I. Project Context

Country Context

More than a decade after the 1997 crisis, Indonesia has made remarkable progress and emerged as a middle-income economy with macroeconomic stability. In contrast to the post-1997 crisis days of a 13% decline in GDP, a sharp rise in poverty and near collapse of its financial sector, Indonesia proved to be quite resilient during the 2008-09 global economic downturn, and the economy continues to build momentum towards achieving stronger and more inclusive growth. Growth slowed sharply but remained positive in the fourth quarter of 2008, at the depths of the global downturn. By mid-2009, Indonesia’s economy had recovered to pre-crisis averages, and the economy grew by 4.5 percent in 2009, making it one of the fastest growing economies in the G20. This growth was largely supported by robust domestic demand and, later in the year, improving economic conditions abroad. Indonesia’s economy grew by 6.5 percent in 2011, with a projected growth of 6.2 percent in 2012, possibly increasing to above 7 percent by mid-decade, largely due to accelerating domestic demand and external competitiveness, while accounting for greater uncertainty surrounding the global economic outlook. The overall positive economic outlook provides a robust foundation for stronger and more inclusive growth, provided that the necessary institutional reforms continue to take place.

Indonesia has remained committed through the years to infrastructure reform and service delivery, evidenced inter alia in (i) a series of Infrastructure Summits (January 2005, February 2006, April 2009); (ii) issuance of two infrastructure “policy packages” (Inpres Presidential Instruction 6/2007 and Inpres 5/2008) setting out numerous policy reforms to be undertaken during 2005-2009, and steadily implementing the program; (iii) more than doubling budget allocations for infrastructure (in nominal terms) since 2005; (iv) announcement of a substantial infrastructure element in the Government of Indonesia’s (GOI’s) March 2009 fiscal stimulus package; and (v) reforms intended to increase sub-national government spending on piped water services. Sub-national governments, particularly districts, have played an increasing role in infrastructure spending since decentralization and accounted for 57 percent of public spending in 2008; the central government accounted for the remaining 43 percent.

Nevertheless, to realize the vision and potential of a “rising Indonesia”, much remains to be done. Public investment in infrastructure has increased since 2005 but spending remains a small share of the total budget and GDP. Growth has restarted and has been robust, but infrastructure continues to be poor and the investment climate remains weak. The dramatic falloff in infrastructure investment from 7% of GDP before the 1997 crisis has not yet been reversed, rising to just over 2% in 2001, and since then to over 3% of GDP. This contrasts with investment levels of about 10% of GDP by some other countries in the region, such as China and Vietnam. Government spending on infrastructure has remained less than that on subsidies (5.5% of GDP), education (3.5%), and government administration (3.2%). Lower than adequate investments in the transport, energy and water and sanitation sectors have resulted in road congestion and deterioration, blackouts across the country and health issues related to the lack of water and sanitation. Significant improvements are also required in the effectiveness and efficiency of public infrastructure spending. Overall, levels of investment have been insufficient to meet the growing demand for infrastructure resulting from rapid urbanization and growth, and to address the extremely low access to basic infrastructure services. At the same time, there is increasing recognition that public funding alone will not be enough to fill the financing gap in infrastructure. Indonesia needs to explore alternative models of attracting and leveraging private financing into infrastructure. This would require implementing market-oriented policies of raising infrastructure financing based on international best practice, tailored to the Indonesian context. In this regard, it would be critical to pay careful attention to the first few infrastructure transactions involving private financing so as to build credibility with the private sector and financial markets.

II. Sectoral and Institutional Context

The Government of Indonesia (GOI) has made some progress in the area of infrastructure public-private partnerships (PPPs), including establishing a supportive regulatory and institutional framework, and pursuing several PPP transactions. However, progress has generally been slow owing to a number of institutional, financing and governance issues.

(i) Poor quality of project preparation prior to bidding, with inadequate background analysis undertaken prior to tendering, resulting in
GOI is keenly aware that the private sector considers infrastructure PPPs in Indonesia high-risk investments and has been considering offering guarantees. However, the Government has realized that simply offering more guarantees without addressing the underlying reasons contributing to heightened perceptions of risk associated with infrastructure projects may not be the most appropriate response to mitigate private sector concerns. GOI has therefore developed the Infrastructure Guarantee Fund (IGF) as an independent public entity to address the concerns of the private sector, with the following objectives:

(i) Facilitate PPP deal flow by providing GOI guarantees to mitigate risk to private sector stemming from government actions (or inactions) in well prepared PPP projects.
(ii) Improve the quality of PPPs by establish a single window for appraising all PPPs requiring GOI guarantees and providing guidance to contracting agencies on how to prepare bankable PPPs.
(iii) Provide clear and consistent rules for how CAs can take advantage of guarantees vis-à-vis the IGF for well prepared PPPs.
(iv) Ring-fence GOI liability vis-à-vis guarantees to PPPs.

