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Removing Infrastructure Bottlenecks to Increase Indonesia's Competitiveness towards the ASEAN Economic Community



SUMMARY

Facing the ASEAN Economic Community, which takes into effect on December 31, 2015, requires high competitiveness in order to gain the benefits from it. Among ASEAN member countries, Indonesia is one of the countries which have low competitiveness. This is due to insufficient infrastructure in Indonesia. The government of Indonesia is facing many obstacles in developing infrastructure. This edition of ASEAN Briefs shows that there are at least four main problems hindering infrastructure development in Indonesia, namely: financing issue, land acquisition problem, lack of capacity in implementing projects, and lack of coordination. If the upcoming government does not resolve those problems, Indonesian companies will struggle to compete with other ASEAN member-states when the ASEAN Economic Community takes place.

Therefore, this ASEAN Briefs will (1) examine Indonesia's current state of readiness ahead of the ASEAN Economic Community 2015 in terms of infrastructure and competitiveness, (2) the obstacles and challenges facing the new government in developing infrastructure, and (3) give possible recommendations to the new government in order to increase Indonesia's infrastructure and competitiveness ahead of the ASEAN Economic Community 2015.

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Introduction

The ASEAN Community that will come into effect by the end of 2015 is built upon three pillars, one of which is the ASEAN Economic Community. As the new government of Indonesia takes office in October 2014, it will be both confronted by numerous economic challenges and be presented with several opportunities in the ASEAN Economic Community pillar.

Compounding the pressure to address these challenges and opportunities is the fact that from the moment of his presidential inauguration on October 20, 2014 to the realization date of the ASEAN Community on December 31, 2015, Indonesia's new leader Joko Widodo will have just over a year left to prepare the country's readiness for the ASEAN Economic Community. Given the huge task facing the new government and the limited time remaining, it is apparent that the issue of Indonesia's readiness for the ASEAN Economic Community 2015 is a critical one.

One of the prerequisite for ASEAN member-states to benefit from the ASEAN Economic Community is to have high competitiveness. Unfortunately, Indonesia's competitiveness is still low compared to several ASEAN member-states. One major factor that hinders Indonesia's competitiveness is poor infrastructure.

Infrastructure Development in Indonesia

Over the past ten years, Indonesia's competitiveness has actually improved. According to Darwin TrisnaDjajawinata, Director of Projects Development and Advisory of PT. Sarana Multi Infrastruktur, this was due to the stability of the country's GDP growth, improvements in Indonesia's infrastructure and connectivity, and better governance.¹ Nevertheless, the current competitiveness is still low compared to several ASEAN member-states. Based on The Global Competitiveness Report 2014-2015, Indonesia is ranked 34th out of 144 countries. This position is below Singapore (2), Malaysia (20), and Thailand (31). One major factor that hinders Indonesia's competitiveness is poor infrastructure when compared to other ASEAN countries. Singapore, Malaysia, and Thailand have better infrastructure with the report showing that Singapore is ranked second in terms of infrastructure, followed by Malaysia, Thailand, and Indonesia (Table 1).

In terms of road infrastructure, Indonesia's length of toll road was 778 km in 2012. This was shorter than Malaysia (7,000 km) and China (65,065 km).² Moreover, the quality of road in Indonesia is ranked 72nd out of 144 countries. This lags behind Singapore (6), Malaysia (19), and Thailand (50).³ The road infrastructure development in Indonesia also varies in each island. In 2009, the road network in Sumatera and Java accounted for 59% of the total road network in Indonesia. On the contrary, Maluku, West Nusa Tenggara (NTB), East Nusa Tenggara (NTT) and Papua only make up for 13% of the total road network.⁴ The data therefore shows that there is an infrastructure development gap between western and eastern Indonesia.

Developing road infrastructure is crucial since the demand for road services is increasing. According to the World Bank data, there were 34 vehicles per km in road in 2011. This meant that the volume gradually increased from 20 vehicles per km in road in 2004.⁵ However, the road development in Indonesia still cannot keep pace with the increase in the number of vehicles especially in big cities such as Jakarta, Surabaya, and Medan.

