase consumer access to energy; (ii) to promote private sector participation (PSP) and to ensure better coordination in the development in the energy sector.

Water

The water programme is directed towards expanding coverage to serve more smaller communities and completing full coverage and efficient service provision to the community in the urban areas and to industry. Investment and operational management improvements will be a high priority in all initiatives for raising the efficiency and quality of existing over stretched urban services as a prerequisite to concurrent expansions to meet rapid growth in the major urban areas and so releasing resources to achieve the same for other communities. Water resources and catchments for the larger urban and industrial areas, particularly in Java are under pressure. Major efforts are required to protect catchments, as well as to retain and use existing river basin resources for multiple purposes more efficiently, and also to improve raw water quality. Complementing this programme, waste water treatment, which is still in its infancy, and improved solid waste management, are planned to be expanded for urban areas.

3.7 Private Sector Support to the Sector Strategies

A key part of our development strategy to achieve these objectives is a strong partnership between the community, government as well as the domestic and international private sectors.

Our target is that a full 77% of ongoing development will be by the private sector at the end of the 25 year period. We plan that this will be reflected by similar shift to a relatively high reliance on the private sector in infrastructure services, averaging about 52% over the next 5 years. The issuing of Government Regulation number 20 of this year was a strong signal and important step towards accelerating the implementation of this strategy. Another initiative is to change project evaluation criteria and service pricing structures to reflect as far as practical, true economic value, whilst providing basic services at a very low cost to the poorer members of the community. This is already much the case for power, other energy services, telecommunications, transport and toll roads, so its major impacts will be in water resources, sanitation and waste management.

A more complete description of how an enabling environment will be provided to the private sector is given in sections 5 and 6 below and the supporting volumes on general investment conditions and sector opportunities.

4. SCOPE AND PRIORITIES OF INFRASTRUCTURE PROGRAMMES AND PROJECTS

The Government's current Medium (RPJM) and long term development plans (RPJP), provide clear indicators of the priority for investment, in each infrastructure sector within the overall development programme. The government's development strategy is based on the premise that the private sector, driven by market forces must be the primary engine of development. The programmes for which we solicit private sector participation are all amongst those that we believe are viable for private sector investment, on a stand alone basis, or with reasonable government enabling and direct practical support.

Private sector participation in public infrastructure, other than as contractors, commenced in Indonesia with toll roads in 1988. The Government relatively late comers to the world-wide initiative to open up infrastructure to private sector enterprise. Nevertheless, progress is accelerating and the Government reform program in the medium term is undoubtedly radical. Firstly, it involves structural reform of the Public Enterprises. SOEs and ROEs will be corporatized and then run on commercial principles, using modern management and financial techniques. The Eventual aim of the government is to privatize the SOEs (and ROEs) at the appropriate time.

The second component relates to the large scale decentralization process that was introduced in the late 1990s. The current government aims to improve the process of fiscal transfers from the center, promote inter regional cooperation, improve the institutional capacity of the regional governments and agencies and prevent local government from imposing unnecessary regulations or in appropriate taxes and levies.

Thirdly, the government intends to complete the process of re defining the role of the government for many sectors. This process has been initiated, but much work remains to be done.

Lastly, the government intends to develop good governance as the norm in the conduct of government and business. Corruption in the civil services is a concern to the present administration.

Attracting foreign direct investment will be more challenging in the future for at least two reasons. Firstly, FDI is on the decline globally, and secondly competition is becoming much fiercer, with china and India still the preferred destinations. The Government issued on the early 2006 Inpres No. 3/2006 on the Policy Package for improving the investment climate in Indonesia to improve the General investment climate in Indonesia. The measures are as follows:

(1) to simplify the procedure to obtain permits and licences to within 30 days
(2) to revise laws and regulations on investment and infrastructure provision, and
(3) to provide tax incentives to promote direct investment in business activity and/or in certain national priority areas (to reduce regional disparity)

The package covers five main policy areas for 2006. The first policy area emphasizes general issues, including institional strengthening of investment services thru the new investment law which has been issues by the Government on April 2007. Harmonizing and synchronizing national and local government regulations, and the requirement for conducting a proper environmental impact analysis.

The second policy area deals with customs and excise improving customs procedure, expediting flow of goods, promoting the role of bonded warehouses, eradicating smuggling, and debureaucratization of the responsible agency.

