# Government Guarantee in Public Private Partnership: The Features Of Indonesia Infrastructure Guarantee Fund


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## ABSTRACT

The financial crisis in 1997-1998 slowed down the infrastructure development in Indonesia as it affects the state budget. In response to that, the government of Indonesia has taken a strong response by reforming the legal framework on the infrastructure projects. The government of Indonesia now encourages the public private partnership scheme for the development of its infrastructure projects, and introducing the Indonesia Infrastructure Guarantee Fund (IIGF) to guarantee those PPP projects. This thesis is dealing with the question whether IIGF has sufficient features to attract investors to participating in Indonesian PPP projects. Another government guarantees schemes from the Brazil such as Federal Guarantee Fund and Companhia Paulista de Parcerias – CPP (Paulista Partnership Company), also Mexico's FONADIN and Partial Credit Guarantee including their application in their respective PPP projects are used as a comparison to the application of IIGF. Three main features of the government guarantee were analyzed: (i) the purpose of the guarantee; (ii) the form of the guarantee; and (iii) the allocation of risks. This thesis concludes that event tough IIGF has the features required to attract investors to participate in Indonesian PPP projects, it is still too early to say that IIGF will be a success in the future, as it depends on other factor such as political and economic stability of Indonesia.

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# Chapter 1
# Introduction

In a traditional sense, the government has always been considered responsible to provide public infrastructures and services such as roads, bridges and tunnels, light rail networks, airports and traffic control systems, prisons, water and sanitation plants, hospitals, schools, and public buildings.[1] Public infrastructure has been created mainly by the public sector, using traditional procurement methods such as design-bid-build and 'design and build'.[2] The contracts for those projects were awarded to the private sector contractors and financed using the government budget. After the projects have been completed, the public sector entities who awarded the contracts took over the projects developed by the private contractors and become in charge of the provision of services to the public. Therefore, in the past, the private sector was only responsible to prove the design and perform the construction of the facilities.[3]

In the 1980s, governments considered two alternative mechanisms for engaging the private sector: total privatization of public facilities and Public-Private Partnership (PPP).[4] Both alternatives offer the sale of government-owned enterprises or assets.[5] The difference in those two alternatives is the degree of control hold by the government. In privatization, the government transferred all its responsibilities to the private sector from developing, managing and providing the service to the public. In PPP, the government still has the control, for example, on the pricing arrangement of the services, while at the same time transferred its responsibilities in providing the financing and the development of the services to the private sector.[6]

Privatization was a common scheme used by governments especially after its introduction in the early 1980's by the United Kingdom. Privatization indeed was extensive taking on the public enterprises engaging in key areas of infrastructure such as electricity, gas and water utilities, and oil and airline

[1] Richard Hemming, "*Public-Private Partnerships, Government Guarantees, and Fiscal Risk*," (Washington DC, IMF, 2006), 1.
[2] Graham Winch et al., "Taking Stock of PPP and PFI Around the World," *Summary of Research Report 126* (London, The Association of Chartered Certified Accountants, 2012), 7.
[3] Id.
[4] Winch et al., *supra note 2*, in which the book also cite from Ford, R and Zussman, D, *Alternative Service Delivery: Sharing Governance in Canada*, (Toronto: Institutes of Public Administration of Canada).
[5] Hemming, *supra note 1.*
[6] Winch et al., *supra note 5.* For this passage, the book cited from Gunawansa, "Legal Implications Concerning Project Financing Initiatives in Developing Countries," *Attorney General's Law Review*, July 2000; E. Savas, "Privatisation and Public Private Partnership," (New York: Chatham House PUblicshers), 2002.; and A.M Abdul Aziz, "Successful Delivery of Public Private Partnerships for Infrastructure Development," *Journal of Construction Engineering and Management,* 133:918-31, 2007.

companies. Despite of that, the high cost in providing economic infrastructure and the tendency of the private sector to undervalue social infrastructure have been considered as obstacles to privatization.[7] Further, governments were hesitant to subject certain facilities to total privatization for reasons such as national security.[8]

By the late 1990s, the concern over infrastructure remained in many countries. PPP began to be recognized as a way to obtain capital from the private sector and management expertise for the infrastructure investment. PPP may not only provide the answer on the issues of increasing economic and social efficiency, but also to bypass expenditure controls, to shift public investments and public debt off the government balance sheet.[9]

The term of PPP itself is not limited to a specific project scheme. In fact, there is no clear agreement on what does and what does not constitute a PPP.[10] There are several names for project schemes types relevant to PPPs: Private Finance Initiatives (PFI), DBFO (design-build-finance-operate), and BOT (build-operate-transfer).[11] Some countries use the same name for their project scheme, however that does not signify that those countries have the same structure and arrangement for the project. Japan and UK can be used as an example as both use the term PFI for their projects scheme. In UK, it refers to the specific contractual arrangement between public and private sectors players where the government reimburses the special project vehicle directly through the unitary charge.[12] In Japan, PFI is used more generally for a PPP that encompasses various new institutional and contractual arrangements between the public and the private sectors.[13] The East Asian Countries have taken the private participation in infrastructure projects mostly through build, operate, and transfer schemes and variants founded mostly on contractual arrangements to support off-balance sheet financing.[14]

PPP can be attractive to both the government and the private sector. The government will receive several benefits from the use of private financing such as to avoid the risk of increasing the government's debt, and having the user charges as a source of revenue. Handing the management of