For seaport infrastructure, based on American Association of Port Authorities (AAPA) data, only TanjungPriok port is among the list of the 100 biggest ports in the world. Unfortunately, the capacity of TanjungPriok is still lower than Singapore and Malaysia's port. In 2012, TanjungPriok - as the biggest port in Indonesia - only had a capacity of approximately 6 million twenty-foot equivalent units (TEU) per annum. Meanwhile Singapore had 30 million TEUs per annum, whilst Port Kelang and TanjungPelepas in Malaysia had 10 million TEUs per annum and 7 million TEUs per annum respectively.⁶ As a maritime country with a coastline length of 95,181 km, large ports capacity is important. Aware of the situation, the government has begun a project to increase TanjungPriok's handling capacity by up to 12 TEUs per annum by 2017.⁷

Besides road and seaports, the development of airports infrastructure also faces substantial challenges. For the past 5 years, the number of air passengers in Indonesia increased significantly to 85 million people in 2013 from 27 million people in 2009.⁸ This development forces some Indonesian airports to run beyond their capacity. Hence, some of airports in Indonesia are already overcrowded. In response to this, a number of airports have begun upgrading themselves. Among them, two are especially important: Soekarno-Hatta airport in Jakarta—Indonesia's largest airport—has begun a major upgrade to double its capacity in 2013 and is projected to complete in 2015;

Tabel 1. Global Competitiveness Index 2014-2015 : Infrastructure

No.	Country	Overall Rank	Quality of Overall Infrastructure	Quality of Roads	Quality of Railroad Infrastructure	Quality of Port Infrastructure
1.	Singapore	2	5	6		2
2.	Malaysia	25	20	19	12	19
3.	Thailand	48	76	50	74	54
4.	Indonesia	56	72	72	41	77
5.	Philippine	91	95	87	80	101

Source : World Economic Forum (2014)

while Medan has seen the completion of a new Kuala Namu Airport to replace the old Polonia airport.⁹ While these are positive initiatives, the implementation of the projects did not proceed without problems. For example, the improvement of Surabaya's Juanda International Airport capacity fell behind its passenger growth rate.¹⁰ Moreover, the projected completion of Ngurah Rai Airport improvement in 2013 was also delayed until later in 2014.¹¹

At the same time, other ASEAN countries are also making improvements to their airports. Leading this is Singapore's Changi Airport that has embarked on a project to double its current capacity of 70 million passengers by 2017.¹² Based on that fact alone, Indonesia will automatically already lag behind Singapore.

Overall, Indonesia's infrastructure quality is still lower than other ASEAN member states such as Singapore, Malaysia, and Thailand (Table 1).

Negative Impact of Inadequate Infrastructure

Insufficient infrastructure does not only reduce Indonesia's competitiveness but it is also preventing Indonesia from achieving its potential economic growth. Karsten Fuest, International Finance Corporation (IFC) senior investment officer said, "Lack of infrastructure results in bottlenecks, hampering future growth opportunities".¹³ According to Ndiame Diop, Lead Economist of The World Bank during the Seminar "Indonesia: Avoiding The Trap", Indonesia lost 1% of economic growth each year for the past few years due to low infrastructure investment.¹⁴ Furthermore, based on McKinsey Global Institute analysis, a 1% infrastructure investment will create 700,000 direct and indirect jobs in Indonesia.¹⁵ Hence, Indonesia will lose the opportunity to create more jobs for every 1% decrease in infrastructure investment.

Inadequate infrastructure has created high cost economy due to high transportation and logistics costs. Logistics cost in Indonesia was recorded at 27% of GDP. This is higher than Malaysia (15%), Japan (10.6%), and the United States (9.9%).¹⁶ According to the Chairman of Indonesian Logistics Association (ALI), Zaldy Masita, logistics costs were supposed to be no more than 15%.¹⁷ In addition, among ASEAN member states, Indonesia's logistic performance is lower than Singapore, Malaysia, Thailand, and Vietnam with a score at 3.08 (Table 2).¹⁸ Realistically, it is hard for Indonesia to have the same low logistic cost as a continental country if we recall that Indonesia is a maritime country with 17,499 islands. However, the government should not let the logistic costs become too high.

Table 2. Logistic Performance Index 2014

No.	Country	LPI Rank	LPI Score
1.	Singapore	5	4.00
2.	Malaysia	25	3.59
3.	Thailand	35	3.43
4.	Vietnam	48	3.15
5.	Indonesia	53	3.08

Source : World Bank (2014)

Moreover, since transportation infrastructure development is lagging and only concentrated in Java and Bali, transportation cost is also soaring for production and inputs.¹⁹ High logistic costs and transportation costs will lead to high price of Indonesian products.