The third policy area covers tax reforms, investment tax incentives, consistent implementation of a self assessment system, realigning value added tax to promote exports, and protecting the rights of tax payers as well as promoting transparency and disclosure.

The fourth policy area involves labor issues; creating a more conducive environment for industrial relations to support job creation, protecting and assisting proper job placement for overseas Indonesian labor, facilitating amicable, quick, cost effective and just settlement on labor disputes, simplifying the process of permit issuance on labor/employment related matters, creating a flexible and productive labor market and developing new approach for transmigration to generate employment.

The last policy area focuses on issues related to empowering small and medium enterprises (SMEs) and cooperatives.

4.1. In Telecommunications

PSP in Indonesian telecommunication sector was introduced in 1995 when 15 year operation partnership (KSO) concessions and licenses were granted to private consortia to operate fixed line local services in five out of seven Telkom Regions. The KSO scheme were intended to accelerate the rollout of fixed lines without forcing Telkom to completely give up its monopoly, and to pave the way for Telkom's privatization Telkom's privatization and planned public listing at the time. The KSO awards were made through a competitive process, with each winning consortium consisting of at least one international operator. The agreements contained specific fixed line installation obligations and for revenue sharing with Telkom according to adefined formula. The KSO granted control over existing Telkom as well as new built assets. The KSOs are expected to invest US $. 2 billion in infrastructure and install up to 2 million lines. In 2004, PT. Cyber Access, a 60% owned subsidiary of Hutchison Telecommunications international, and PT. Natrindo Telepon Selular, which is 51% owned by Malaysia's Maxis Communications, were each awarded a 3G license. In 2006, through an auction, Government awarded PT. Indosat, PT. Excelcomindo and Telekomunikasi Indonesia (Telkom) and PT. BAkrie Telecom did not secure a concession however, having failed to meet the minimum bid requirement of Rp. 100 billion for the ten year license. Indosat agreed to pay Rp. 160 billion, while Telkomsel and Excelcom tendered Rp. 218 Billion and Rp. 188 Billion respectively.

Value Added Services

Demand for phones between now and 2010 is expected to be in the area of 25 million new subscribers with many evolving added value services. By that time, we see technological innovation as being an even stronger stimulus to growth than the demand suggested by the demographic forces described earlier.

4.2. in Tourism

Tourism is an increasingly important contributor to our national output. Tourism development program with private sector participation include 13 projects with an estimated total investment of above US$ 643.6 million which are now at various stages of development. Indeed with its vast territory Indonesia has a lot of untouched places of interest that wait for a visible hand to discover its commercial potentials

4.3 In Energy

PSP in the upstream oil and gas industry is undertaken on the basis of a cooperation contract for oil and gas exploration and exploitation, which can be in the form of a productions haring contract (PSC), a technical assistance contract (TAC) or an enhanced oil recovery contract. These awarded by BP Migas on behalf of the government. PSCs are the main form of PSP in oil and gas, and there are signs of a new, more investor friendly approach to structuring the PSC. While the upstream oil and gas sector has been implementing PSP since early 1970s through PSCs, PSP has yet to make a significant impact in the downstream sector. In the downstream oil and gas sector, two gas pipeline projects were trendered by BPH Migas in 2005. The public notice was issued in July 2005.

In power sector was initiated through implementation of Paiton IPP Project in 1994, the paiton project was then followed by 39 others IPPs. The 1997 crisis and the subsequent depreciation of the Rupiah have made PLN unable to fulfill its obligation. As a result a number of IPPs were cancelled and 26 are continued after price renegotiaton. On the recent development only one project (Cirebon 600 MW coal-fired steam power plant was put out for tender in 2005.

4.4. in Sea Transport

There are over 2.133 ports in Indonesia: 977 General ports and 1.156 special ports. The SOEs, the various Pelindos, between them operate 111 ports. Two of the ports have the potential to become international hubs,namely Tanjung Priok and Tanjung Perak. Government is now planning another port in East Indonesia as another international hub (Bitung in North Sulawesi). Based on Law no. 21/1992 on shipping and PP 70/1996 on Port are the governing legislation. The new draft law removes the current restriction that PSP can only be undertaken as a joint venture with a Pelindo.