[7] Hemming, *supra note 1*.
[8] Winch et al., *supra note 2*.
[9] Hemming, *supra note 1*.
[10] Id.
[11] Winch et al., *supra* note at 17.
[12] Id.
[13] Id.
[14] Aldo Baietti, "Private Infrastructure in East Asia: Lesson Learned in the Aftermath of the Crisis," (World Bank Technical Papers 2001), 1.

the private sector will provide efficiency as they have superior management capabilities and more incentives to innovate than the public sector, which in the end will result in the combination of better-quality and lower cost of services. On the other hand, this could also open business opportunities for the private sector.[15]

Despite the attractive features and opportunities offered, PPP also faces non-exhaustive list of risks among others, financial, contractual, and political risks. Over a decade ago, the financial crisis that hit the East Asia countries has proved to be a major drawback in its progress of mobilizing private investment for infrastructure. Projects were reevaluated and cancelled because of increased investment risk and sharply rising costs.[16]

Indonesia, along with other the East Asian countries like Malaysia, Philippines, Thailand, Vietnam and the Republic of Korea, were suffered heavily due to the exposure of the financial risk. Especially for Indonesia, during the period of 1994 to 1999, total private investment in Indonesian infrastructure was more than USD 20 billion, with USD7.3 billion in 1996 and USD3.6 billion in 1997. There was no investment in 1998 and the country had only USD 429 million in 1999.[17]

The severe effects of financial crisis to Indonesia can be seen by the decrease of the demand for infrastructure and related services. The telecommunication sector suffered about 23% drop of the use of local access network traffic. State enterprises also sought to amend the power purchase agreements, BOT, and BOO agreements to change the payment currency into local currency and also to change the rate to become less than the market rate. Most power projects that were already in financial disclosure and starting the construction phase, had to be suspended or cancelled by the presidential decree in late 1997.[18]

To be able to attract investors and promoting private projects, government had to enter into guarantees and contractual obligations which make them vulnerable to various risks. In case of infrastructure project in power sector, the extensive guarantees provided by the governments shifted the commercial risk which should be borne by the private sector to the government. At the time of the crisis where

[15] Hemming, *supra note 1*.
[16] Baietti, *supra note 14*.
[17] Baietti, *supra note at 16*.
[18] Id.

there were decline of demands, the governments were exposed to such risk and had to release the guarantee to the private sector. In case of Indonesia, the contractual liabilities and losses were estimated at USD11 billion.[19]

Learning from the past, Indonesian government has taken a significant reform in infrastructure policy and regulations. The strategy to enhance PPP in infrastructure development described in the National Development Plan 2010-2014 is by shifting the government role to be facilitator or enabler and focus on the service sustainability through efficient and effective investment.[20] In 2009, another important improvement has also been made by taking a step forward from the traditional concept of government guarantee by establishing a state owned enterprise known as Indonesia Infrastructure Guarantee Fund (IIGF). With IIGF, the government of Indonesia will not be exposed directly to the contingent liabilities that may arise during the infrastructure projects as the capital participation of the government of Indonesia in IIGF is separated from the state budget. Other than as a risk fencing, IIGF will not only to provide guarantees for PPP projects, but also to improve credit worthiness of the projects.

Hemming describes the government guarantees as "*a form of government intervention intended to reduce the financial costs of risks faced by the private sector and/or by other public entities, should they materialize*."[21] In Indonesia, the provision of infrastructure guarantee can be done in two ways: (i) direct government support/guarantees which given through the Ministry of Finance jointly with IIGF; and (ii) and the government support/guarantees given solely through the IIGF.

This thesis will compare IIGF with the general structure and the role of financial guarantees offered by Brazilian government through the creation of Fundo Garantidor de Parcerias Publico – Privadas (FGP), and the similar scheme offered by BANOBRAS (National Works and Public Service Bank) and the National Infrastructure Fund (FONADIN) in Mexico. Latin America has experienced an increase of investment in private infrastructure projects since 2005, the and also improvement in investment in the first half of 2011. Brazil and Mexico were chosen as they have driven the increases in investment, which has been particularly concentrated in energy and transport public-private partnerships.[22] The purpose of

[19] Baietti, *supra note at 9*.
[20] Bastary Pandji Indra, *PPP Policy and Regulation in Indonesia*, 2011.
[21] Hemming, *supra note at 30*.
[22] World Bank Institute, "*Best Practices in Public-Private Partnerships Financing in Latin America: The Role of Guarantees*," (Washington, DC., 2012), 5.

the comparison is to be able to address the question of this thesis on whether IIGF already has the features that will provide the incentives to investors in Indonesian infrastructure projects.

The structure of this thesis is as follows. Chapter II will discuss the government guarantee from the theoretical perspective, while Chapter III explains about the features, structure and the role of IIGF based on the prevailing regulations in Indonesia and also the scheme of guarantees used in Brazil and Mexico, including the application on their infrastructure projects. Chapter IV of this thesis will analyze whether IIGF has been equipped or lacked with the features that will incentivize investors. Chapter V will close the thesis with the conclusion.