The lack of sufficient infrastructure also hinders the delivery process especially in the delivery of horticultural products. Since these products are perishable and easily deteriorating, the delivery process should take place in a timely manner. Unfortunately, according to McKinsey Global Institute, insufficient infrastructure makes almost 50% of production lost during the delivery process.²⁰

Price disparity is another negative impact of poorly performing infrastructure. For example, according to A. Tony Prasetyantono, Director of Center for Economic and Public Policy Studies, Gajah Mada University, cement prices in Papua is Rp 1,5 million per bag which is almost 25 times more expensive than cement price in Java which is Rp 60,000 – Rp 70,000 per bag. The cement needs to be delivered from Jayapura to Wamena since it cannot be delivered through land transportation because there is no road between the two cities. As it has to be delivered through air transportation thus the price is expensive.²¹

In addition to that, price disparity sometimes encourages people to import foreign products rather than buying local products. According to Samsu Rahardja, Senior Economist of The World Bank, the reason for this is that foreign products are cheaper to import than local products although it is transported domestically from other islands in Indonesia.²² This fact shows us that connectivity within Indonesia is very poor and limited due to insufficient infrastructure.

Another problem created from poor infrastructure is traffic congestion. Due to cheap fuel price, people tend to buy private cars. However, the development of roads in Indonesia cannot keep pace with the increase in number of vehicles. Among the big cities in Indonesia, Jakarta is one of the cities which faces gridlock. Based on McKinsey Global Institute, the congestion cost in Jakarta in 2010 reached \$5.2 billion; higher than the previous year which was recorded at \$4 billion.²³ The costs consequently lead to loss in productivity and fuel consumption.

Businessmen in Indonesia already complain about poorly performing infrastructure. Ivan Iskandar Batubara, Chairman of Indonesian Chamber of Commerce (KADIN) of North Sumatera, stated that due to the poor infrastructure, production costs in Indonesia are high thus competing with other countries would be hard.²⁴ If the upcoming government does not resolve this issue it will result in Indonesian companies struggling to compete with Singapore and Malaysia when the ASEAN Economic Community takes place.

Infrastructure Development Challenges in Indonesia

The Indonesian government faces many infrastructure challenges. There are at least four main problems that

hinder the development of infrastructure in Indonesia, namely financing issue, land acquisition process, lack of capacity in implementing projects, and lack of coordination.

Financing Issue

Financing issue is one of the biggest challenges in developing infrastructure in Indonesia. Sarvesh Suri, IFC Indonesia Country Manager, stated "Many Asian countries such as Indonesia are still facing constraints in developing and funding infrastructure projects".²⁵ Based on the draft of National Medium Development Plan Term (RPJMN) for 2015 – 2019, the government needs approximately Rp 5.452 trillion during that period or Rp 1.090,4 trillion each year to build infrastructure.²⁶ Unfortunately, the government has limited abilities to finance infrastructure projects. In the 2015 budget, allocation for infrastructure is only Rp 169 trillion, lower than the 2014 budget which is Rp 206 trillion.²⁷ Thus, there is a funding gap between funding needs and the government budget.

Infrastructure investment does not only consist of government spending but also investment from state owned ownership (SOE) and private sector. Before 1997, the government and the private sector invested a lot in infrastructure, thus infrastructure investment could reach 5% of GDP. However, after the crisis, infrastructure investment was decreased to 2% of GDP. Since then, it could not achieve the same percentage as it was before the crisis.²⁸ Sjamu Rahardja said that if the government wants to achieve economic growth at 7%, spending on infrastructure should be at least 10% of GDP.²⁹

Apart from the government budget, another source of financing in developing infrastructure is the banking sector. However, there are several problems related to banking sector funding. *First*, infrastructure projects need long-term financing meanwhile banking sector can only provide short-term financing. The range of deposit tenure is mainly 1 month to 12 month. In contrast, most of the infrastructure projects will take more than five years. Thus, there is a mismatch between the timeframe of infrastructure project implementation and the supply of money from the banking sector. Nonetheless, infrastructure financing still rely heavily on the banking sector.

According to the Head Commissioner of Financial Service Authority, Muliaman D. Hadad, it was important to find another source of financing such as insurance, capital market, and pension fund.³⁰ Those non-bank financial institutions can provide long-term fund which is needed to finance infrastructure projects. Unfortunately, at the moment this is still limited.

Second, instead of availability of long-term fund, infrastructure projects also need low interest rate fund. Unfortunately, lending rate in Indonesian banking sector is relatively higher than other ASEAN countries. From the World Bank data, the lending rate in Indonesia in 2013 is 11,7%, higher than Singapore (5,4%), Malaysia (4,6%), and Thailand (7%).³¹ Although infrastructure financing still rely on the banking sector, high lending rate can increase

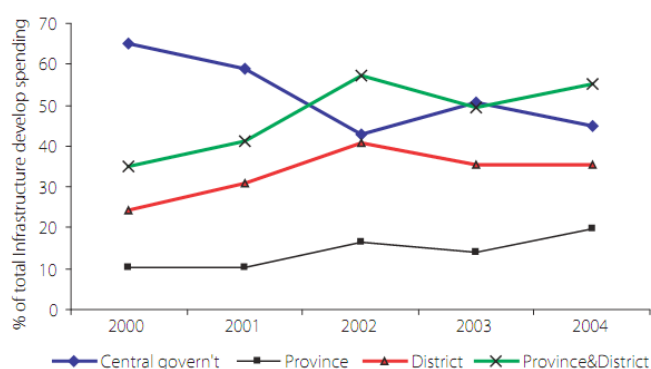
the financial burden of the project since high lending rate means high borrowing cost.