There are two major PSPs under Pelindo II: The Jakarta International Container Terminal and the Koja Container Terminal. In 1999, Pelindo III corporatized its container terminal operations. P & O Ports hold a 49% stake in the company. Since then the company has invested over US$. 60 million in new equipment and facilities.

Bojonegara port has been considered as a potential project. However, private interest in the proposed green-field port has been dampened by the fear that other ports in the vicinity would reduce the viability of Bojonegara.

4.4. Road Transport, Railway and InlandWaterways

Within 1994/1995 - 1998/1999, among 30 units of new passenger main terminal and 13 units of cargo terminal for land transport at a total cost of around US$ 47.2 million, most of them are expected to be funded by private investors.

In terms of development of railway there are the construction of 382 km railway tracks such a double track for Jakarta-suburban lines and Cikampek-Cirebon line, the improvement and rehabilitation of 847 km railway tracks and 177 railway bridges, the procurement of 56 signalling systems that mostly installed in the northern and southern railway-lines of Java, the procurement of 74 units of locomotive, 250 units of passenger coach, 124 units of electric rail car, and 430 units of coal wagon. In order to make a better modal split proportion, that is, to enhance the share of passenger using public transport services as well as to meet the passenger transport demand up to 2015 in Jakarta, the development of an MRT (Mass Rapid Transit) system is being planned as well. A study for the underground transportation system is being carried out and the implementation of the system is expected to come true in the next years. Private sector, national and international investors, is encouraged to fund this project which will account for around US$ 2.3 - US$ 3.2 billion (preliminary capital cost estimates). A such MRT system for other big cities, such as Surabaya , Medan , and Bandung, is also being considered to be implemented . By introducing this system, it is expected that passenger will prefer to use public transport services instead of private cars. In line with the implementation of the MRT system and faced with the development of congestion, the Ministry of Communications has supported the implementation of Area Traffic Control (ATC) systems in those cities.

To anticipate the increasing passenger and cargo demand on inland waterways, the construction of 51 new ferry berths, 60 new river and lake quays, the procurement of 27 ferries, and the instalment of river / sea traffic signs will be realized. The total budget for road traffic facilities, railway, and inland waterway programmes is projected about US$ 3.8 billion.

Air Transport

The air transport five year development programme responds to strong continuing business and tourism growth, as well as to anticipate the development of regional growth centres. These programmes include the improvement and the development of three main airports involving private sector as well as the improvement of runways at ten locations.

The Government still continue development, extension and modernization of several main airports, such as Hasanuddin Airport, New Lombok Airport and New Medan Airport, in order to facilitate the fast growing air passenger of more than 20% per year. Simultaneously, the Government also extend run ways and improve Instrument Landing System for most airports.

Roads

The basic regulatory framework on Road were Law No. 38/2004 and Government Regulation on Toll Road No. 15/21005, the Establishment of Indonesian Toll Road Authority based on Minister of Public Works Decree. Among the public works' infrastructure development program, toll roads and bridges are most attractive to private investments and thus are leading in terms of their stage and scale ofinvolving private sector participationSince 2005, the progress on Toll Road transactions as follows:

1. On the operation stages: 3 links (Cikampek-Padalarang, JORR E1 seksi 3 and 4, JORR W2 S2, approximately 47.85 km length
2. On the construction stages: 5 links JORR E3 Cakung – Cilincing, JORR E1 Utara Seksi 4, SS WAru Bandara Juanda, Jembatan Suramadu, Surabaya Mojokerto approximately 64.55 km.
3. On the concession agreement award 13 links (Kanci-Pejagan, Pandaan-Malang, Gempol-Pasuruan, Bogor Ring Road, Makasar Seksi IV, Depok Antasari, Cinere-Jagorawi, Kertosono-Mojokerto, Pejagan-Pemalang, Pemalang-Batang, Semarang-Batang, JORR W2 North) 497.50 km
4. On the finalization of concession agreement, 9 links (Waru-Wonokromo-Tg Perak, Gempol-Pandaan, Ciranjang –Padalarang, Bekasi-Cawang-Kp. Melayu, JORR seksi W1, Ciawi-Sukabumi, Semarang-Solo, Pasuruan-Probolingo, Cikarang-Tanjung Priok approximately 303.37 km
5. On tender 4 links (Cengkareng-Batuceper-Kunciran, Kunciran-Serpong, Serpong-Cinere, Cimanggis-Cibitung)
6. On the prequalification process, 2 links (Solo-Mantingan-Ngawi, Ngawi-Kertosono) approximately 177.12 km.