## Chapter 2
## Government Guarantees

### A. The Need for Government Guarantees

Government guarantee is a form of government intervention which rationale is to respond to the inability of markets to distribute risks optimally.[23] It provides protection to the private sector against the risks involved in PPP contracts which mostly involve the provision of high-cost, single-use, long-lived assets. The private sector may not want to enter into such PPPs or other arrangement with the governments without such protection.[24] Government guarantees are a way for governments to incentivise the private sector (e.g. sponsors, banks, capital market investors, equity providers) to participate in PPP programs or projects.[25]

PPP projects have very broad range of risks that have to be managed by both the public sector and the private sector. In principle, a risk should be borne by the party who has the ability to manage it, in the sense of being able to anticipate risk, control exposure to risk, and thereby minimize the cost of risk. The private sector is having a better position in anticipating the project risks such as the construction and operating risks are common in PPP projects. More importantly, the private sector also has the ability to mitigate the risks either by diversification or insurance. However, the private sector risks cannot handle risks, which cannot be diversified or insured against. In these circumstances, the government has the role of shielding the private sector from such risks. For example are the ability of government to control the entities it's owned, or to amend laws and regulations.[26]

In general, there are three main drivers on why the government guarantees are used in PPPs. The European PPPs Expertise Centre identifies those three main drivers: (i) public sector policy drivers; (ii) financial drivers; (iii) and project risks drivers.[27]

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[23] Hemming, *supra note at 33*.
[24] Fiscal Affairs Department of International Monetary Fund, "*Government Guarantees and Fiscal Risk*,"(International Monetary Fund, 2005), 8.
[25] European PPPs Expertise Centre (EPEC); "*State Guarantees in PPPs: A Guide to Better Evaluation, Design, Implementation, and Management*," March 2011, 5.
[26] Hemming, *supra note at 33*.
[27] EPEC, *supra note at 7*.

For the policy purposes, government guarantee can serve in building up confidence in a PPP market and demonstrating government commitment. In the emerging PPP market, or even where the PPP market is already established, the private sector may be unwilling to commit into long term PPP arrangements as they have a limited understanding of the risks involved in the projects. There may also a situation where there are very limited financiers who are able to finance the projects. With government guarantees, the government can signal its commitment to its PPP projects thus encourage the private sector to participate in the projects.[28]

Government guarantee may also be used as an instrument to accelerate the implementation of investments. PPP transactions is a complex transaction that has to be performed in several stages, starting from the long procurement stage, due diligence, and negotiation processes, especially for the funding of the project where usually come through project finance. The government guarantee may cover the risks that may cause delay in the negotiation or due diligence issues, therefore the negotiations can be simplified and the parties may proceed to the commencement of the projects.[29]

From the public policy perspective, another important function of government guarantee is that it could serve as a safeguard the credibility of a PPP program. The failure of the projects or impeding negotiations of a PPP project may be viewed as a collapse of an entire policy. Government guarantee may be used to avoid this issue. However, this would only relevant if the whole PPP program would be damaged by a failure of a single PPP project and if the program is very important from political point of view that protection to the program is considered imperative.[30]

The second driver on the use of government guarantee is financial issues. Initially, the government guarantee would improve the credit quality of the loan to attract the funding, and as a result, more banks are willing to provide financial support to the project. Further, government guarantee would encourage lower pricing and longer debt tenors thereby improving funding conditions of the project, and would overcome the blockages in debt market.

[28] Id.
[29] Id.
[30] Id.

Without the guarantee, the debt market disruptions would have discouraged private sector participation.[31]

The third driving factor for the provision of government guarantee is the project risks. The project involves a wide range of risks and effective risk transfer is important for the PPP to be successful. Government guarantee aims to tackle the risks related to the projects and therefore make the PPP transactions bankable and attractive to financial investors.[32]

The coverage of the government guarantee should be limited and should not cover all the risks related to the project. Guaranteeing a broad range of risks would have few negative effects that may undermine the benefits of the projects. First, they reduce the incentive of firms to perform efficiently. For example, when the government guarantees the cost overruns, the firms will have the tendency to let costs exceed the initial estimation. Assuming limitation on some risks will increase the incentives for the firms or franchise holder to be more efficient.[33]

Second, the guarantees also reduce the incentive to screen projects quality carefully.[34] The experience of San Jose Lagoon Toll Bridge project scheme could be set as an example that would be best to illustrate this condition. Eduardo Engel describes the scheme as follows:[35]

"*The San Jose Lagoon Toll Bridge was built to relieve congestion in the San Juan region in Puerto Rico. The government assumed most of the commercial risk by guaranteeing to buy back the project at the concessionaire's request if traffic fell short of 80 percent of projections during the first three years and 100 percent of projections after nine years. In the event of a buy back, the government would reimburse the concessionaire for all project costs and pay it a 13 percent return on its investment. Under this badly designed guarantee scheme the concessionaire has few incentives to screen the quality of the projects.*"

[31] EPEC, *supra note at 8*.
[32] EPEC, *supra note at 10*.
[33] Eduardo Engel et al., *Infrastructure Franchising and Government Guarantees in Timothy Irwin et al.(eds), Dealing with Public Risk in Private Infrastructure*, (World Bank, Washington DC, 1997), 90.
[34] Id.
[35] Id.

