Getting infrastructure moving

Raj Kannan does not take no for an answer. The founder and managing director of Tusk Advisory is one of the strongest advocates of finding workable solutions to Indonesia's seemingly intractable infrastructure challenge. By **Shoeb Kagda**

Stretching nearly 2,700 km from its northern tip to its southern end, Sumatra has vast natural resources as well as plenty of land for cultivation. It has relatively low population density when compared to its southern neighbor Java, but is many times larger.

Connecting Sumatra in order to be able to tap its vast hinterland has long been a goal of the government. But despite repeated attempts, that goal has failed to be realized.

"Sections of the Trans-Sumatra Highway project went to tender six times and failed each time because no private sector company could or would be willing to bear the entire risk," notes Raj Kannan, founder and managing director of Tusk Advisory, an infrastructure strategy consulting firm. "Due to low traffic, the return on investment would take too long for a private sector company."

Tusk Advisory, however, was convinced that the project was critical to Indonesia's economic development and refused to give up. "Our thesis was that the infrastructure backbone that the project would provide would have huge economic value."

The big challenge was that despite its economic viability, the Trans-Sumatra Highway had very low financial viability. Kannan therefore set out to convince the government to change its approach to infrastructure funding and development. Rather than rely on the private sector, the government had to play the leading role.

"Our recommendation was to use the state-owned enterprises (SOEs) and we helped raise Rp3.6 trillion ($300 million) for Hutama Karya to get the project off the ground," he recalls.

Although a full business plan has yet to be finalized, the $23 billion project has at last got off the ground. Hutama Karya has been granted sole responsibility of building the Trans-Sumatra Highway but can cooperate with other partners. Work has already begun on Phase 1 of the project at the North Sumatra capital of Medan.

"This is a case of how Indonesia can do it," says Kannan. Hutama Karya was also successful in obtaining Indonesia's first 25-year loan with a 15-year grace period from the state-owned infrastructure funder PT Sarana Multi Infrastruktur.

China used a similar model to kick start its development, notes Kannan. "China basically said that infrastructure development would be the government's responsibility and that it would help provide the funds."

China too used its SOEs to execute projects, working hand-in-hand with private companies. Many of the SOEs were small when they started but due to experience and expertise gained from working on the large infrastructure projects, developed into billion dollar enterprises.

Japan built China

Much of the lack of progress on infrastructure development in Indonesia has revolved around financing and permits. President Joko Widodo's government and the previous administration have been rightly wary of taking on debt to build infrastructure, insisting on private capital to fund the bulk.

But due to the long-term nature of many infrastructure projects coupled with the short-term budget planning cycles imposed on the government, raising the necessary funds entirely from the private sector has been difficult.

The Jakarta MRT project, for example, took more than 15 years to get started because the government could not decide how to fund the project. Key government agencies and senior officials continue to believe that the private sector can absorb both the completion risk as well as the revenue risk despite the overwhelming evidence that most MRT projects in the world are built with government funds.

The solution, according to Kannan, is to tap concessionary loans or Official

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Linking Sumatra: A new toll road under construction.

Development Assistance loans (ODA) offered by Japan and other donor agencies. These loans carry very low interest rates and are often 40 to 50 years in tenor.

"From 1980 to 2005, China borrowed $35 billion from Japan, or over $1 billion a year in ODA to finance its massive infrastructure build-up," notes Kannan. "All the projects went though joint ventures between Japanese companies and Chinese SOEs. Japan built China and even cannibalized its own economy in doing so," he adds.

"The Japanese also trained 30,000 Chinese engineers and technicians over that 25-year period, allowing China to improve its capabilities."

This is the point Tusk Advisory is pushing hard to the Indonesian government. That it does not need to worry about taking concessionary loans for building infrastructure because as the economy grows on the back of new infrastructure, the government will have enough funds to repay the loans.

In essence, the projects will pay for themselves and in the process contribute to increased economic productivity as well improving the living standards of millions of Indonesians.

Mindset shift

As an emerging nation, Indonesians are rightly proud of their achievements and fiercely guard their sovereignty. As a former colony, the country is also highly sensitive about giving up its economic independence.