Total on going Toll Road Project consist of 36 links around 1.152,33 km which total cost approximately Rp. 86.482,36 billion. Other significant process is on the setting up a land revolving fund to ensure that land is acquired before a project is put out for tender. The BPJT (Indonesia Toll Road Authorities act as a Land Banking which will facilitate and manage the land acquisition process

4.4 Drinking water

Provision of clean water across the country is primarily the responsibility of Public Water companies (PDAMs) of which there over 300. Since 1992, the Government of Indonesia has undertaken the PPP in the water supply subsector in small scale such as for meter reading and bill collection as well as maintenance Works. The first PPP project is BOT project I Denpasar 1993. Then water supply services in Batam in 1995. In 1998, the modified concession in both of Western part of Jakarta and Eastern part of Jakarta by PT. Payja and PT. Thames PAM Jaya respectively and be continued up to now. Some success stories of PPP in Water supply sub sector which included BOT in Depasar, Concession in Batam, and BOT in Medan. There are at least now 2 projects on the operation stages of using the BOT schemes, BAnjarmasin water supply 500 l/sec and SAmarinda Water supply project 400 l/sec. There are some potential water projects which approximately will costs around Rp. 4.6 billion within the 13 recencies and municipalities including 1 (one) dam to increase investor certainty on the abailability of bulk water.

5.5. PRIORITIES, LEGAL AND FINANCIAL FRAMEWORK FOR PRIVATE SECTOR

5.1 General Infrastructure Investment Facilities

5.1.1. Perpres 67/2005 Public Private Partnership in Infrastructure

Perpres 67/2005, issued on 9 November 2005, defines the cross sector regulatory framework for the private provision of Infrastructure. Two modes of cooperation with the private sector are mentioned in the Perpres, either in the form of a Public Private Partnership (PPP) or a business license. The bulk of the stipulations in fact regulate the nature of PPPs and how there are to be implemented in Indonesia.

Perpres 67/2005 is a landmark for several reasons. Firstly, it provides a clearer, more transparent and accountable basis for infrastructure PSP. Procurement of the PPP concessionaire or business licensee must be done on a competitive basis, and the unsolicited approach discouraged. Secondly, there is the emphasis on partnership, of mutual benefit and gain that can be expected from engaging in a PPP rpoejct with the Government, which is captured in the notion of a reasonable rate of return to the investor. Without this precept, it would be difficult to sustain the PPP approach. Sustainability is crucial, given the huge infrastructure financing gap that Indonesia is faced with over the next 10 years. Thirdly, there is the prescription on proper project due diloigence that must be undertaken by the government agencies before any PPP project is put out to tender or a business license is put out for auction. This would help reduce the cost of doing business in Indonesia, especially since the development cost of transacting a PPP rpoejct is significant. Without proper due diligence, delays and extra costs in negotiating a PPP deal are likely to occur. Last, Perpres 67/2005 stipulates that fiscal support is admissible. This a politically sensitive issue, need to provide government financial support on any PPP project. The question of fiscal support would not arise in the case of a business license, as any need for fiscal support would be factored in the auction price.

5.1.2. Land acquisition under Perpres 65/2006

Land poses a major impediment for PPPs in Indonesia, because land for the project is often not available or acquired, unlike many countries, before the latter is put out for tender. Consequently, any potential investor in a PPP project has to factor in the risks associated with land acquisition: how long the process would take and how much the land would cost. This acts as a huge deterrent to potential foreign investors.

Land cost could be a negotiation item. It could be provided free to the project or paid for by the project, as an upfront cost or as part of operating cost il.e. a rental, both payable to the government. AHow land cost is treated clearly affects the project financial viability in different ways. Proof of land availability is usually a requirement for financial closure. In May 2005,the government issued the Perpres 36/2005 on land procurement for development related to the public interest, superseding Keppres 55/1993. Perpres 36/2005 further refined through Perpres 65/2006 which can be seen as part of the government’s effort to expedite land acquisition for the purpose of infrastructure development. A draft law on land procurement for development activity is at the review stage.

