

Highlights of the week



Conspiracy theories & foreign meddling in elections

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Indonesia-Switzerland MLA treaty: Will it work?

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Jakarta in hot water

Jakarta Governor Anies Baswedan said on Monday that Jakarta would gradually take over tap water management from private operators PT Pam Lyonnaise Jaya (Palyja) and PT Aetra Air Jakarta despite a recent Supreme Court ruling that approved the continuation of water privatization. Anies assigned city-owned water company PAM Jaya to negotiate the terms with both Palyja and Aetra and complete the head of agreements by end of March.



Cement industry to see clash of titans

The expansion of Chinese cement producers in Indonesia may squeeze local players. Considering the ongoing cement oversupply, the news about Chinese cement producers’ entry to Indonesia and their predatory pricing strategy is very likely to spark fierce competition in the industry.

POLITICS

Conspiracy theories abound of foreign meddling in elections

When President Joko “Jokowi” Widodo on Feb. 3 talked about the use of “Russian Propaganda” by the opposition in the presidential election campaign, he upset the Russian government more than he hurt the lone challenger, Prabowo Subianto, for the April 17 election. Russian Ambassador to Indonesia Ludmila Vorobieva did not file a formal protest, but in a press conference the next day she denied any Moscow involvement in the election, something that Jokowi’s statement could have implied. She lamented the use of the term, which she said was borrowed from the conspiracy theories of alleged Russian meddling in the 2016 US elections.

The episode played into conspiracy theories of foreign governments trying to influence the outcome of the elections. Most had expected the United States or China as targets, given their huge strategic political and economic interests. Few had thought of Russia as a possible player, until President Jokowi raised it. The Presidential Office has since clarified that the term did not imply that Russia was involved at all. And just to be sure, a spokesman said the term had been dropped from campaign lexicon to avoid a diplomatic faux pas.

Takeaways:

- Years of European colonialism has made Indonesia overtly sensitive to foreign intervention. This makes the issue of Russian propaganda or other conspiracy theories particularly appealing ahead of the elections, as candidates attempt to strengthen their nationalist image while damaging their rival’s.
- President Jokowi’s subtle and implicative statements on Russian propaganda raised Russian hackles instead of damaging Prabowo’s image.
- Both Jokowi and Prabowo have reportedly retained the services of foreign political consultants. While this is legal, it is very likely to tarnish their nationalist image. Thus, both candidates would never admit to have hired one.

Background: Indonesia is overtly sensitive about foreign governments intervening in its domestic affairs. This paranoia is not without reason. Centuries of enduring European colonialism, which extracted Indonesia’s wealth of natural resources, is one reason. But there is more recent, well documented evidence of foreign governments meddling in its domestic affairs: The United States supporting the rebellion against Sukarno in the 1950s and China’s support for the Indonesian Communist Party (PKI), which had been blamed for the abortive coup against Sukarno in 1965.

In the 1960s, Sukarno made the famous remarks “to hell with your aid” in response to apparent US meddling. He even took Indonesia out of the United Nations. Both events made Sukarno, “the great orator”, even more popular. If you believe in the conspiracy theories, they also led to his eventual downfall in 1965. One version of the coup laid the blame on the US.

Nowadays, any such meddling, if it exists at all, is done subtly. But this gives way for the rise of conspiracy theories and they almost always surface every time Indonesia holds general elections.

Accusing the opposition of working for foreign interests, including powerful multinational companies, helps burnish your nationalist credentials. In advancing theories of conspiracy, you don't need to have solid evidence to prove your point. This makes an effective and powerful tool in election campaigns. And the foreign country or interests cited sometimes have little or no say, for responding otherwise would strengthen the conspiracy theories.

Indonesia's heavy reliance on foreign aid (at least until recently) and on foreign investment to fuel economic development has also created fertile ground for theories of conspiracy of politicians serving foreign interests. Any incumbent inevitably is most vulnerable to such accusations. But in the 2019 elections, it is Jokowi's camp that went on the offensive about foreign involvement.

Insight: The claims of Russia's intervention go back to the first round of presidential debates on Jan. 17. A photo that went viral that night was of a Western man walking alongside Prabowo as he arrived at the venue. That photo raised speculation about who this man was. First it was thought to be the American political consultant that Prabowo had been alleged to hire, said to be the same man that helped Donald Trump win the US election in 2016. When it was found that the man in the photo was a Russian diplomat, the speculation quickly turned to Russia's involvement. The diplomat was one of many foreign dignitaries, mostly ambassadors, invited to watch the debate. He was not walking as the photo caption suggested. Like other foreign dignitaries, he stood up to greet Prabowo.

But the damage has been done. In the mind of many Indonesians, Russia is a possible player. So it was not difficult to digest Russian involvement when President Jokowi cited "Russian propaganda" in one of his campaign speeches. The term was first coined by the US-based Rand Corporation to refer to the "Firehose of Falsehood" of high-volume and multichannel propaganda, disseminating messages without regard for the truth, in rapid, continuous and repetitive ways.

Without the President elaborating on what he meant, in the mind of the public now accustomed to short messages on social media, they only saw the word "Russia". And stories coming from the United States about Russia's role in helping Donald Trump win the US elections only made the claims of Russia's hands in Indonesia more believable than it would otherwise be.

In the past, the United States had been the prime target of conspiracy theories of meddling, given the history of CIA support for rebellions in the 1950s, but more recently because of constant White House interventions on the issue of the operation of Freeport McMoran, an American mining company that runs the world's biggest gold mine in Papua.

In past elections, Freeport would be a weapon to use against any incumbent, or to burnish your nationalist credentials, because no president had been able to break the contract that blatantly worked against Indonesia's interests. Freeport is no longer an issue after Jokowi forced the American company to relinquish its majority interests to Indonesia last year.

The incumbent has burnished his nationalist credentials and when it comes to resource nationalism, his track record over the last five years is unbeatable. Besides the takeover of Freeport, he secured the nationalization of the Duri oil field in Riau, Indonesia's most productive well, from Chevron, and the Mahakam gas fields in East Kalimantan, from the French oil company Total.

China is considered another possible target for conspiracy theorists given its immense economic clout and growing presence in Indonesia, through its products, investments, credit lines and workers that carry out Chinese investment projects. But Jokowi had been careful not to play into the hands of these theorists. He delayed a planned visit to China, originally for November, until after the elections. Any notion that Prabowo would raise anti-China sentiments in his election campaign was dismissed when the challenger appeared at the Oct. 1 reception to mark the China National Day hosted by the Chinese Embassy in Jakarta.