Third, the guarantee would shift the obligations of previous administrations to the next administrations as they create contingent liabilities for the government. These contingent liabilities are rarely valued and typically are not addressed in yearly budget or even considered as government debt. When the guarantee may become effective due to recessions or other conditions, such obligation is very likely to trigger a new type of debt crisis.[36]

In order to deal with the above issues, it is necessary to have efficiency consideration when designing the guarantees, by addressing the scope and period of the guarantee. It should not cover the impact of legal and regulatory changes that applied to the whole range of economy, but instead it should only focus to the risks that affect specific project or other comparable projects. A careful consideration and analysis on the risks that will be covered by the government guarantees is required to address the occurrence of specific events that would trigger the guarantee. The possibility of changes in regulation whereby the government would allow competition in previously protected market or the changes in market pricing policy in a market which could change the level profitability are the examples where the guarantee should be focused at.[37]

A similar example as the San Jose Lagoon Toll Bridge scheme could be used, which is a minimum revenue guarantee scheme. A private sector may require the government to guarantee their revenue shortfalls, which shortfalls could probably happen due to the government's action in the future by opening another competing project or as a result of the private sector poor performance in managing the project. In case of the government action resulting in competition, the private sector concern of losing their revenue could be justified. However, the guarantee could not be applied to the latter case.[38]

Designing of government guarantee deals with the problem of allocating the risks between the parties and it depends on case by case basis, although the basic principle that "the risks should be borne by the party who are best placed to manage it" is still applied. In fact, there are risks that cannot be placed in either private sector or the government because both parties don't have a clear position. Take natural disaster for an example. Whether the government or the

[36] Id.
[37] Hemming, *supra note at 34*.
[38] Hemming, *supra note at 35*.

private sector should bear the risk depends on the commercial availability of the catastrophe insurance.[39] Still, there are more risks that have to be defined and analyzed carefully when designing the government guarantees and allocating the risks. The next part will discuss in details on the risks related to the PPP projects, as it will provide a clear picture on where to allocate the risks, and therefore recognizing on which risks that the government should provide the guarantee against.

B. Risks and Risks Allocation

Designing a project involves calculation of uncertainty or risk as it will affect the value of the project. There are a lot of possibilities of events that will occurs, which one of the events will determine the value of the project. Estimation of the total project value could be done in advance, however its ultimate value is unknown.[40] Risk is unpredictable variation in value.[41]

The term risk is often made as reference to the possibility of loss, uncertain but possible bad outcomes.[42] The following are the risks present in PPP projects, which list is non-exhaustive and somewhat overlapping between each category.[43] Some risk are project specific, some are economy wide.[44]

1. Construction risk

   This risk related to the design problems, building cost overruns, and project delays.

2. Financial risk

   Risk related to the flexibility of interest rates, exchange rates, and other factors that affecting financing costs.

3. Availability risk

   Risk related to the continuity and quality of service provision.

4. Demand risk

   Risk related to the ongoing need for services.

[39] Hemming, *supra note at 34*.
[40] Timothy C. Irwin,"*Government Guarantees: Allocating and Valuing Risk in Privately Financed Infrastructure Projects*," (The World Bank, Washington D.C, 2007), 49.
[41] Irwin, *supra note at 5*.
[42] Id.
[43] Hemming, *supra note at 12*.
[44] Irwin, *supra note at 51*.

5. Residual value risk

Risk related to the future market price of an asset.

The objective of PPP is to transfer some of the risks from the government to the private sector.[45] However, we are still posed with the question on when which parties should take the risk and how those risks should be allocated between the government and the private sector. Traditionally, the answer would be that risk should be allocated to the party that has the ability to handle it. The answer is correct, but not self-explanatory. Irwin explains three ways to allocate risks by considering each party's ability to (i) influence the corresponding risk factor; (ii) influence the sensitivity of total project value to the corresponding risk factor – for example, by anticipating or responding to the risk factor; and (iii) absorbing the risk.[46]

Allocate a Risk to the Party Best Able to Influence the Risk Factor

Other things being equal, this part of the principle implies that a risk should be allocated to the party that has the most influence over the corresponding risk factor.[47] The reasoning is that if a party is able to influence the risk factor and bears the corresponding risk, it has the advantage to improve risk factor's result and bears the costs of doing so. As it bears the costs and ability to control over the risk factor, it has the incentives to spend its resources and pay the costs wisely, so the costs would not be higher than the benefits that it would receive. In this sense, it also has the incentive to maximize the total value of the project.[48]

The example of the application of this idea could be seen in the construction project whereby the construction-cost risk is allocated to the construction company. Construction-cost risk could be managed by giving the construction company the control on the operating cost of construction, whether by way of choosing its materials, the use of construction method and techniques and how it manages the construction process, which things should be done without sacrificing the quality of the construction. By controlling those, the construction company could avoid the construction-cost risk. Having said this, the value of the project could be higher if the

[45] Hemming, *supra note at 12*.
[46] Irwin, *supra note at 57*.
[47] Id.
[48] Irwin, *supra note at 58*.

construction company bears the construction cost. The construction company itself will have the profits if the construction cost when the actual cost is less than estimated cost, or it losses if the actual cost is higher than the estimated cost.[49]

As the construction company has control over the cost of construction, which cost is very likely to change during the project period, allocating the construction-cost risk also requires "a not doing something" – as in terms of not giving a rate-of-return guarantee or adjustment to the price due changes to actual operating cost which attributable to the construction company. The adjustment of price could be given on the basis of the economic changes or industry-wide price indexes which are out of the construction company's control, but not on the basis of changes in actual cost resulted from the company's performance, which in fact is the responsibility of the construction company.[50]