4.1.1. New Law on Investment

Direct investments in Indonesia are presently governed by the law on domestic investment (Law No. 6/1968) and the law on foreign investment (law 1/1967). These laws regulate the limited liability companies PT. PMDN for limited liability companies PT. PMDN for domestic investment and PT. PMA for foreign investment.

On the PMA side, the government has a negative list of investments i.e. businesses that are closed to foreign investment or where partial ownership is allowd. The present list is defined by Keppres 118/2000. Industries related to national defence such as, the productions of firearms, ammunitions, explosives, and war equipment are closed to foreign investment. While PMA cannot be wholly owned by a foreign investor, it can own up to 95% in the following infrastructure sectors, it can own up to 95% in the following infrastructure sectors such as: (i) Port development; (ii) Power Plant, transmission and distribution; (iii) shipping; (iv) water supply; (v) water supply; (vi) Railways; (vii) Telecommunications and (viii) Air Transportation.

All Foreign investors need to obtain approval from the Investment Coordinating Board(Badan Koordinasi Penanaman Modal) before establishing a PMA company. The role of BKPM is to provide a “one stop service”, as stipulated in Keppres 29/2004, especially on matters related to approval, licensing, and investment incentives. However, BKPM only facilitates the obtaining of the licenses and approvals from various ministries.

New laws on Investment stated that various implementing regulations are intended to establish a conducive business climate, create opportunities for cooperation between domestic and foreign investor, guarantee fair and healthy business competition and provide procedures that would speed up the obtaining of licences and permits. The significant change is the non discrimination between the domestic and overseas investor. An important concern, and there has been many public complaints on this, is the delays in obtaining licences and permits. The future role of BKPM will be more of an investment promotion and liaison agency for obtaining licenses and permits.

4.1.2. Law on Construction Services

Law 18/1999 on construction service is intended primarily to ensure quality of construction services. However, it also governs the procurement of construction services. It states that, irrespective of who is responsible for procuring the EPC contract, it must be conducted on the basis of a competitive tender. Under law no. 18/1999 exemption from the principle is permitted under certain circumstances. If the law is applied to the EPC contract under a PPP project, it implies that a construction company, which happens to be a member of the consortium awarded the PPP concession, may not be awarded the EPC contract. The Draft OGM (Operational Guidelines Manual) recommends that the EPC procurement should be unregulated for two reasons. Firstly, the PPP concession would have been awarded competitively and on the basis of a capital cost scrutiny by the contracting agency. Secondly, it may lessen unnecessarily private interest in PPP.

4.1.3. Law on the Management of the Environment

Environmental issues are governed by Law 23/1997 on the Management of the Environment and PP 27/1999. The latter stipulates that the proponent of a project may be required to submit an AMDAL proposal, consisting of a KAANDAL (the terms of reference for the environmental impact assessment), and ANDAL (The Environmental impact assessment), a RKL (mitigation plan), and a RPL (Monitoring Plan) to the appropriate environmental agency. Once the AMDAL proposal is approved, the proponent then conducts and submits the ANDAL, RKL and RPL on the basis of the KA-ANDAL. Final approval depends on the AMDAL being satisfactory and that there are no major adverse environmental impacts which can not be mitigated. The whole process can lasts between six to eighteen months. However, if an AMDAL is not required, the proponent still has toproduce the RKL and RPL.
Indonesia provides a healthy macro-economic and legal climate for private sector investment, enshrined under the Capital Investment Law No. 1 of 1967, amended by Law 11 of Indonesia provides a healthy macro-economic and legal climate for private sector investment, enshrined under the Capital Investment Law No. 1 of 1967, amended by Law 11 of 1970. The international component of investment is rising in response to a well established environment of sound fiscal and monetary management, freedom to enjoy the returns on investments, and a continual rationalizing of investment policies and procedures.

An increasingly conducive approach is provided to general industry and infrastructure investments. The most recent deregulation following issue of Government Regulation number 20 of 1994, is perhaps the most profound demonstration of our determination to attract, enable and safeguard private sector investment generally, and in infrastructure services in particular.

The international and domestic private sectors are now encouraged to invest on almost equal terms in new companies and projects in all of the infrastructure services that I have described. International investors are allowed to set up companies to operate in Indonesia on the basis of 100% Foreign Direct Investment, unless the business activities are categorised as important to the State and serving the public. Ports, electricity, for public use, telecommunications, hipping lines, airlines, potable water and public railways fall under this classification. Based on the same principle, toll roads would also fall under this classification.