Both Jokowi and Prabowo have retained the services of professional political consultants, and some of these subcontracts the work to, or work in collaboration with, foreign political consultants. Or they may hire individual foreign consultants. There is nothing illegal about the use of consultants, whether local or foreign. But no one would ever admit to have hired one, least of all foreign consultants.

In 2015, news reports claimed that Indonesia paid US\$80,000 to United States-based lobbyist R&R Partners to help President Jokowi secure an appointment to address a joint sitting of the Congress during his visit to the United States. The only other Indonesian president to have done that was Sukarno in 1956. The effort failed, but news of the \$80K bill for consulting fees surfaced later.

Elections in Indonesia are not won or lost because of claims of foreign meddling, if there was any. The impact on the electability of candidates is likely to be minimal. Engaging in conspiracy theories in the end is nothing more than a popular pastime for Indonesian politicians.

Indonesia-Switzerland MLA treaty: Will it work?

After years of negotiation, Indonesia and Switzerland signed a bilateral agreement on mutual legal assistance (MLA) relating to international financial crimes such as corruption and money laundering. The MLA treaty has been warmly welcomed as it is expected to assist the complicated process of detangling financial crimes in the country. Looking at the precedents, however, it appears that Indonesia still has a long way to go before legal assistance can be effectively enforced.

Takeaways:

- Mutual legal assistance treaty does not necessarily guarantee positive outcomes in asset recovery, rather it merely assists accelerating the procedure. Public expectation, thus, should be reasonable.
- Indonesia must address existing legal hurdles to ensure the smooth implementation of mutual legal assistance. This includes ironing out legal incongruence among Indonesian agencies and between Indonesian agencies and foreign agencies.
- Inadequate mechanisms among Indonesian agencies often exacerbates ineffective asset recovery efforts. Sectoral egocentrism and unilateral measures are some of the consequences ensuing from the absence of a standard mechanism.

Background: Law and Human Rights Minister Yasonna Laoly and Swiss Justice Minister Karin Keller-Sutter signed a bilateral agreement stipulating Indonesia-Switzerland's cooperation in detecting and prosecuting international crimes. Consisting of 39 articles, the treaty's focuses

include mutual legal assistance in recovering stolen assets. This involves tracing, freezing and confiscating stolen wealth.¹

Mutual legal assistance refers to measures employed by a country (the requested country) as requested by another country (the requesting country) to facilitate the investigation of transnational criminal offenses committed in the requested country. Considering that Switzerland is one of Europe's largest financial centers, forging mutual legal assistance cooperation is an important step for Indonesia, especially since Switzerland is notoriously known as a safe haven for embezzlers because of its tough commitment to protecting the secrecy of its financial sector. According to Reuters, the amount of money stored by foreign individuals in Swiss banks stands at US\$2 trillion.

Meanwhile, scoring only 38 out of 100 in the corruption index², Indonesia is perceived as one of the most corrupt countries in the world. Having an effective mechanism and efforts to recover assets, thus, will benefit the country and also President Joko "Jokowi" Widodo, who promised to root out corruption early in his presidency.

The Indonesia-Switzerland MLA treaty is the 10th treaty that Indonesia has signed with other countries. Previously, Indonesia signed treaties with ASEAN countries, Australia, Hong Kong, China, South Korea, India, Vietnam, the United Arab Emirates and Iran. Quantity, however, does not necessarily correlate with quality. Previous occurrences prove how legal issues remain huge obstacles for Indonesia's asset recovery efforts.

Insight: Two important aspects, namely legal hurdles and inadequate mechanisms, need to be addressed by Indonesia to not only ensure the effective implementation of mutual legal assistance in asset recovery between Indonesia and foreign countries, but also counter corruption at large. Indonesia's complicated and flawed legal foundation as well as the absence of standard mechanisms guiding Indonesian agencies are often perceived as the culprits behind Indonesia's stagnating anticorruption measures³ (it scored 37 in 2017)⁴.

In regard to legal aspects, Indonesia's scattered legal discourses and their incongruence with foreign countries' legal discourses often pose major problems in recovering stolen assets. For one, even among fellow Indonesian agencies responsible for asset recovery themselves, legal paradigms that they adopt are not uniformed. While some agencies adopt "follow-the-money" paradigm (*in rem*), which focuses on recovering stolen assets, some adopt "follow-the-suspect" (*in personam*) paradigm that focuses on arresting suspects instead. Consequently, for agencies that adopt *in personam* paradigm, stolen assets stored in foreign countries are not prioritized.

Incoherence also occurs between Indonesia's and foreign countries' legal discourses; Indonesia and other countries do not necessarily have the same understanding in addressing corruption as well as recovering assets, making it particularly difficult to regulate stolen assets as some cases may not meet the dual criminality principle. Since the Tipikor Law clearly details its stipulations about corruption, such minutiae may hamper corruption cases involving other countries if their

¹ Kemenkumham.go.id, "Tandai Babak Baru Kerja Sama Hukum, Menhukam Tanda Tangani Perjanjian Mutual Legal Assistance Indonesia-Swiss" 5 February 2019 <https://tinyurl.com/y35drxpo>

² Transparency.org, <https://tinyurl.com/y52yx32>

³ Transparency.org, "Indonesia: Overview of Corruption and Anti-Corruption" 18 October 2018 <https://tinyurl.com/yvndqapv>

⁴ Transparency.org, "Corruption Perception Index 2017" <https://tinyurl.com/y87e7fjh>

legal paradigms prove to be mismatched. In the case of Switzerland, it is important to note that the country adopts the dual criminality principle in enforcing mutual legal assistance.⁵

Previously, the dual criminality principle hindered effective mutual legal assistance between Indonesia and Switzerland because of the two countries' different understandings of a criminal offence. In 2011, for instance, Indonesia could not freeze former Bank Mandiri president director ECW Neloe's US\$5.2 million assets that were stored in Switzerland's Deutsche Bank as the Swiss government believed that Neloe's assets were not acquired through illegal means.⁶

Different legal understandings between Indonesia and Switzerland also prevented the Indonesian government from freezing assets of former Bank Century owner and graft convict Robert Tantular amounting to US\$156 million. While the Supreme Court had concluded that the means Robert employed to acquire his assets were categorized as a crime, Swiss governance argued that it was merely an "administrative offense"; hence, Switzerland felt authorized to protect Robert's assets.⁷

Another example of potential legal incongruence between Indonesia and Switzerland is the countries' different stance toward the Rome Statute of the International Criminal Court; while Switzerland is one of the statute's signatories⁸, Indonesia officially refused to ratify the statute back in 2013.⁹ Legal differences between the two countries are only matter of eventuality, thus. Indonesia's Criminal Law Procedures Code (KUHAP), for instance, adopts the principle of trial in absentia, in which judges are allowed to issue verdicts without the presence of the defendants. Such a stipulation, however, is prohibited under the Rome Statute.

