

What Are Challenges to Achieve Inclusive Development, Technology Transfer, Employment Creation and Human Development Through Quality Infrastructure

Suharso Monoarfa

Excellencies,

Distinguished guest and speakers,

Ladies and gentlemen,

Good morning,

First, allow me to express my sincere gratitude to Minister of Foreign Affairs of Japan for inviting me to the ASEM seminar on “Sustainable Connectivity and Quality Infrastructure”.

This seminar is very timely particularly for emerging economy like Indonesia that is currently facing a daunting challenge in fulfilling the infrastructure gap under growing uncertainty of global economic situation.

Ladies and gentlemen,

Indonesia with a population of 265 million, more than 50% live in urban area, with growing and affluent middle class to support GDP has a large domestic market where 55% of GDP is derived from consumption.

According to Global Competitiveness Report, in 2015 the country ranked 62nd out of 140 economies in the category of infrastructure development and logistic performance index 63rd of 160 countries with cost of logistics increasing to approximately 26% of GDP. Since the economic crisis in 1998 Indonesia has struggled to reduce a wide and growing infrastructure deficit. This problem is a result of decades of underinvestment following the economic crisis in 1998. As an illustration of infrastructure deficit, according to ADB report, after the economic crisis in 1998, urban infrastructure spending averages 3% of GDP compared to 8% of GDP in the years prior to 1997.

Geographically, the growing infrastructure deficit also lead to regional inequality due to uneven distribution of population and due to the economic activities, that is mostly

concentrated in the western part of the country particularly in Java and Sumatra in which covers 80% of GDP.

Recognizing this growing infrastructure deficit, the government is pledging to improve infrastructure development. President Joko Widodo has established the Medium-Term Infrastructure Development Plan (2015-2019) covering a wide variety of infrastructures including but not limited to the development of airports, seaports, roads, railways, highways, power plants, ICT infrastructures, water resources, sanitation, and housing with total budget around 5,500 trillion rupiah. This plan increases infrastructure funding compared to the previous period by nearly 10 billion US dollar per year.

The development of infrastructure is carried out and funded by the government of Indonesia through the national budget, private sector investment, public-private partnership and the state own enterprises investment as well.

The state budget is appropriated mainly to build infrastructures in the region where the availability of the infrastructure still under developed such as in the eastern part of Indonesia and in the outer islands region. Meanwhile the development of infrastructure projects with high financial viability is offered to the private sector through competitive bidding and the projects with medium financial viability is conducted through the public-private partnership scheme. Regarding infrastructure projects with low to moderate financial viability especially those that have not got funding consideration from the private sector are directed to the state own company.

In promoting the infrastructure development, the government also provides various funding facilities, among others, through PT. SMI to provide infrastructure financing and advisory services for commercially viable infrastructure projects. PT.SMF to provide housing loans and PT. PII to provide financial guarantee for PPPs so that the private sector can obtain loans from banks or from non-bank financial institutions.

Therefore, to build and to fix infrastructures is a must task for enhancing social and economic capital in Indonesia. In combination, along with this effort the government also boosting the capacity of SMEs specially to support them in getting access to financial institutions. To do so, the government establish credit facility to SMEs and injected it into commercial bank as a low-cost fund which in its turn could bring down

the financing interest rates. With this credit scheme SMEs can get low interest loan from the bank that provide this credit facility.

The government also create similar scheme of funding to provide housing loan to low and medium income families. In this case the eligible family can obtain long term loan with fixed low interest rates.

Besides that, to strengthen financial posture of SOEs, the government injected additional equity capital to SOEs with amount according to the financial need of their assignment respectively. With this support SOE eligible to have opportunity for obtaining another financial support to finance their infrastructure projects.

The government could also provide guarantee in the form of comfort letter for SOEs particularly when its product price is a mandatory price in line with the assignment of public service obligation. For instance, PT.PLN, the state own power enterprise has could not decide the electricity cost directly to consumers.

Along with this physical infrastructure projects, a wide range of special aid program for social safety net is also provided to low income and poor families such as school operational aids, health insurance, low cost food, low cost transportation and scholarship.

The government also sets out a range of policies to reduce the high economic cost such as the reduction in port dwelling time, one stop investment licensing process, reduction of regulatory and bureaucracy burden, and a one-fuel-price policy, so that people in the outer region can enjoy the available energy at affordable prices.

After 4 years of implementation of such a program under President Joko Widodo administrations, the result is quite encouraging. According to Global Competitiveness Report, in 2018 the country ranked in the category of infrastructure development has improved from 62nd in 2015 to 52nd in 2018 and logistic performance index improved from 63rd in 2015 to 46th in 2018. According to the World bank, the combination between infrastructure development and the social aids program shows that these efforts not only contributed to the economic growth but also contributed to the reduction of inequality and to the poverty alleviation as well.

Ladies and gentlemen,

The biggest challenge for infrastructure development in the last 4 years is the problem of funding. From the fiscal side, tax ratio remains low and the realization of tax revenue always below the annual target level, therefore some of the financing of the infrastructure must be paid out of the government debt/loans. From the banking side, domestic banking assets ratio is still relatively low at 52% of GDP. And most of these assets are concentrated in the state-owned banks. As a comparison, banking assets ratio to GDP in the Philippines is 92%, in Thailand 96%, and in Malaysia 114%. With the relatively low ratio of banking assets against GDP, the source of funding for infrastructure development could not be fulfilled from domestic banking, therefore the infrastructure investment needs offshore loans.