However, even for these sectors, 95% foreign ownership and 5% ownership by an Indonesian legal entity is allowed. These capital investments, once approved through BKPM, the Investment Coordinating Board, receive renewable business licenses for 30 years. They enjoy full protection under Indonesian Law and the safeguards of International Law. They also benefit from international investment guarantees, provided to investors from most countries under bilateral agreements, as well as the security of the Indonesian government’s long record of demonstrating respect for internationally accepted legal norms and the rule of contract. Such investments also enjoy tax provisions and other facilities to assist administrative processes that are set out in brochures issued from BKPM.

In accordance with the BKPM process and laws and regulations governing infrastructure sectors, access to infrastructure investment is provided either by way of solicited investments for particular projects or by investors coming forward with proposals in line with the Government programme or for innovative improvements of services. The government agency or relevant public enterprise therefore provides the means to obtain market access. They are also agents for ensuring compliance with regulations requiring infrastructure services to achieve quality standards, and be open to the public at an affordable cost. A draft of national regulation that would provide a general framework the processes of procuring private investment in infrastructure consistent across sectors is now under consideration. This will provide additional clarity as well as uniformity within the regulations and models applied in each infrastructure sector. The Government gives a very high regard to the commitment made by the private sector when it takes on the business under these conditions which are necessary to protect the public interest. The need to operate within these restrictions and the burden they place on companies that have committed large funds to immobile infrastructure investments must be responded to by the Government and public enterprises. The overnment provides support to safeguard the long term viability of investments against constraints to income due to regulation, or material adverse effects of government actions, or specified macro economic changes. The Government actions to ensure viability of investments and the infrastructure services they support are tailored to the characteristics of each programme and to each mode of private sector participation. They are also tailored to the needs of specific projects according to their special cost, affordability and risk characteristics.

The proposed innovations in ADB's guarantee policy will provide a tremendous opportunity to augment and extend these methods of ensuring investment viability and creditworthiness. We see them as providing opportunities to improve terms from financiers, to make the investments appealing to a wider range of institutional and smaller investors and to reduce the transaction cost of establishing investmment and risk management.

As Financing terms continue to evolve, we are increasingly in need of, and being approached with innovative financing methods that have application in lower margin and lower long term risk investments. The current status of the legal system and diverse circumstances for investment in each infrastructure sector have prompted the Government to adopt a flexible approach. We can re-phrase that by saying, the Government's approach is to be responsive to the equirements to make each kind of project viable within a consistent set of policies, supported by regulations to protect the public interest.

This approach can be illustrated by reference to the modes of support provided to some of the recent past projects; and perceptions of how we would proceed with similar future projects.

5.2 Sector Investment Facilities

Although sector policies and facilities originally developed independently there is a common rational to the selection of projects and the determination of the level of government support to achieve a viable private sector investment. Projects are seen as falling into three categories:
? Projects that have a relatively high direct cost recovery potential. Value added and mobile telecommunications, as well as toll roads have generally been in this category; ? Projects whose product can be absorbed in a broader system and the value of the product is relatively high and can be readily determined in terms of, cost reduction in the system, alternative

production costs or value net of distribution costs, such as for power supply; ? Projects that have a high economic or social value that justifies additional government support, but significantly less than the burden of public sector implementation, although they may initially have more slowly developing cost recovery potential. Water supply and waste management are examples that tend to fall more into this category.

Within those categories the Government has tended to offer to the private sector those projects which are to respond to the more clearly visible and large scale shortfalls in capacity compared to demands. This has been predominantly projects that serve the intra-urban and interurban needs of the large cities of Java, whilst public sector funding and multilateral agency funding has been applied more to the other projects in these areas and the infrastructure needs of the remainder of the country.

The application of the selection and graduated government is illustrated below by selected references to sector policies. A more complete picture is provided in separate Sector Report volumes.

Telecommunications

In telephone services revenue sharing supported by conventional guarantees on price for services in place has been successfully used. We are now moving towards joint operation schemes in which investor's can be rewarded for sharing in a much broader spectrum of the business activities, risks and benefits. The lucrative nature of this market in Indonesia continues to make investments in projects, and in founding supporting manufacturing facilities, very attractive without the need for other substantial government assistance. Other forms of investor participation are through equity participation in permanent joint ventures with corporatised state enterprises and through public share flotation on the domestic and New York bourse.