Not only with Switzerland, complications surrounding mutual legal assistance implementation also occurred in other countries that have forged bilateral cooperation with Indonesia such as Australia and Hong Kong. In handling the Bank Indonesia liquidity support (BLBI) corruption case involving former Bank Harapan Sentosa president director Hendra Rahardja, for instance, the Indonesian government found difficulties in recovering stolen assets stored in Australia because of different legal understandings. In prosecuting Hendra, the Indonesian court had to resort to trial in absentia as Hendra fled to Australia after he stole state assets amounting to Rp 1.3 trillion. As the extradition process took too much time, Indonesia decided to try Hendra in an *in absentia* trial, which Australia was against.¹⁰

Other than legal aspects, inadequate mechanisms among domestic agencies pose major problems to the effective implementation of mutual legal assistance and asset recovery. It is alleged that to date, there is no standard guideline regulating agencies and their coordination with other agencies involved in recovering assets. In handling cases, for instance, the police often disclose their investigation to the public because of the absence of antitipping off guidelines, providing means for irresponsible actors to conceal their assets acquired through illicit means.

To make matters worse, poor coordination often results in agencies employing unilateral and/or clashing measures, creating a sense of disunity. In settling a case, for instance, it is possible for district courts and the Supreme Court to arrive at different conclusions.

⁵ Swiss Federal Office of Justice FOJ, "International Mutual Assistance in Criminal Matters" <https://tinyurl.com/y2z9mzp3>

⁶ Kontan.co.id, "Kejaksaan belum berhasil blokir aset Neloe di Swiss" 21 June 2011 <https://tinyurl.com/y2gjwbb6>

⁷ Rmol.co, Aset Robert Tantular Belum Bisa Disita Jaksa" 20 May 2012 <https://tinyurl.com/y4v4db9p>

⁸ Internationalcriminalcourtnashie.weebly.com <https://tinyurl.com/yxne8bgp>

⁹ Thejakartapost.com, "Govt officially rejects Rome Statute" 21 May 2013 <https://tinyurl.com/y37pvl9y>

¹⁰ Liputan6.com, "Hendra Rahardja Meninggal di Australia" 27 January 2003 <https://tinyurl.com/yxzxjuq4>

Frequent use of unilateral measures, in turn, may create internal schisms and further alleged sectoral ego among agencies. A study by voluntary organization Partnership for Governance Reform (Kemitraan) found that sectoral ego among Indonesian agencies involved in asset recovery remained a major problem in the implementation of mutual legal assistance and asset recovery. A “rivalry” reportedly grew between the Attorney General’s Office (AGO), the National Police, the Corruption Eradication Commission (KPK) and the Finance Ministry’s State Assets Directorate General (DKJN). Such a rivalry often centers around the issue of authority as agencies claim to be the most authorized in handling asset recovery.

Existing legal and mechanism difficulties indicate that Indonesia still has a long way to go before it can effectively recover stolen assets, particularly those stored in foreign countries. Nevertheless, it should be noted that the law and judicial system is complex. While it does assist accelerating the process of recovering assets, mutual legal assistance treaties do not always guarantee successful outcomes. In regard to the Indonesia-Switzerland treaty, for instance, the Swiss government has previously affirmed that any individual “affected by measures taken under the law is entitled to legal protection and may go before the Swiss courts”.¹¹ Furthermore, the Swiss government has also ensured that “legal remedy is expressly provided to enable politically exposed persons [...] to request that their names be removed from the Swiss government’s list of people subject to an asset freeze”.¹²

The Indonesian government’s efforts to address legal hurdles through bilateral cooperation should be appreciated, yet at the same time people’s expectation must also be reasonable. No states adhering to the law can supersede legal proceedings no matter what treaties they have.

¹¹ Unodc.org, “Foreign Illicit Assets Act (FIAA) of 18 December 2015” <https://tinyurl.com/y3zlzkb6>

¹² Ibid.

BUSINESS & ECONOMIC POLICY

Jakarta in hot water

Jakarta Governor Anies Baswedan said on Monday that Jakarta would gradually take over tap water management from private operators PT Pam Lyonnaise Jaya (Palyja) and PT Aetra Air Jakarta despite a recent Supreme Court ruling that approved the continuation of water privatization. Anies assigned city-owned water company PAM Jaya to negotiate the terms with both Palyja and Aetra and complete the head of agreements by end of March.

Takeaway:

- Disagreement between the government and Palyja and Aetra over drinking water management in Jakarta dates back to the financial crisis in 1998, when the city administration attempted to cancel contracts with the two private companies. The move failed because it would have been detrimental to the country's standing and financial condition.
- Water privatization in Jakarta has been considered a failure because the contracts benefit Palyja and Aetra not matter what their performance. Under the contracts, the companies are guaranteed profits whether or not they meet the expected targets.
- Governor Anies Baswedan is very likely to proceed with his takeover plan because it is crucial for Jakarta's sustainability: protecting the livelihoods of poor households and stopping land subsidence in Jakarta.

Background: The squabble between the city administration and Palyja and Aetra dates back to the beginning of the privatization, which effectively started during the financial crisis in 1998. After the crisis, the city administration attempted to cancel the contracts, but was unable to do so as it would have been detrimental to Indonesia's standing and made it difficult for the country to obtain badly needed foreign loans.