On the other hand, in the construction project, there is risk that is best allocated to the government, such as land acquisition. The reason behind this is that the government has the ability to influence the cost of land acquisition more than any other party. In addition, the government also bears the cost related to the delay in the land acquisition process. Therefore, it is make sense that the allocation of this risk to the government will provide the government with the incentives to minimize the cost of land acquisition.[51]

Another example where a party could influence risk factor is demand risk in telecommunication sectors which could be higher or lower than the initial forecast. The firm, as a matter of fact, has the ability to increase the number of demand, especially by maintaining its level of services either by keeping the quality of the connections or timely responds to problems. Other things being the same, demand risk should be allocated to the firm because its ability to influence demand.[52]

[49] Id.
[50] Id.
[51] Irwin, *supra note 40 at p.58*.
[52] Timothy Irwin et al., "*Dealing with Public Risk in Private Infrastructure: An Overview*," in Timothy Irwin et al.(eds), Dealing with Public Risk in Private Infrastructure, (World Bank, Washington DC, 1997), 8.

Allocate a Risk to the Party Best Able to Anticipate or Respond to the Risk Factor

For the case of risk factor which no one can influence of, the first part of the principle would be inapplicable as the risk factor could not be allocated to any parties. However, even when no one can influence such risk factor, one party may be able to respond or anticipate it.[53] This second part of the principle will describe on how the party's ability to anticipate or respond to the risk factor. By anticipating or responding to the risk factor, that party may be able to mitigate the downside risk and exploit upside risk.[54]

The occurrence of earthquake is an example of an event of risk which no one influence of. Even so, a party may be able to mitigate the risk of an earthquake. If a party has sufficient knowledge regarding earthquake and it has the responsibility to choose the site of the project, it can respond to the exposure of an earthquake by choosing a location which has less possibilities for an earthquake. Another type of respond could also be taken is by choosing the construction methods and materials for the projects.[55]

Demand risk is another example where no parties may have any influence of. However, demand could be forecasted and so the design of the project could be adjusted in accordance with the result of the forecast. The demand risk then is best to be allocated to the party who has the ability of forecasting the demand factor. Demand could affect the total value of toll road project, for instance, whether it would become profitable or unprofitable. By allocating the demand risk to the party who is able to forecast demand, the relevant parties may be able to analyze the viable options to determine a better decision on the project, as to whether to build the road or not, therefore project may have maximum total value.[56]

The respond to the demand risk could be taken in different approach as in power plant project. The size of the power plant is depending on the demand. Suppose that at the beginning of the project the demand is small but it grows higher later over time. In response to this risk, the investment for the power plant may be performed is stages, starting with the small capacity and

[53] Irwin, *supra note 40 at p. 59*.
[54] Id.
[55] Id.
[56] Id.

then developed to higher capacity according the increase of the demand. If the firm is better in responding appropriately to the changes of demand, allocating the demand risk to the firm will likely maximize the total project value.[57]

Allocate a Risk to the Party Best Able to Absorb the Risk

There are several factors that affect a party ability to absorb risk. First factor is it depends on the degree to which the risk factor is associated with the value of the party's other assets and liabilities.[58] If the risk is small and not related to the existing assets and liabilities, then the cost assuming the risk would be small. If the risk is substantial and closely associated to the existing assets and liabilities, the cost would be proportionally high.[59]

For instance, the government of a large country with many taxpayers would be better to assume demand risk on a lower cost than a small telecommunication company. Put it otherwise, a big size telecommunication company with diverse shareholders could assume demand risk at lower cost better than the government of a small country. The government would not want to assume demand risk because they may have to compensate the consequences of low demand at the time their tax revenue fallen. On the other hand, it would be better to allocate the demand risk to foreign investor as they may have a portfolio of assets which value is not related to local business conditions.[60]

The second factor is a party ability to bear a risk also varies with its ability to pass the risk on to others.[61] The firm and the government may be able to pass the risk by buying derivatives to protect them from the fluctuation of interest and exchanges rates and commodities prices. However, residential customers would not be able to do the same as they don't have the ability. With other things being the same, the risk is better be placed in the firm and the government as they may have lower cost in absorbing such risk compare to the residential customers.[62]

[57] Id.
[58] Irwin, *supra note 40 at p. 60*.
[59] Id.
[60] Timothy Irwin et al., "*Managing Government Exposure to Private Infrastructure Risks*," (The World Bank Research Observer Vol.14, no.2, 1999), 235.
[61] Irwin, *supra note 40 at p. 61*.
[62] Id.

Third factor, the parties may differ in their ability to spread risk among other ultimate risk bearers.[63] Government and firms are not the ultimate risk bearers. Risk allocated to the government is ultimately borne by the taxpayers and other beneficiaries of its spending: if the government does well, taxes may reduce or the expenditure increases; in contrast, if the government does poorly, taxes will rise or expenditure subsides. The allocation of risk to the firm will also ultimately be borne by its creditors, insurers, subcontractors, and shareholders.[64]

Other common argument of the government spreading the risk to the taxpayers is that the government will have the advantage over the private sector in managing risks. However, that doesn't necessarily true as the private sector is not only able spread the risk to the financial markets, but they also have better risk managers than the governments. In this sense, allocating the risk to the private sector is better than allocate the risk to the government.[65]