Third, nowadays banking sector is facing limited liquidity. Loan to deposit ratio (LDR) has already reached 88,93% as of September 2014.³² LDR in Indonesia has ranged between 78% - 92% based on the Bank of Indonesia's rule. Therefore, the banking sector is facing narrow space to finance infrastructure projects.

Lack of capacity

Due to the decentralization, building infrastructure in local area also becomes the sub-national government's responsibility. Hence, after 2000, infrastructure spending by sub-national government has been increasing by 20% from 35% in 2000 to 55% in 2004.³³

Graph 1. Infrastructure Spending After Decentralization



Source : World Bank (2007)

Even though the sub-national governments have their own infrastructure budget, this does not mean that the financing issue has been solved. They should have the capacity to use and manage the budget properly. According to former finance minister, Chatib Basri, local government should have better project planning and ease the land acquisition process because sometimes money was not the issue in developing infrastructure.³⁴ Regional Autonomy Watch (KPPOD) recorded idle and undisbursed funds of around Rp 116 trillion in 2013 - an increase from Rp 99 trillion in 2012.³⁵ Not only idle, sometimes the spending is only concentrated at the end of the fiscal year. This is due to the lack of efficiency in using limited infrastructure budget. Facing the limited budget for infrastructure, it is necessary for the central and sub-national government to use and optimize the existing budget.

Aside from the lack of budget management, the underspent budget is also caused by lack of capacity and communication between line ministers.³⁶ A study conducted by Iqbal and Suleman showed that lack of capacity of the local governments caused slow budget disbursement for infrastructure projects and delay project implementation.³⁷

In addition to that, sub-national governments are actually not only responsible for building new infrastructure but also for maintaining the quality of infrastructures

that have been built. Nevertheless, many sub-national governments do not do these maintenance, thereby many infrastructure projects done by the government end up with low quality. According to Kannan and Morris, sub-national governments often fail to do the maintenance because they do not allocate enough money.³⁸ In the future, it is important to enhance efficiency and effectiveness of the use of infrastructure budget by sub-national governments, whether to build new infrastructure or to do the maintenance. This can only be done by enhancing capacity of sub-national governments to have better project management.

Lack of coordination

A study conducted by Kannan and Morris showed that lack of coordination often becomes an obstacle in resolving land acquisition process.³⁹ Additionally, according to Pisu, the underspent budget is also caused by lack of coordination.⁴⁰

One of the reasons is lack of ownership. For example, the implementation of the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) project was quite slow as a result of the lack of ownership of local governments in the project.⁴¹ Local governments were not involved during the project preparation and implementation thus their ownerships of the project were not as high as with the central government.⁴²

The second reason is that there are too many institutions and authorities involved. Responsibilities to develop infrastructure are spread among ministries thus it creates a complexity in resolving problems such as land acquisition. Many institutions involved means there will be many permits needed, especially when there is lack of coordination. The new government under President Joko Widodo has already acknowledged the complication in ministries' coordination. Thus, in the first cabinet meeting, President Joko Widodo ordered his ministries to remove their "sectoral egos" in order to resolve problems hindering development programs, such as land clearance.

At the moment, there are many government institutions as well as state-owned ownerships that deal with infrastructure development, namely the Coordinating Ministry of Economic Affairs, Ministry of National Development Planning/National Development Planning Agency (BAPPENAS), PT. Sarana Multi Infrastruktur (SMI), Indonesia Infrastructure Fund (IIF), and Indonesia Infrastructure Guarantee Fund (IIGF). The most important thing is to increase coordination among existing institutions in order to accelerate infrastructure projects implementation.