The privatization itself was preceded by a US\$92 million loan from the World Bank to city-owned water company PAM Jaya in the early 1990s to improve water services in Jakarta. The World Bank eventually advised the privatization of Jakarta water services as a cure to the continuing failure of public water delivery.¹³

In 1995, then-president Soeharto ordered Jakarta's water privatization, appointing two foreign companies without open bidding: French Suez Environment, which together with the Salim group founded Palyja, and British Thames Water with Soeharto's son Sigit Harjojudanto through PT Kekar Thames Airindo, later named Aetra. In 1997, the two companies signed a 25-year agreement with PAM Jaya to manage water in Jakarta, with Palyja controlling water services in the western part of the city and Aetra in the eastern part.

Since the fall of Soeharto, various efforts have been taken by the city administration and civil society groups to take over the private water companies. But no serious efforts were made until

¹³ The Jakarta Post, "What you need to know about Jakarta's water privatization", April 12, 2018. <https://tinyurl.com/y2dr4scb>

Joko “Jokowi” Widodo became governor of Jakarta in 2012, when he promised and initiated efforts to take over the two water companies. Jokowi assigned city-owned property companies PT Jakarta Propertindo (Jakpro) and PT Pembangunan Jaya to acquire Palyja.

The plan, however, hit a snag after civil society groups under the Coalition of Jakarta Residents Opposing Water Privatization (KMMSAJ) filed a citizen lawsuit via the Central Jakarta District Court in November 2012 against the Indonesian president, vice president, the city administration, the city legislative council, Palyja, Aetra and PAM Jaya, urging the court to cancel water privatization in Jakarta and arguing that privatization had failed to provide clean water for all.

Jokowi then sat down with KMMSAJ representatives, asking the coalition to withdraw the lawsuit. KMMSAJ, however, did not budge and questioned the Jakarta administration’s decision to buy the shares. The coalition asked the administration to wait for the court’s verdict, because if the court annulled the agreement, the city did not need to spend any money.¹⁴

The court did approve the KMMSAJ’s lawsuit, ending water privatization in Jakarta. The court argued that water privatization had been negligent in fulfilling the right to water for Jakarta residents. The verdict, however, came in March 2015, when Jokowi was no longer the governor. The Jakarta administration, under new governor Basuki “BPT” Tjahaja Purnama, appealed the verdict.

The Jakarta High Court sided with the city administration, overturning the district court’s decision. The appeal court decision in February 2016 was mainly based on technicalities in the KMMSAJ’s lawsuit. The KMMSAJ then appealed the verdict at the Supreme Court.

The Supreme Court decided in October 2017 to overturn the Jakarta High Court’s verdict, saying that privatization had not improved access to water in terms of quality, quantity and continuity. The Supreme Court ordered the termination of water privatization as it contravened Jakarta Bylaw No. 13/1992 on city-owned water company PAM Jaya.

Newly installed Jakarta Governor Anies Baswedan welcomed the Supreme Court ruling and he soon established the Water Management Team, consisting of experts and technocrats who will provide recommendations on how the city administration should take over water management from the private sector.

While the city administration is preparing a strategy, the Finance Ministry in March 2018 filed a case review to the Supreme Court, arguing that the KMMSAJ lawsuit did not meet the criteria as a civil lawsuit because it put Palyja and Aetra among the defendants.¹⁵ The Supreme Court then ruled against the KMMSAJ in a verdict issued in November last year. The public heard about the ruling only last month.

Governor Anies Baswedan said recently that the city administration would continue with its plan to take over the two private water companies. He argued that his course of action had a strong legal basis, including a 2015 Constitutional Court (MK) decision on water supply, which forbids water privatization. Anies aims to finish the negotiations with Palyja and Aetra by the end of March.

¹⁴ Tirto.id. “Jalan Panjang Gugatan Swastanisasi Air di DKI Jakarta”. Oct. 11, 2017. <https://tinyurl.com/y3l6jb7u>

¹⁵ Tempo.co, “PK Kemenkeu Dikabulkan, Anies Tetap Mau Hentikan Swastanisasi Air, Jan. 29, 2019. <https://tinyurl.com/y6yt68b4>

Key dates of Jakarta's water privatization struggle:

- * 1992: World Bank advised privatization
- * 1995: Soeharto appointed two companies for privatization
- * June 1997: privatization agreement signed
- * February 1998: private operation started
- * November 2012: KMMSAJ filed a lawsuit annulling 1997 agreement
- * March 2015: Central Jakarta District Court approved the lawsuit
- * February 2016: Jakarta High Court cancelled the district court decision
- * October 2017: Supreme Court annulled the 2016 appeal win
- * November 2018: Supreme Court ruled against the KMMSAJ

Insight: By any measure, the privatization of water in Jakarta has failed to achieve the purpose of privatization as suggested by the World Bank: to provide affordable clean water to all Jakartans, including the poor. The service performance of two private companies is below the standard promised by the privatization policy. As a result, there has been continuous squabbling between two private water companies and the city administration and civil society.

In the original contract, Palyja and Aetra were responsible for universal coverage (98 percent) for 25 years until 2023. In the first five years, the two companies were expected to increase coverage from 42 percent before the privatization to 70 percent, but in reality, they barely managed to increase coverage to barely above 50 percent.¹⁶ After 20 years of operation, according to Governor Anies Baswedan, the coverage only reached 59.4 percent,¹⁷ lower than Surabaya's 87 percent and Medan's 66 percent.

Despite various efforts by the two private companies, the poor continue to be the most disadvantaged group. According to a World Bank report, poor households in Jakarta have to spend 13 to 25 percent of their income on water. While the poor mostly lack easy access to tap water, because of low water coverage, many rich households and commercial facilities also rely on groundwater extraction, which is blamed for land sinking in Jakarta.

The problem does not stop there. The quality of treated water has not yet reached drinking water standards (potable) and there is a high level of water loss (about 45%) – higher than the levels in Surabaya and Medan – while water rates in Jakarta are among the highest not only in Indonesia, but also in the region.

Despite all those unachieved targets, the private water companies continue to enjoy their guaranteed profits and even refuse to reduce the level of profits. Only later did one of them – Aetra – agree to reduce the guaranteed level of return. There seems to be no penalty applicable to the private water companies.