Implementation of key sector policy reforms under the Infrastructure Development Policy Loan (IDPL) program has progressed on several fronts, supported by appropriate legal instruments, including Presidential Decrees (Perpres) and submission of budgets to the MOF. Key sector reforms include: (i) a 5-10 percent average electricity tariff increase in 2010, the first time since 2003, improvements in PLN’s financial condition, and steps towards energy conservation; (ii) enactment of Perpres 29 providing for a government support regime to assist financially sustainable public water utilities (PDAMs) access long-term loans. A total of 104 PDAMs were assessed as “healthy” in 2010 (compared with only 37 in 2005) through financial restructuring, more than 200,000 new connections were achieved through output-based incentives paid by the MPW to well-performing PDAMs, and about USD1 billion in additional investments were made by national and local governments to PDAMs since 2007; (iii) enactment of Perpres 13/2010 extending the application of Perpres 67/2005 on PPPs to projects proposed by sub-national governments and state-owned enterprises. Other key reforms undertaken include (iv) establishment of the IGF, including staffing of senior management and drafting of operating procedures; (v) establishment and staffing of the Indonesia Infrastructure Financing Facility (IIFF) and submission of a business license application to BAPEPAM (Capital Market Supervisory Agency); and (vi) preparation of medium-term expenditure plans (currently by the Ministry of Public Works) to serve as the basis for performance-based annual budget requests from the MOF.

III. Project Development Objectives
The Project Development Objective (PDO) of the Infrastructure Guarantee Fund Project (IGFP) is to strengthen the Infrastructure Guarantee Fund (IGF) as a single window institution to appraise infrastructure Public Private Partnership (PPP) projects requiring government guarantees.

IV. Project Description
Component Name
Component 1. WB-Supported IGF Guarantees. The Project will provide US$25 million to support IGF in issuing its own IGF guarantees for qualifying projects.
Component 2. Technical Assistance. The Project will provide a loan for Technical Assistance (TA) in the amount of approximately $4.6 million to develop IGF’s institutional capacity.

V. Financing (in USD Million)

<table>
<thead>
<tr>
<th>For Loans/Credits/Others</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Borrower</td>
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<tr>
<td>International Bank for Reconstruction and Development</td>
<td>29.60</td>
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<tr>
<td>Total</td>
<td>79.60</td>
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</table>

VI. Implementation
The IGF will be the implementing agency for the Project. The IGF is 100% Government-owned, and has been established for the purpose of supporting the PPP program and mitigating specific risks associated with infrastructure PPP projects. The IGF was officially launched on May 11, 2010 by the Indonesian Minister of Finance.

The IGF will use a single OM developed under the IGFP to appraise all projects seeking government guarantees. If IGF proposes a project for WB support under component 1, the WB will conduct a full appraisal of the project. Based on WB appraisal, the WB will give an NOL to IGF to provide a loan-based IGF guarantee.
Typology of Risks to be Covered by the IGF. IGF will make the final decision on risk coverage on a project-by-project basis to minimize probability of guarantee call and other operational consideration vis-à-vis quality of project preparation which are stipulated in details in the OM.

Typology of Risks to be Covered under WB-Supported IGF Guarantees. IGF will be able to utilize WB loan proceeds under Component 1 of IGFP to cover a subset of eligible risks identified by IGF, which include the following:

(i) Breach of contract risk
(ii) Changes in Laws and Regulations that adversely affects the financial equilibrium of the private investor/sponsor in so far as these translate into payment obligation by the CA/government under project contracts.

WB-supported IGF Guarantees will not cover the following risks:
(i) Delays/failures relating to land acquisition
(ii) Delays/failures relating to approvals of licenses and permits
(iii) Delays/failures relating to financial close
(iv) Failure to enforce against illegal activity
(v) Termination risk

IGF guarantees utilizing WB funds will cover debt service defaults on a loan when such defaults are caused by a government’s failure to meet its obligations under project contracts to which it is a party. Payment will be made, therefore, if the debt service default is caused by the government’s failure to honor the terms of the contract to which it is a party. As appropriate, WB funds may also cover non insurable events. WB-supported IGF guarantees will not cover loans originating from any entity which has received a loan from WB or the International Finance Corporation (IFC), or an equity investment from the IFC.

The nature and scope of the risks to be covered by the IGF for a particular project will be determined through IGF’s risk assessment methodology and as a result of consultations with the project sponsors and their respective lenders. As a result of this assessment the IGF will determine the most suitable risk(s) to be covered and the most appropriate guarantee structure. Based on the nature of the risks to be covered, the size of the project, and credit enhancement requirements by project lenders, IGF will determine, in consultation with WB, which guarantees will be provided by the IGF using its own capital, by the IGF using WB funds, MOF guarantees, or a combination thereof.

IGF Capital and Management & Operations. Capital adequacy ratio. IGF is being operationalized under a very conservative investment policy based on a maximum 1:1 capital adequacy ratio for all guarantees it will issue. Once it has established a track record of underwriting guarantees, and importantly, its recourse mechanism has been well established and confirmed, the IGF may start to explore underwriting models involving more leverage.

IGF Project Pipeline. IGF, in consultation with MOF and BAPPENAS and other stakeholders, carefully considers on a continuing basis the long list of PPP projects in various stages of development and preparedness in Indonesia, to identify a pipeline of projects that could possibly approach the IGF for guarantee coverage.

VII. Safeguard Policies (including public consultation)

<table>
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<tr>
<th>Safeguard Policies Triggered by the Project</th>
<th>Yes</th>
<th>No</th>
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</thead>
<tbody>
<tr>
<td>Environmental Assessment OP/BP 4.01</td>
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<tr>
<td>Natural Habitats OP/BP 4.04</td>
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<td>Forests OP/BP 4.36</td>
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<td>Pest Management OP 4.09</td>
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<td>Involuntary Resettlement OP/BP 4.12</td>
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<td>Safety of Dams OP/BP 4.37</td>
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<td>Projects on International Waterways OP/BP 7.50</td>
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</tr>
<tr>
<td>Projects in Disputed Areas OP/BP 7.60</td>
<td>X</td>
<td></td>
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</tbody>
</table>

VIII. Contact point

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