Power

Power generation projects for sale of product to the National Power Enterprise, PLN, have been based on a guaranteed market and on a negotiated value of output. The government's support is through its ties to PLN and the establishment of an extensive distribution grid that enables the commitment of PLN to take the output at agreed prices. The prices have been expressed in foreign currency equivalent where appropriate. On the other hand, the private sector is also invited to supply directly to special areas, such as a group of industries, under contracts negotiated with the consumers. For thermal generation BOO is the preferred arrangement. We are also open to initiatives for power transmission and performance improvement investments. The government is examining further ways to gradually restructure the power sector and improve efficiency through competitive pressures.

Roads

The toll road projects under way and under negotiation receive revenues from tariffs based on user cost savings formulae. Alternative routes are always ensured to the public and so investors cost recovery is calculated from an agreed formula reflecting traffic build up, underlying cost indices and a ceiling of 70% of user cost savings. the necessary formula based adjustments receive presidential approval ensuring the national commitment to toll road viability and system extensions that is so necessary to economic development. This protects investors from any local or project specific public pressures against justified tariff adjustments.

The specific government support here has been in land provision, where necessary, and the support the Government provides to the National Highway Corporation, Jasa Marga, which is both owner and an equity and operating partner for individual investments. This has, in turn, allowed Jasa Marga to assist in cash flow management for projects during periods when tariff adjustments are still being processed.

Water

Water supply in Indonesia generally falls into the category of projects that have a high economic or social value but with initially slowly developing cost recovery potential. It is therefore a good subject for illustrating the government's policy of progressive commercialization and graduated assistance to infrastructure provision.

Water supply is the responsibility of public enterprises, utilities called PDAMs, owned by municipalities. Key factors effecting the financial viability of water supply investments have been that:

1. The enterprises with a history of low tariffs and their owners, the municipalities, are not well place to carry any risks or subsidise the project during any early shortfalls in cash flow;
2. There is no longer a direct national government connection to these PDAM enterprises, nor a national water authority that enables the support or risk and cost spreading that are possible for toll roads, power and telecommunications through their national authorities;

Some projects are quite feasible in those circumstances, many were not. It is the Government's policy that water enterprises now be run on a more commercial basis in balance with fulfilling social service obligations. Even so, full cost recovery on commercial terms is sometimes not viable in the first few years of projects. To respond to this, the Government will require local government enterprises to raise tariffs faster than inflation up to economic cost recovery levels before system expansions will be assisted. In turn, the Government will consider each case on its merits for complimentary investments and other interim financing supports that will reduce the short term burden to consumers of meeting full economic cost recovery.

The process to determine the level of assistance to a project is generally as follows. Calls for private sector participation in water supply are made by the water enterprises, supported by the Ministries of Public Works and Home Affairs. The subsequent presentations to the private sector and project refinements have three strong characteristics. These are, the search for financing sources that value the high long term returns available, and that can accommodate low or fluctuating short term returns. Secondly, the identification of practical risk management measures in preference to contracted risk transfer or sharing. Thirdly, a case by case examination of the technical, economic and social merits of each system improvement to receive central government complimentary investment or financing of the water enterprise's complimentary investments. Lastly, a final allocation of net risks.

The private sector now also is enabled to invest in providing water on a commercial contract basis directly to special areas, such as groups of industries. The government is continuing to examine measures to increase the range of projects and speed at which private sector enterprise can be brought into water supply and waste management. The Indonesian Government is also examining how longer term and more flexible financing, as enjoyed by the public sector, may be made available to the private sector on government endorsed infrastructure projects. There remains latent demand for infrastructure services over and above the basic programme targets described in section 4. Investors can propose further investments to serve that demand, particularly in value added services where full cost recovery is born by consumers. Earlier we noted that whilst the opportunities for completions beyond 1999 are relatively unrestricted. There are some conditions that would be applied to reviewing new project proposals to go beyond Repelita VI targets before then. Our concern here is that further acceleration neither overburdens the government in terms of large calls for counterpart investment, nor tends to overheat the economy. By the latter we mean that the government takes a more cautious approach to approving major new investments, beyond that already allowed in the Repelita VI, when they call for large borrowings of international funds.