These are the results of poor contract drafting during the initial process of privatization. While this was understandable during the Soeharto political environment, it has created significant problems now. Soeharto's corruptive practices in appointing two foreign partners with his crony Salim and his son Sigit has resulted in a heavy burden for later generations. Over the years, though, the ownership has changed several times, with Sigit no more a shareholder, while the Salim Group through Moya Holding Asia made a comeback after acquiring 100 percent of

¹⁶ UNDP, Human Development Report 2016, "Disconnected: Poverty, Water Supply and Development in Jakarta, Indonesia", 2016. <https://tinyurl.com/y4jhm7tv>

¹⁷ The Jakarta Post, "Jakarta to take over tap water from private firms," Feb. 12, 2019.

shares of Aetra from Recapital, which was controlled by then-Jakarta deputy governor Sandiaga Uno and Indonesian Chamber of Commerce and Industry (Kadin) chairman Rosan P. Roslani.¹⁸

The contract is designed to benefit the private water companies more than the people, guaranteeing a certain level of profits for them. Based on the contracts, PAM Jaya pays a “water charge” to the two private operators to supply water to residents while customers pay “water tariffs”. Worse still, the water charge is increased every semester, but the water rate cannot be increased automatically because it often involves a political process with the City Council. As a result, water charges are mostly higher than the rates, increasing PAM Jaya’s expenses.

That’s not the end of the story. The contentious issue that makes people question the city administration is that the guaranteed internal rate of return (IRR) for both Palyja and Aetra is set at 22 percent. If the targeted IRR cannot be achieved at the end of the contract, the city administration has to pay them a compensation to reach the target. The city has been trying to renegotiate the terms, but only Aetra complied and signed an agreement with PAM Jaya in 2012 to reduce the rate of return to 15.8 percent, and Aetra also agreed not to demand any compensation if the rate of return does not reach the agreed figure at the end of the contract. Palyja, however, refused to renegotiate the IRR. According to the city administration’s water management team, with the 22 percent IRR, the city is likely to pay Palyja Rp 6.7 trillion at the end of the contract.¹⁹

Therefore, it is understandable for Anies to insist that he take over the two water companies despite the Supreme Court’s newest ruling that allows the privatization of water in Jakarta. The question is how Anies will pursue his efforts in taking the private companies public. The water management team advised him by presenting three options: terminate the contracts unilaterally, keep the status quo or buy the controlling stakes at the two companies. The team has advised Anies to take the third option. Anies asked PAM Jaya to negotiate with the two companies to pursue the acquisition and set the deadline for concluding negotiations at the end of March.

It remains to be seen how the issue will proceed. It needs to be noted that acquiring the two companies by the city administration will not guarantee better services either. It all depends on the people behind PAM Jaya. For the general public, it does not matter who provides the services. They have waited too long for access and better tap water services.

What we’ve heard: Following the Supreme Court verdict in November 2017, Finance Ministry officials met with representatives of the Coalition of Jakarta Residents Opposing Water Privatization (KMMSAJ) to bury the hatchet. However, the coalition declined the ministry’s peace offer. The ministry then filed a case review with the Supreme Court in March 2018, arguing that the KMMSAJ lawsuit did not meet the criteria as a civil lawsuit because it included Palyja and Aetra as the defendants. The court agreed with the ministry and ruled against the KMMSAJ in a verdict issued in November 2018.

One source said the Jakarta administration was at odds with the Finance Ministry regarding the former’s decision to request the case review, which complicates the administration’s plan to take over the water company. Overall, the source said, the Finance Ministry and the city administration had different positions on the privatization of water supply in Jakarta. The Finance Ministry prefers that Palyja and Aetra complete their water management contract until 2023, albeit having to pay Palyja and Aetra Rp 6.7 trillion at the end of the term.

¹⁸ The Jakarta Post. “Salim Group acquires Aetra Air, Jakarta tap water operator”. Aug. 31, 2017. <https://tinyurl.com/yy54nfnq>

¹⁹ Kompas. “Menimbang Untung-Rugi Pilihan.” Feb. 12, 2019

One of the ministry's considerations, the source said, was to avoid any mistake in the city's decision to end the privatization. The ministry warned the city administration not to cancel the contracts arbitrarily, because that could tarnish the investment climate and business certainty in Indonesia.

The second consideration is that the privatization of water in Jakarta has been pursued through a public-private partnership (PPP) scheme, which the ministry has been promoting to investors as a model of financing infrastructure projects. Finance Minister Sri Mulyani herself has actively promoted PPP projects at various occasions.

In addition, the ministry is not convinced that Jakarta-owned water company PAM Jaya would perform better than the two private companies. Nothing could guarantee that passing the baton to the city-owned company would improve water management. Furthermore, regional-owned water companies across the country are notorious for their low quality of work and excessive debts.

Another source said PAM Jaya should also shoulder responsibility in the failure of the two private companies in meeting the targets stipulated in the contracts. As a result of their partnership, half of PAM Jaya's workers are working at Palyja or Aetra. It is a public secret, however, that a lot of PAM Jaya officials are involved in efforts to get their family members to work at Palyja or Aetra. This non-merit recruitment system reportedly has been holding back the private companies from meeting their targets, especially in reducing water leakage, as many of these employees were protecting those who steal water from Palyja's and Aetra's networks.

Chinese cement expansion challenges local establishment

The expansion of Chinese cement producers in Indonesia may squeeze local players.

Considering the ongoing cement oversupply, the news about Chinese cement producers' entry to Indonesia and their predatory pricing strategy is very likely to spark fierce competition in the industry.

Takeaway:

- The local cement industry is facing a problem similar to that faced by the steel industry: Chinese players expansion, which has been found to deliberately reduce market's base price
- The tactic is likely to exacerbate the problem of oversupply and upset the industry's equilibrium, whereby established players' (mostly local) financial standing is gradually eroded
- The government has been left with difficult options: protecting local players or maintaining strategic partnership with China, both could change the tide of the election battle during this political year.