In terms of the cost of bearing risk, comparing the benefits of allocating risk to a party best at controlling risk with a party who can bear the risk with the least cost is also important. Allocate the risk a few agents who are able to control risk would be better rather than diverse the risk to shareholders or taxpayers. Risk diversification to shareholders and taxpayers may lower the cost, but giving managers the stakes in the project will provide them with stronger incentives for them to increase demand and reducing risk.[66]

In addition to the principle above, it is also important to note that allocating a risk to a party is not fixed, but depends also on how the rights to make decisions are allocated among the parties. The risks and rights should be matched and allocated in parallel.[67]

The demand risk for power projects could illustrate how to match risks and rights. It would be reasonable to think that firms have the ability to forecast demand, therefore allocate the demand risk to them. If the government intends to get the benefit from the firms' forecasting ability, should give the rights to make decision to them so the firms would be able to anticipate or respond to demand. The government must allow the firm to make decisions on when to

[63] Id.
[64] Id.
[65] Hemming, *supra note at 13*.
[66] Irwin, *supra note 59*.
[67] Irwin, *supra note 40 at p.61*.

invest, what technology they will use, and so on. If governments intend to do otherwise, as to make decisions by itself, then they have to assume the demand risk.[68]

C. Types of Government Guarantees

There are two types of government guarantee commonly used in PPP namely non-financial (contractual) guarantees and financial guarantees. These guarantees are the most frequently used and not intended to be inexhaustive.[69]

1) Non-financial (contractual) Guarantees

Government guarantees sometimes given through contractual provisions of PPP contract between the government and PPP company. The commonly used provisions are as follows:[70]

a. Revenue or usage guarantee

Under this provision, the government guarantees the PPP company a certain level of usage (usually in toll road project) or revenue guarantee, whereby the government will compensate the shortfall of the PPP company if their revenue does not reached a certain amount.

b. Guaranteed minimum service charges

The government guarantees that the amount of service charge it pays will not decrease under a certain limit, regardless the performance of the PPP company.

c. Change of law/regulation

This provision protects to the PPP company against the changes of law/regulation in the future. For the governments whose regulatory frameworks have not yet developed, they may need to provide this guarantee.

d. Termination payment

With this provision, the government guarantees to pay the compensation to the PPP company when the PPP contract is terminated early due to default of the PPP company.

[68] Id.
[69] EPEC, *supra note at 13*.
[70] EPEC, *supra note at 15*.

e. Debt assumption undertakings

Under this provision, the government guarantees to assume the debt of PPP company if the PPP contract is terminated, by means of novation the government becomes the debtor.

f. Residual value payments

This provision usually used for the PPP contract which duration is less than the PPP company's loan agreement, therefore the PPP company will not able to fully paid its debt to the lender. The government then guarantees to pay the PPP company, upon the expiration of the contract, an agreed amount which reflects the value of the underlying assets.

2) Financial Guarantees

A financial guarantee is a technique used by debtors to improve their credit rating of their debt, in order to lower their financing cost. We could say that it is a "credit enhancement". Lowering the financing cost is exactly the purpose of financial guarantee in the develop market like US, in which the investors are sophisticated and diverse. The investor would require more securities to the debt for the issuer who has no financial guarantee and lower rating. By having a financial guarantee, the issuer will have higher ratings and lower interest rates. In developing countries, especially for the financing of infrastructure projects, the value of financial guarantee goes beyond the interest rate, which is to open access to long term institutional investor market.[71]

Types of Financial Guarantees

There are two types of financial guarantees: (i) Full Wrap; and (ii) Partial Credit Guarantees (PCG). They also served as "credit enhancement", while the Full Wrap covers 100% of the debt of the issuer, PCG covers only specified percentage of the obligation.[72]

Full Wrap has three characteristics: unconditional, irrevocable, and timely. Unconditional means that the guarantor commits itself to pay for the issuers in all circumstances, including the

[71] World Bank, *supra note at 41*.
[72] Id.

issuer's default in paying the premium. In this regards, the guarantor waives any and all of its rights it may have, by law, contract, or otherwise, to avoid his obligation to pay or excuse itself from making a payment under the guarantee. Irrevocable, meaning that it is issued for the full tenor of the guaranteed obligation, and the guarantor also waives all of the rights it may have to terminate the guarantee before the maturity of the debt. As a "credit enhancement", the rating agencies also take into account the ability of the issuer to pay in full and timely manner, another characteristic of Full Wrap is that it covers the payment of the obligation on time.[73]

Another type of financial guarantee is PCG. This guarantee has similar characteristics as Full Wrap, except that PCG only covers a percentage of the principal amount of the guaranteed debt.[74]

Table 1 below will describe the characteristics of Full Wrap and PCG:[75]

Table 1 Characteristics of Guarantee

| Characteristic | Full Wrap Guarantee | Partial Credit Guarantee |
|---|---|---|
| Guarantee of Principal and Interest on a timely manner | Yes. | Yes. |
| Irrevocable | Yes. | Yes. |
| Unconditional | Yes. | Yes, subject to the maximum limit amount of the guaranty. |
| Limit to the coverage of the Guarantee | No limit. Covers 100% of every coupon of principal and interest. | Limit determined according to the number of notches of credit enhancement required. |
| Credit Enhancement | Increases the rating of the guaranteed obligation to the rating level of the guarantor. | Increases the rating of the guaranteed obligation a specific number of notches according to the size of the limit amount of the guarantee. |

[73] World Bank, *supra note at 43*.
[74] World Bank, *supra note at 44*.
[75] Id.