These sentiments run deep within the political and social psyche of the nation and changing mindsets can be a thankless task. But unless the government and legislature alter their thinking, especially on foreign borrowing for capital expenditure, the country will not achieve its growth targets.

"Economies are not built on the basis of tax revenue alone," notes Kannan. "There is no issue of national pride when it comes to using bilateral loans to build infrastructure. Did China lose its national pride when it borrowed from Japan?" In fact, he argues, China gained much more than any perceived loss. It has world-class infrastructure and has taken over from Japan as the world's second largest economy.

"That is why the Indonesian government needs to change its mindset," he notes. "This rhetoric about not borrowing for infrastructure is not helping the economy nor the people of Indonesia." Most of the government's current borrowings are used for recurrent budget subsidies, which don't add much value to capital formation for economic growth. "What we are advocating is targeted concessional loans for high economic-value projects", Kannan stressed.

The beauty of building infrastructure is that it provides both immediate benefits as well as long-term gains. Every $1 invested in infrastructure generates $3 in economic growth in the short term and more over the long term and, once the infrastructure is ready, the benefits flow to just about every sector.

Indonesia will need $150 billion a year for the next five years to achieve 7% gross domestic product growth. If it wants to be a middle-income economy by 2025, it must fundamentally change its approach and thinking towards financing large infrastructure projects.

Tusk Advisory has proposed a set of new reforms including new funding schemes and a new infrastructure law to fast-track projects and provide certainty for investors as well as protect government servants from frivolous 'state loss' law suits. The new law would only apply to strategic infrastructure projects and would be only valid for a limited period, say 10 years, to achieve the country's growth targets.

"It's important to remember that even countries with good track records of delivering infrastructure, such as the United Kingdom, pass specific laws to support their infrastructure delivery," said Kannan, referring to the Infrastructure Act 2015 passed by the UK government in April this year to fast-track the delivery of its infrastructure programs.

Although Indonesia's proposed infrastructure law is still under consideration, the government has successfully established a new coordinating agency called the KPPIP to accelerate priority and strategic projects. Tusk Advisory has supported the government in establishing KPPIP and has managed to secure a five-year budget to fund the organization to support its work. More importantly, the government approved the recruitment of private sector practitioners as the program director and project directors of KPPIP.

"One of the most satisfying components of my work is that I work with some of the most talented and passionate government officers who are focused on doing the right things for the country's growth," says Kannan. "Our role is to empower these people to make it happen."

Now in Indonesia for more than a decade, Kannan has extensive experience in advising governments on infrastructure and executing projects. Apart from advising the Indonesian government, he has also worked with the government of Queensland in Australia at a time when it was facing an infrastructure crisis.

In 2006, southeast Queensland was facing a massive influx of 1,200 people a week and the state could not cope. "It launched a massive infrastructure development program that included 440 projects that we were mandated to help deliver," recalls Kannan

"The program management office team consisted of six consultants working closely with six public servants," Kannan says. "That is the idea we have introduced to KPPIP."

Many countries around the world have proved that they can conquer the infrastructure challenge. Indonesia is not alone in facing such a challenge but if the government wants to deliver on its promises, it needs political courage.

"What we do is arm the public servants with the right tools and information to sell the idea to the politicians," Kannan says. "We do comprehensive surveys and benchmarking to show that such ideas do work and have been successfully implemented in other countries." He adds that every country is unique so the solutions Tusk creates incorporate local factors that work for Indonesia.

Tusk's team of consultants boasts varied academic backgrounds, from engineering and science to economics and maths to strategy and business. Most are graduates of the Bandung Institute of Technology or the University of Indonesia with additional masters' degrees from top overseas universities. Highly experienced international advisers support this team of young professionals.

"These young men and women inspire me" says Kannan and he believes it's these Indonesians themselves who will lead the economic growth of the country, working alongside committed government officers and enterprising private sector companies.

But he adds that every country is unique so the solutions Tusk creates incorporate local factors that work for Indonesia. So far, it is proving that when the will is there, success can be achieved.

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