Background: State-owned cement holding company PT Semen Indonesia (SI) reported to Industry Minister Airlangga Hartarto last week (Feb. 8) of its successful acquisition of PT Holcim Indonesia. The former paid US\$917 million (Rp 12.8 trillion) and obtained 80.6 percent of the latter's shares, allowing Semen Indonesia to control 55.8 percent of the market share

(from 40.8 percent) in Indonesia and giving it the highest production capacity among competitors.²⁰

10 Biggest Cement Producers in Indonesia 2017

Name	Production Capacity (million tons)	Market share (percent)	Ownership
Semen Indonesia	35.9	33.4	Local
Indocement TP	24.9	23.2	Foreign
Lafarge Holcim Indonesia	15.7	14.6	Local
Semen Merah Putih	7.5	7.0	Foreign
Semen Bosowa	7.4	6.9	Local
Anhui Conch Cement Indonesia	5.2	4.8	Foreign
Semen Baturaja	3.8	3.5	Local
Semen Panasia (Semen Bima)	1.9	1.8	Foreign
Siam Cement Group	1.8	1.7	Foreign
Semen Jui Shin	1.5	1.4	Foreign
Total	105.6	98.3	

Source: Investor Daily, Indonesian Cement Association, Tenggara Strategics Research Team

The news of Semen Indonesia's successful market grabbing follows similar moves by other state companies to control natural resources, such as the takeover of the Rokan oil block in Riau and state mining company Inalum's move to acquire a majority stake in cooper and gold mining giant Freeport Indonesia. Semen Indonesia's acquisition, however, might unfold some hard truths about Indonesia's cement industry.

Since 2011, Indonesia's cement industry has been suffering from an oversupply, especially with the uncontrolled development of cement plants by Chinese investors. Although the establishment of six new producing facilities in 2016 transformed Indonesia into the biggest cement producer in East Asia with 92.7 million tons of production capacity, it worsened the situation by raising the oversupply more than 50 percent in the following years.²¹ The growing consumption from massive government infrastructure projects across the country was not enough to absorb the oversupply from the continuously growing production.

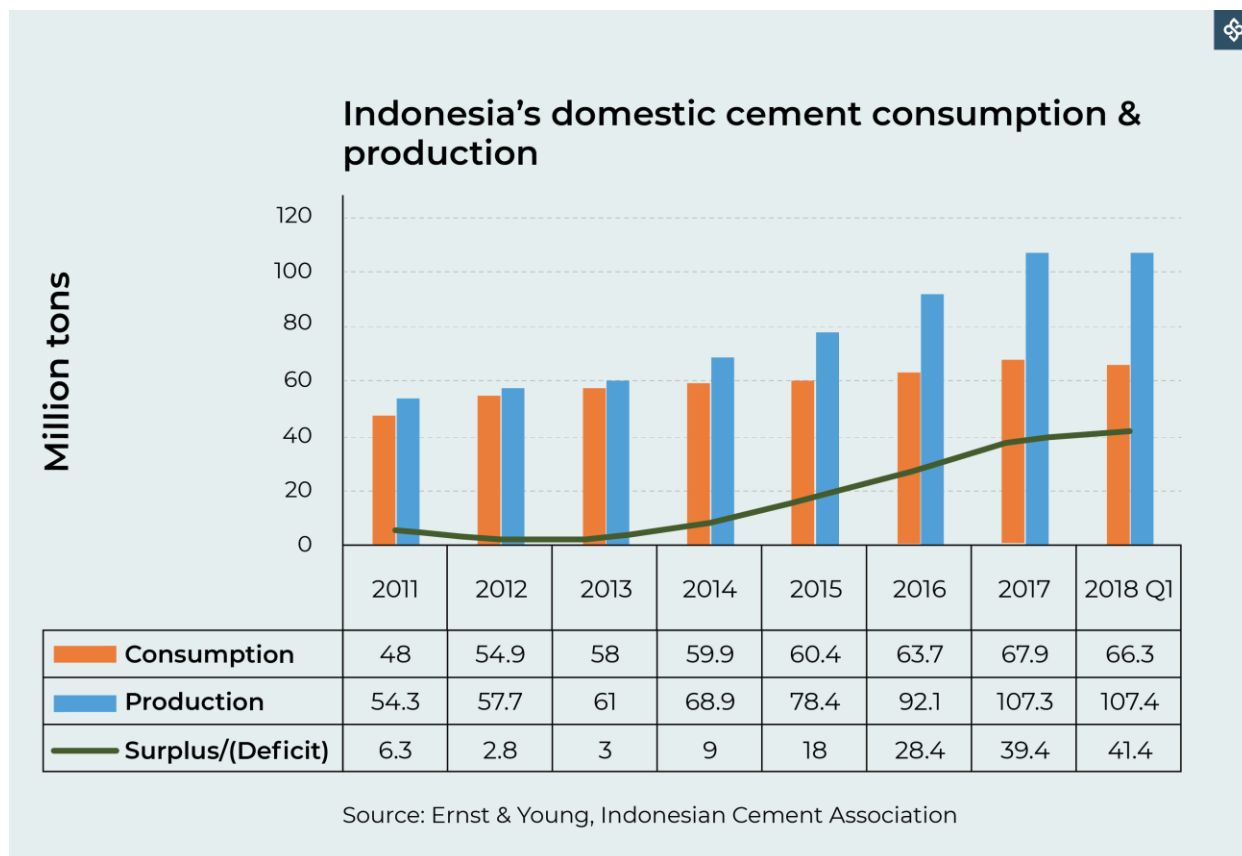
With more than 70 percent of domestic cement consumption coming from property development, the sluggish residential property market since 2015 has capped the average annual growth of cement consumption in this industry between 5 and 6 percent, whilst production grew at a much faster rate of 15 to 18 percent per year.²²

Insight: The Indonesian cement industry now faces a new threat: Chinese cement producers' ambition to obtain a bigger market share. The situation may elevate and potentially resemble the ongoing conflict between local and Chinese steel producers without government intervention (see Backgrounder Dec. 28 and Dec. 21).

²⁰ Investor Daily, "PT SI kuasai 55.8% pangsa pasar semen di Indonesia," Feb.8, 2018

²¹ Bisnis.com, "Semen oversupply sampai 2020," Sept. 13, 2016. <https://tinyurl.com/y3cyb4fi>

²² Ernst & Young, "Overview of Indonesia's Cement Industry: Staying competitive in an oversupplied market," October, 2016. <https://tinyurl.com/y5s33mu6>



Since 2011, a number of Chinese cement producers have gained entry to Indonesia together with numerous signings of Indonesia-China joint infrastructure project partnerships.²³ Some notable Chinese cement companies, such as Jui Shin Cement, Panasia Cement (Semen Bima) and Anhui Conch (Conch Cement Indonesia), have even successfully established local production centers. More are coming. Hongshi Holding Group, a big cement group whose capacity matches that of Semen Indonesia, recently announced it will develop a factory in Jember, East Java, partnering with local producer Semen Imasco.²⁴

Their products are slowly gaining market popularity due to their competitive prices (See Table on the top 10 cement producers).