| | | |
|---|---|---|
| Complexity | Simple and standardized. Investors need to understand the underlying risk but derive comfort from the 100% guarantee. | More complex. Investors need to understand the characteristics of each PCG, the underlying risk, the credit enhancement provided and its sufficiency. |
| Versatility of Application | Limited. Applicable only to projects that can achieve an investment grade underlying rating in the global scale. | Can be applicable to non-investment grade projects. |
| Maximum Credit Enhancement | To the rating of the guarantor. If the guarantor is rated "AAA", and the underlying rating is "BBB-" (minimum investment grade) the credit enhancement achieved is equivalent to 10 notches. | Normally not more than 5 notches. |
| Cost | Normally less than 1.0%, applicable to the full amount of the guaranteed obligation. | Normally above 2.0%, applicable to the guaranteed amount. |
| Scope of Work of the Rating Agencies | Underlying rating (without considering the guarantee) and public rating (with the guarantee). All work is done by the Infrastructure / Project Finance Group. | Underlying rating done by the Infrastructure / Project Finance Group; sizing of the PCG and public rating done by the Structured Finance Group. |
| Guarantors | Monoline insurance companies and banks in the form of Stand By Letters of Credit. | Multilateral agencies. |

## Chapter III
### Experience of Brazil, Mexico, and Indonesia

This chapter will describe the features of infrastructure guarantees in Brazil, Mexico, and Indonesia, also their experiences and implementation in the projects. Brazil and Mexico are specifically used as the benchmark for IIGF as Indonesian infrastructure guarantee scheme because of the similar character between those three countries, which is their need in attracting private sectors/investors participation for infrastructure development. Even though Brazil and Mexico were considered as countries with medium risk in their credit ratings (Brazil and Mexico are rated BBB- and BBB respectively, which was higher than Indonesia that was rated as BB (based on Standard & Poor's ratings for the year of 2010)), their success in implementing PPP projects shows that their infrastructure guarantee scheme were able to convince the investors to participate in their PPP projects. Of course the availability of guarantee scheme is not the only factor that supports the success of PPP projects as legal frameworks and political stability should also be taken account, however, investors will not even be interested to participate in PPP if the government does not guarantee the projects.

The experience of Brazilian federal government in implementing the Federal Guarantee Fund (Fundo Garantidor de Parcerias Publico – Privadas (FGP)) in Pontal Project and Companhia Paulista de Parcerias – CPP (Paulista Partnership Company) in 4th Line of the Metro of Sao Paolo state level are included in this chapter as case studies. In Mexico, the infrastructure guarantee schemes are National Infrastructure Fund (Fondo Nacional de Infraestructura – FONADIN), Partial Credit Guarantee (PCG) and Contract Payment Enhancement Guarantee (CPEG). The illustration on use of PCG in tax securitization as a source of financing in Mexico is also included. Lastly, this chapter also describes the features of IIGF and its first application in the coal fired power plant 2x1000 MW Central Java Power Plant (CJPP) Project.

A. Brazilian Guarantee Schemes

1) Federal Guarantee Fund (FGP)

FGP is a legal entity under public law[76], which established in 2005 under the Law 11,079/04 regarding the Federal Public-Private Partnerships Law. FGP does not aim to guarantee the

[76] World Bank Institute, *supra note at 61*.

project risk,[77] it was promoted only to secure the government financial obligation to private investors, therefore avoiding government default infrastructure contract.[78] In addition, FGP would also mitigate the risk of government insolvency, providing more liquidity, thus assuring investors to carry out the project and improving the credit risk upon the financing the project.[79]

Bank of Brazil is in charge in managing the FGP[80], and the FGP equity is formed by the capital contribution of the shareholders which consist of Federal Government, its independent agencies and public foundations up to the aggregate limit of R$ 6 billion. The capital participation can made by way of cash contribution, government bonds, government-owned real properties, moveable assets (including government shares in government' state owned companies), or other rights with property value.[81]

Bueno (2010) describes the types of guarantees that can be provided by FGP:[82]

"*a. surety (fiança), without the privilege of order for the guarantor;*

*b. pledge of movable properties or rights that make up the FGP equity, without transferring possession of the pledged asset until enforcement of the guarantee;*

*c. mortgage of real properties;*

*d. conditional sale in which the Public-Private Partnership Guarantee Fund or the trustee it appoints will continue in possession of the assets;*

*e. other collateral contracts; or*

*f. a collateral or personal guarantee covered by separate assets and rights of the Public-Private Partnership Guarantee Fund*."

To date, FGP has been applied to the Pontal Irrigation Project. For the purpose of case study, the following is the summary of the Pontal Project. Pontal Project is located in Petrolina, state of Pernambuco, Northeastern Brazil, which has exported over USD 100 million fruit per year, mostly from land under irrigation. For this project, Brazilian Government, through CODEVASF as

[77] Jose Luis Vittor and Tim R. Samples, "*PPPs and Latin American Infrastructure Markets: Brazil and Chile*," (Latin American Law Business Report, July 2011), 4.
[78] World Bank Institute, *supra note at 61*.
[79] Id.
[80] World Bank Institute, *supra note at 62*.
[81] Julio Cesar Bueno, "*PPP Projects in Brazil: Opportunities and Challenges For The Construction and Engineering Industries*," (Sao Paolo, 2010), 11.
[82] Bueno, *supra note at 12*.

its agency assigned to promote the development of Brazil's semi-arid region through implementation of irrigation projects, will enter into Public-Private Partnership Scheme with the private sectors to operate 33,526 hectares of land, out of which 7,717 hectares are considered as irrigable land, for the period of 25 years.[83]

For the purpose of the Project, the private sector consortium will form a Special Purpose Company (SPC), which will sign the contract with the Government and subcontractors to build and maintain the infrastructure required to provide the service. The main obligation of the private sector is to perform the construction, operate, and maintain the irrigation infrastructure and also to distribute to the agribusiness companies as the users. The users will have the autonomy to choose the crops.[84]

During the period of the Project, SPC is entitled to receive the following revenue:[85]

(i) Tariff collection from users on water and land.