In addition, the funding sources that come from commercial banks can only provide short-term funding with the relatively high interest rates that leads to a mismatch against infrastructure funding that requires a long-term funding with low interest rates. Meanwhile, the source of financing from the multilateral institutions that capable of providing long-term funding with relatively low interest rates are yet not optimally explored and utilized.

Another challenge is the balance of payments. Since the year of 2012, the current account suffers a shortfall in which, among others, is caused by a fall in the price of export commodities and the high dependency of the domestic industry on imports of capital goods and raw materials. In addition, approximately 41% of the governments bonds are in foreign parties or have been issued in foreign currency denominations. This condition coupled with quantitative tightening lead to the depreciation of exchange rates and in its turn causes the rising of debt burden particularly in the sector of infrastructures.

Ladies and gentlemen,

Despite the improvement of infrastructure and a wide range of social assistance programs-that have been well implemented- have shown the encouraging results, the challenge of inequality reduction and poverty alleviation is still daunting. Gini ratio in the year of 2017 still high around 0.39, the poverty rate is still about 10.64%, the

unemployment rate is still around 5.5%, and the level of productivity expressed by GNI per capita is around USD 3540. This productivity level has decreased compared to the year of 2013 with per capita GNI around USD 3730. For the last 4 years the productivity in current US dollar value has remained unchanged among others due to exchange rates depreciation.

Based on the data from the Asian Productivity Organization, in the period of 1970 to 2015, the largest share to the economic growth of Indonesia is coming from capital (80%), while labor share 17% and total factor productivity (TFP) share only 3%. This means that the growth of Indonesia's economy is highly dependent on the capital especially physical capital such as infrastructures, while the technology contribution to GDP growth was almost negligible as indicated by TFP around 3%.

Low share of TFP is a factor causing relatively low national productivity and at the same time it is an impediment to triggering higher economic growth. As a comparison, for the same period, Japanese TFP equals to 31%, China 34%, Hong Kong 24%, Thailand 24%, and Vietnam 16%.

Besides the TFP, the role of ICT in productivity improvement is well recognized. As far as the role of ICT infrastructure in Indonesia is concerned, the share of ICT capital to the economic growth in the period of 1970-2015 was only 3%, while in Japan 12%, Singapore 10%, Hongkong 8%, Thailand 6% and Malaysia 5%.

Ladies and gentlemen,

According to a World Bank report, one of the main causes of inequality has been found to be a problem with the productivity gap caused by the skills gap. Based on this report and from the fact that the important role of human capital in fostering high economic growth, President Joko Widodo has set up a policy directive that for the next five years the government not only focus on the continuation of infrastructure development but also on the human resource development and the improvement of productivity specifically to address the skills gap problem.

The greatest challenge indeed is how to increase the productivity of the economy so that Indonesia can achieve high economic growth. Productivity gains will become a focus because this policy in its turn will increase the GDP that would increase tax

revenues, improve saving and increase the banking assets, increase income per capita, boost exports, reduce the trade and payment imbalances, addressing the gaps and reducing unemployment as well.

Ladies and gentlemen,

To conclude, I would like to propose some of recommendations which are currently being put forward for consideration, among others as follows:

First, long-term funding for infrastructure development is basically available with relatively low interest rates, therefore Indonesia needs to elaborate further funding opportunities provided by multilateral financing agencies such as JBIC, ADB and other multilateral institutions.

Second, the assets of various financial facilities that are currently dispersed in different state-owned institutions need to be consolidated. The consolidated assets of the state-owned financing institution such PT.SMI, PT.PII, and PT.SMF is necessary because it would become a funding strength that can be capitalized in the form of a strong development bank as it has been developed in several countries.

Third, the combination of infrastructure improvement along with social programs for low income families need to be continuously strengthened as this effort has been shown to be able to reduce the inequality and alleviate poverty.

Fourth, productivity improvement through education and training, complemented with knowledge infrastructure development including ICT facilities need to be extensively implemented so that the productivity could be improved significantly. Like steelmaking in Industry 1.0, ICT infrastructures equipped with sensors and intelligent controls is the backbone of Industry 4.0.

Fifth, various study shows that higher TFP is associated with the higher science and technology endowment of a country that lead to a high productivity. In this perspective, Indonesia need to gradually improve the human capital especially in higher education through the creation of talents, new knowledge and technology to contribute to the development of a knowledge base economy.

Finally, allow me to use this opportunity to update you on the current economic and political development in Indonesia. The economic growth of Indonesia is stable at 5%. Indonesia is among the top 3 of high economic growth performers in the G20. Despite the current global financial turmoil, Indonesia's economy remains healthy and stable. Debt-to-GDP ratio relatively low at 30%, budget deficit less than 3%, the inflation rate is low, and just recently Fitch has reaffirmed Indonesia's position on sovereign credit rating at BBB or the investment grade. From the political point of view, the upcoming general election including the presidential election will be held for the first time simultaneously on April 2019. Indonesia's structural transition to democracy and the quality of democracy are steadily improving and stable. It can be concluded that from economic and political perspectives, Indonesia has remained and will always be a good place to invest.

Thank you,