The Chinese players' entry into Indonesia in a big way since 2011 has doubled the number of cement producers in the country to 19 from only nine in 2012. And these Chinese players have the capacity to increase production fast, despite the oversupply situation. Conch Cement Indonesia president director Wang Hai Wing, for example, asserted Conch's target by boosting production capacity to 25 million tons after meeting with Coordinating Maritime Affairs Minister Luhut Pandjaitan in July 2018.²⁵

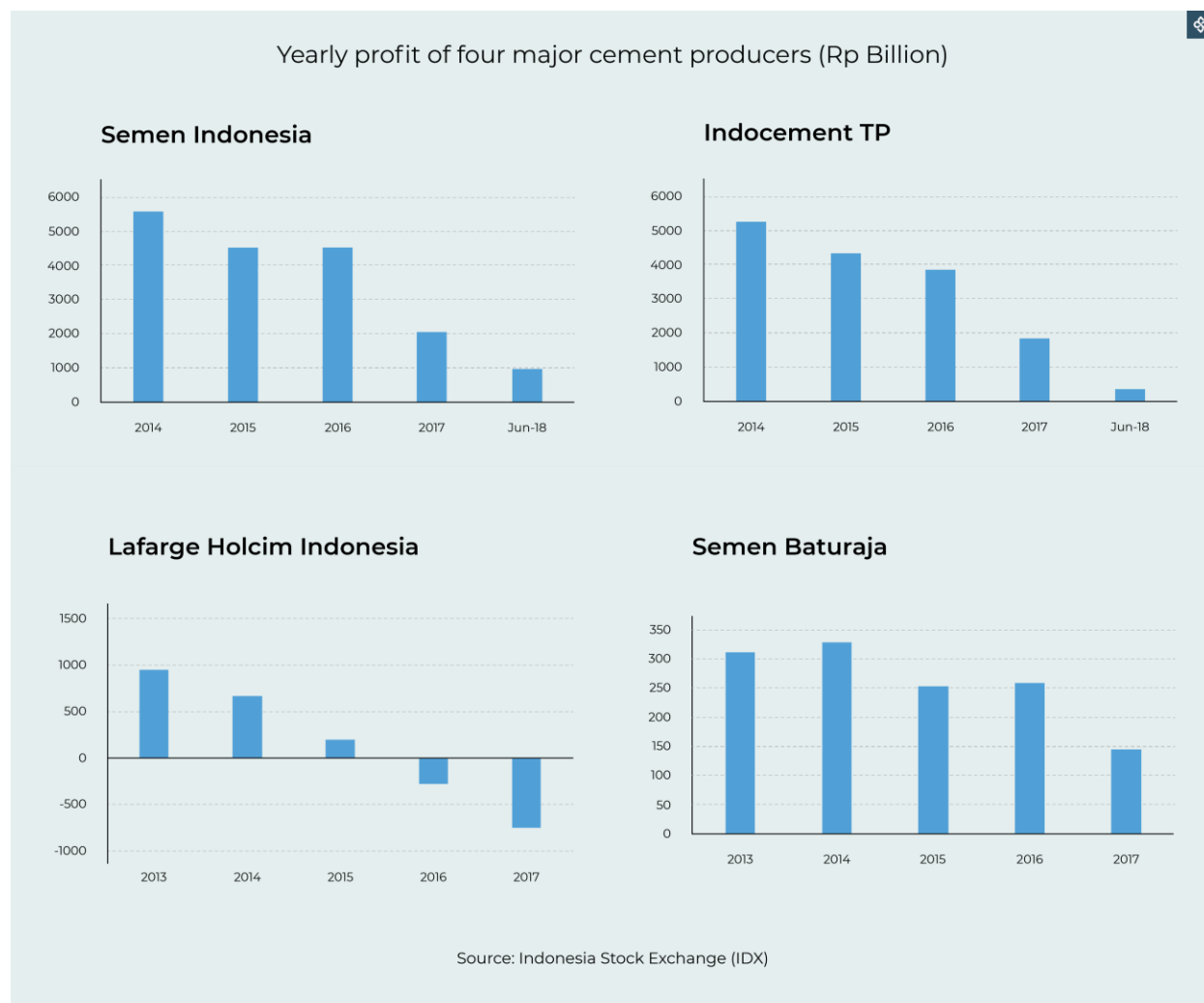
The new investors' production boost amid oversupply has inevitably pressed the commodity's price down. Local producers have accused the Chinese producers of employing a predatory pricing strategy, which aggravates the oversupply. It may lead to a lowering of the commodity's base price in the market. In Jombang, West Java, for instance, construction material shops sold

²³ Tempo.co, "Pabrik Semen Cina Ekspansi ke Indonesia," June 30, 2011. <http://tinyurl.com/y4dbthbc>

²⁴ CNBC Indonesia, "Produsen semen China kian ekspansif di RI," Jul. 11, 2018. <https://tinyurl.com/y4xfxq2z>

²⁵ CNBC Indonesia, "Genjot produksi semen, Conch: Tujuan kami harga semen murah," July 10, 2018. <https://tinyurl.com/y4wsdp7k>

cheaper cement from Semen Bima,²⁶ which sold at Rp 40,000 per 40 kg compared to Semen Gresik's Rp 47,500 and Holcim's Rp 43,000.