A much more flexible stance will be taken by the national capital investment approval board where the projects rely on domestic funding or international equity, or other repayment finance forms that do not add significantly to rigid international debt servicing commitments. Similarly unsolicited or accelerated programme investments which provide relatively high real cost savings to the economy, such as toll roads, are likely to receive a more favourable response.

5.3 Investment Programme Flexibility

There remains latent demand for infrastructure services over and above the basic programme targets described in section 4. Investors can propose further investments to serve that demand, particularly in value added services where full cost recovery is born by consumers. Earlier we noted that whilst the opportunities for completions beyond 1999 are relatively unrestricted. There are some conditions that would be applied to reviewing new project proposals to go beyond Repelita VI targets before then. Our concern here is that further acceleration neither overburdens the government in terms of large calls for counterpart investment, nor tends to overheat the economy. By the latter we mean that the government takes a more cautious approach to approving major new investments, beyond that already allowed in the Repelita VI, when they call for large borrowings of international funds.

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6. GOVERNMENT COMMITMENT SUPPORT AND MANAGEMENT OF RISKS

The Government is committed to achieve the infrastructure programmes above and to provide the private sector with a healthy environment and firm project by project support to implement supporting investments. It is the commitment to achieving those objectives that provides the main impetus for national and local government cooperation with the private sector. Similarly the commitment to ensure that development serves all of the community across Indonesia has so far induced caution against privatization of utilities. It is also this commitment, rather than regulation that provides the basis for establishing the appropriate level of private sector cooperation and government support in each programme and project. This has particular bearing on the shorter term risk management provisions for each programme. Although there may therefore be a wide variation between support measures agreed for each project, once agreed, are fully supported by the government.

The infrastructure demand are huge in this country, in International as well as domestic financial markets, Indonesia has to compete for a limited pool of financial resources to meet its infrastructure needs, while avoiding past experiences that resulted in large liabilities for the Government. There is a need to execute major policy reform on infrastructure such as:

1. The government has to attract private sector into financing, construction, operation and maintenance of commercially viable projects and services. The Government recognizes that financing requirements can only be met through an effective and judicious combination of public and private sector resources.
2. Infrastructure assets and services have at time been offered to the private sector in an ad hoc manner, with unsolicited proposals used as a surrogate for planning. Indonesia should strengthen strategic planning in Infrastructure sectors to identify where and when private sector participation should be encouraged, to monitor whether such participation is adequate to meet needs, and to determine the level of complementary support to be provided through public private partnerships. Private sector investors need clarity and predictability about sectoral incentive frameworks and restructuring plans. With comprehensive planning will enhance the effectiveness of public sector infrastructure investments.
3. Technology Innovation obviate the need for vertical and horizontal integration of infrastructure sectors to reap economies of scale. There will be a creastion of independent infrastructure providers, such power producers and distributors, toll road operators and port concessionaires, can improve efficiency, reduce costs and enhance the quality of service to consumers. Fight against corruption with transparent competitive bidding should be adopted both for sales or concessions of existing assets and the selection of sponsors for new infrastructure projects
4. Tapping domestic currency sources of financing infrastructure development is critical. However the financial capabilities of commercial banks to contribute needs to be carefully assess. It is equally important to ensure that banks manage their sector and single party risks prudently based on a sound governance framework. Long terms Capital market instruments that can effectively mitigate the problems of financing by commercial banks should be developed. Measures taken now to deepen the

development of pension and life insurance sectors. It their funds are invested in the capital markets, would provide alternative sources of financing infrastructure.

5. Setting up appropriate risk mitigation and sharing is essential. Each reform step in the righ direction reduceds the need for government guarantees. The shorter the transition period to credible judicial and regulatory systems, and commercialized and open infrastructure sectors, the lighter will be the guarantee burden. Government guarantees cannot be completely avoided during this transition period in Indonesia, but they should be used judiciously. . The Guarantees need to be quantified, reflected as contingent liabilities in the consolidated public sector budget and capped.

We certainly look forward at any time to suggestions from the infrastructure industry and colleagues in other concerned agencies for innovative ways to facilitate progress in each sector. In the mean time, it will remain government's responsibility to maintain balance by compensating for the difficulties of achieving high rates of private sector investment in some programmes and in some regions with more use of government facilitating support or complimentary investment

LIST OF SECTORAL PROJECTS

UNDER PUBLIC-PRIVATE COOPERATION SCHEME