Land Acquisition

Another problem that impedes the infrastructure development in Indonesia is land acquisition. Many infrastructure projects in Indonesia are delayed due to land acquisition problems. Land acquisition problem is not only acknowledged by the government but also by foreign governments. According to a representative from the Embassy of Japan to Jakarta, Kijima Yoshiko, land

acquisition has become the main obstacle in building infrastructure in Indonesia.⁴³



Source: USAID - <http://goo.gl/XuKApW>

There at least three things to be considered related to land acquisition. *First*, the government should give compensation in terms of money to the people. However, on some occasions when the local people know that there is an infrastructure project that will use their land, they will likely increase their land value in order to seek profit. In other words, speculation often happens during land clearance. This leads to land prices soaring above the estimated price. Thus, negotiating compensation takes time and it becomes hard to reach a deal. *Second*, the government should not only give compensation in terms of money but also non-physical compensation. When the government reallocates people to new places, the government should manage the potential social conflict between the newcomers and the local people. *Third*, determine the people that should be given compensation. The government should consider which people have direct and indirect impact from land acquisition.⁴⁴

Basically, the main problem related to land acquisition is to reach a consensus on land price. According to a survey conducted by the Islamic Development Bank (IDB) in 2009, in terms of cost, 69% respondents said land clearance in Indonesia was expensive.⁴⁵ The government should negotiate the land price not only to the land owner but also to the non-government organization who become the community's adviser, speculators who take advantage of the situation to make profit, and the local government. Hence, negotiation takes a long time and it is full of uncertainty. This condition can cause projects delay and costs increase. Therefore, banks are reluctant to finance infrastructure projects.⁴⁶

In order to resolve land acquisition process, Darwin Trisna Djajawinata mentioned that the implementation of Law No 2/2002 on land acquisition has been somewhat successful in addressing the issue.⁴⁷ Moreover, to accelerate the land acquisition process through "one-map-policy", President Joko Widodo made a new ministry: Ministry of Agrarian and Spatial Planning. Thus, it is expected that land acquisition will not hamper the implementation of development programs in the future.

Policy Recommendations

Based on previous explanations, there are several recommendations to improve infrastructure development in Indonesia, which is critical ahead of the ASEAN Economic Community:

First, since there is infrastructure development gap between western and eastern Indonesia, the government should narrow the gap by accelerating infrastructure development in eastern Indonesia. The ASEAN Economic Community will affect people from both the western side and eastern side of Indonesia. Thus, developing infrastructure across Indonesia is important to increase internal connectivity so that the transportation and logistics cost can be reduced.

More specifically, the government should continue to focus on improving maritime connectivity, as it can help push development in the eastern part of Indonesia by cutting the cost to transfer logistics and construction equipment to the area.

Second, it is important for the government to build basic infrastructure especially in remote areas. Private sectors are sometimes reluctant to expand their business or to build infrastructure in areas where there are no basic infrastructures.

Third, developing other source of financing such as insurance, capital market, and pension fund since those non-bank financial institutions can provide long-term fund which are needed by infrastructure projects.

Fourth, increasing coordination among line ministries to resolve the land acquisition process. Moreover, there should be clear division of responsibilities among related ministries so that there will not be any overlapping tasks.

Fifth, enhancing the capacity of central and sub-national governments especially in project preparation, implementation, and budget management.

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About ASEAN Studies Program

The ASEAN Studies Program was established on February 24, 2010, to become a center of excellence on ASEAN related issues, which can assist in the development of the ASEAN Community by 2015. The Habibie Center through its ASEAN Studies Program, alongside other institutions working towards the same goal, hopes to contribute to the realization of a more people-oriented ASEAN that puts a high value on democracy and human rights.

The objective of the ASEAN Studies Program is not merely only to conduct research and discussion within academic and government circles, but also to strengthen public awareness by forming a strong network of civil society in the region that will be able to help spread the ASEAN message. With the establishment of ASEAN Studies Program, The Habibie Center aims to play its part within our capabilities to the ASEAN regional development.

About Talking ASEAN

Talking ASEAN is a monthly public dialogue held at The Habibie Center in Jakarta. Covering a wide array of issues related to ASEAN, Talking ASEAN addresses topics of: Economic Integration, Socio-cultural, & Democracy, human rights and regional peace, among others. Featuring local and visiting experts, Talking ASEAN is one of a series of twelve dialogues regularly held each month and open to a target audience consisting of ASEAN officials, foreign ambassadors & diplomats, academics, university students, businesses, and the media.



The Habibie Center was founded by Bacharuddin Jusuf Habibie and family in 1999 as an independent, non-governmental, non-profit organisation. The vision of The Habibie Center is to create a structurally democratic society founded on the morality and integrity of cultural and religious values.

The mission of The Habibie Center are **first**, to establish a structurally and culturally democratic society that recognizes, respects, and promotes human rights by undertaking study and advocacy of issues related to democratization and human rights, and **second**, to increase the effectiveness of the management of human resources and the spread of technology.

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