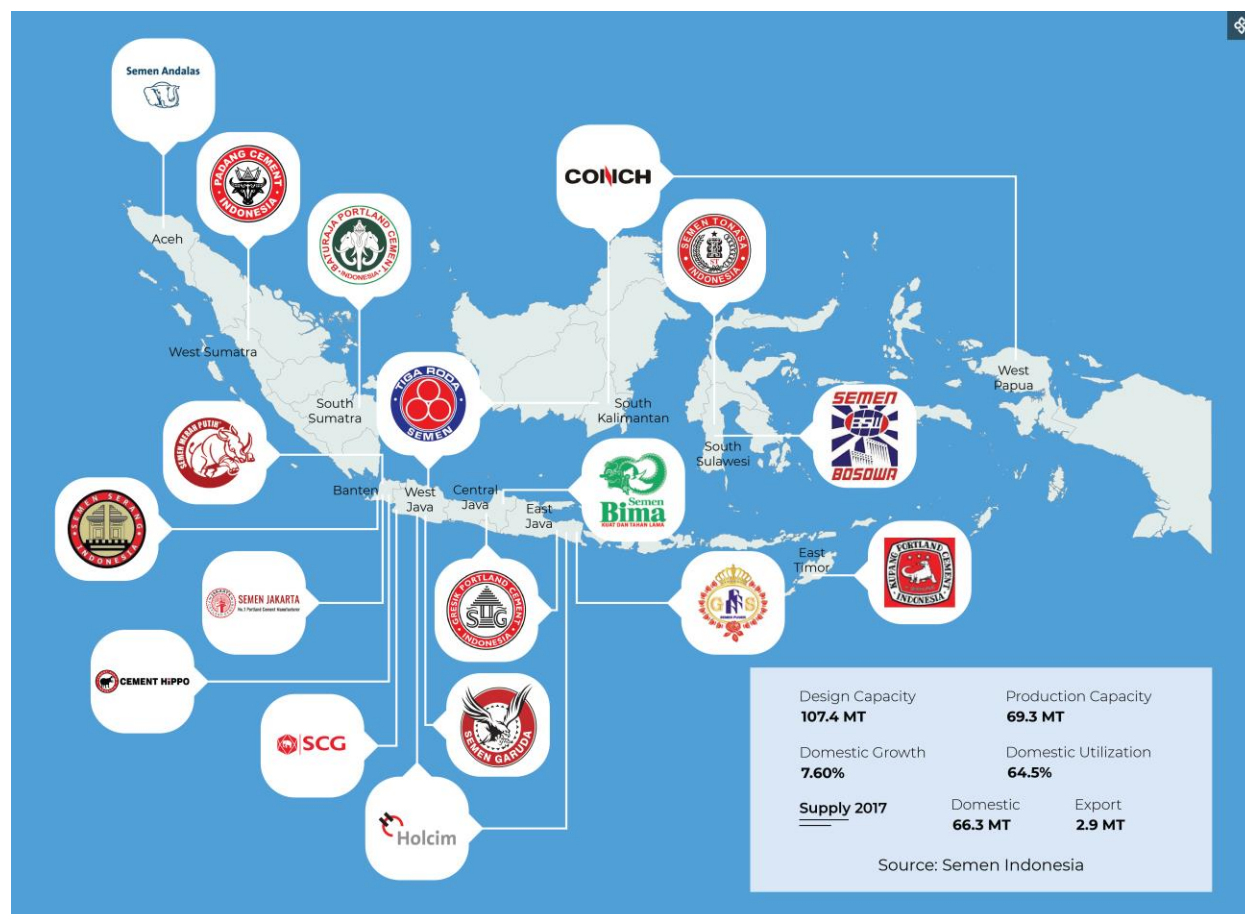
Predatory pricing would suppress older producers' profitability even further despite their increasing sales volume. Indonesia Stock Exchange (IDX) data in 2018 revealed that the performance of the four biggest cement producers – Semen Indonesia, Lafarge Holcim Indonesia, Indocement TP and Semen Baturaja – has been declining due to oversupply since 2013. Holcim even saw a plummeting profit that turned to a deficit in 2015, raising the question of whether older established players would survive the price disruption.

We found that developers in general, including developers of state infrastructure products, preferred cheaper commodities to cut costs, as indicated in our steel report (see Backgrounder Dec. 28 and Dec. 21). If this situation of oversupply and predatory pricing is allowed to continue, it will eventually punish the older players. More will tumble.

It will be interesting to see how the government responds to the ongoing phenomenon. The government's previous attempt to use public housing projects to revamp consumption during a lull in the property market was to no avail, as private developers were reluctant to follow in the government's footsteps.

²⁶ Tirto.id, "Kinerja Pabrik Semen Tersungkur Saat Ramai Proyek Infrastruktur," Nov. 23, 2017. <https://tinyurl.com/y2sbm2xx>

A moratorium policy in the development of cement plants is needed to prevent the oversupply situation from continuing. The government needs to manage the situation prudently, so as to not create a backlash against Chinese investment or event anti-Chinese sentiment, which could jeopardize the country's strategic partnership with China.



What we've heard: A source from the logistics and shipping industry said that Conch has been aggressive in penetrating the cement market in the eastern part of Indonesia since last year. The Chinese cement producer teamed up with the China Construction Bank to supply infrastructure development projects in Papua, especially the Trans Papua highway. To meet demand, Conch rents a 45,000-ton capacity ship just for one shipment.

As a newcomer, Conch deliberately targets the eastern part of Indonesia, where there's fewer competition, to win a slice of the Indonesian market. One of its strongest rivals in the eastern part is Indocement Tungal Perkasa, which ships cement from its production plant in Kalimantan.

Conch did not carry out a lot of marketing and promotion efforts. However, Conch attracted customers by providing far cheaper cement than its rivals. For example, Conch set its ready-casting mix's price at Rp 200,000 per ton, much cheaper than its nearest competitor that sells it at least Rp 500,000 per ton.

Conch is only one of several Chinese cement producers that have entered Indonesia and disrupted the cement market with their relatively lower prices. Their entrance into the market has caused trouble for established cement companies that have enjoyed relatively good margins for a long time.

Conch's entrance into the eastern part of Indonesia, for example, has put pressure on Bosowa Cement, which belongs to Vice President Jusuf Kalla's in-law Akhsa Mahmud's family. Currently, Bosowa only produces 600,000 tons per year, lower than its previous production of 1 million tons per year prior to Conch arrival. Many have questioned Bosowa's survivability.

Conch's strategy of selling products at lower prices has forced competitors to also lower their prices, thus cutting their margin. Indocement and some other producers serving the eastern part of Indonesia have reduced their base price so as to compete with Conch. Conch's arrival had also suppressed Indocement's production to only 17 million tons per year, much lower than its producing capacity of 25 million tons per year.

From the eastern part of Indonesia, Conch moves westward, even to Greater Jakarta, where demand for cement is the highest. They have begun to sell their cheap cement products at retailers, such as construction material shops in Jakarta and several other cities. One source said that Semen Indonesia's corporate acquisition of Lafarge Holcim was to anticipate the expansion of Chinese cement producers into the lucrative market in the western part of Indonesia.

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