(ii) Government contribution.

(iii) Additional revenues generated by Project, if any.

In this Project, FGP will guarantee 100% of the Government contribution payment should the National Integration Ministry fails to perform its obligation. The guarantee fund issued by FGP for this project will be separated from the assets of FGP and kept in liquid and risk-free market instruments.[86]

The following table illustrates the risks allocation between the SPC and the Government:[87]

Table 2 Risk Allocation Matrix

| SPC | Government |
|---|---|
| - Occupation of irrigable land not accordingly to proposal; | - Social/public manifestations that affect in any way the execution of civil works or |

[83] Pontal Project Executive Summary. Available at: http:// www.pontal.org/docs/ExecSummary.pdf
[84] Id.
[85] Id
[86] Id.
[87] Id.

| | |
|---|---|
| - Refusal of Agribusiness Company to pay tariffs;<br>- Insolvency of Agribusiness Company in tariffs payment;<br>- Acquisition of licenses and authorizations related to the Project;<br>- Exceeding costs related to civil works;<br>- Delays in accomplishing foreseen periods established at “Diretrizes Técnicas Mínimas” (minimum technical lines of direction);<br>- Technology used;<br>- Destruction, robbery or lost of goods;<br>- Social/public manifestations that affect in any way the execution of civil works or services until: (a) 15 days (consecutive or not) during each period of 12 months in case injuries caused by these events are not covered by any insurance offered in Brazil at time of occurrence; or (b) 90 days during each period of 12 months in case injuries caused by these events are covered by insurances offered in Brazil at time of occurrence;<br>- Expenses due to hidden defects in goods of the Project;<br>- Increase in cost of capital, including those caused by increase in interest rates;<br>- Fluctuations in exchange rate;<br>- Changes in legislation;<br>- Events of force majeure that are subject to insurance cover in Brazil at time of occurrence; | services when these events exceed a) 15 days in case the injuries caused by these events are not covered by any insurance offered in Brazil at the time of occurrence or b) 90 days in case injuries caused by these events are covered by insurances offered in Brazil at time of occurrence;<br>- Judicial decision that hinder SPC’s ability of tariff collection or tariff readjustment (when decision is not SPC’s fault);<br>- Not attendance by Government of contractual obligations;<br>- Events of force majeure that are not subject to insurance coverage in Brazil at time of occurrence;<br>- Changes, by Government, in civil works or services detailed at “Diretrizes Técnicas Mínimas”, when SPC is not be responsible for delays;<br>- Creation, alteration or extinction of any tax after presentation of proposals, except for income tax;<br>- Costs and expenses related to reallocation of people affected by expropriation. |

| | |
|---|---|
| - Recovery, prevention, remediation and management of environmental liability related to the Project;<br>- Risks that are covered by insurances in Brazil at that time, but stop being due to direct or indirect omission from SPC;<br>- Possibility of inflation rate in certain periods be superior or inferior to readjust index (for tariffs, Contraprestação, or other values in contract);<br>- Civil and criminal responsibility for environmental damages;<br>- Expenses related to expropriations. | |

2) Companhia Paulista de Parcerias – CPP (Paulista Partnership Company)

At the state level, Sao Paolo offers guarantees in different mechanism. Unlike trust fund, Sao Paolo established a company namely Companhia Paulista de Parcerias – CPP (Paulista Partnership Company).[88] The purpose of CPP is to provide securities and performance guarantees to private sector using the public sector assets contributed to the CPP. As it is a company and not a fiduciary fund, CPP is not a bankruptcy remote vehicle.[89]

The CPP will be managed by the State of Sao Paolo, with the State of Sao Paolo also as the majority shareholder, and other state administration entities also allowed being minority shareholders. CPP aims to optimize assets of the State of Sao Paolo by managing the assets transferred to it. CPP has guaranteed the contract of the Line 4 Yellow Line of the Metro of Sao Paolo.[90]

[88] Felsberg Associados, Public Private Partnership(PPPs) An Alternative to Financing Infrastructure Projects in Brazil. Presentation can be accessed in http://www.google.com/url?sa=t&rct=j&q=brazil%20ppp%20guarantee%20fund%20cpp%20felsberg&source=web&cd=1&ved=0CEMQFjAA&url=http%3A%2F%2Fsiteresources.worldbank.org%2FINTINFNETWORK%2FResources%2FFelsberg.ppt&ei=Ro_YT7y-FZPT8QPbteStAw&usg=AFQjCNHAhnaYSMWHk7FGqZdCaaJW8kQ0yQ

[89] World Bank Institute, *supra note at 70*.

[90] Id.

The Line 4 project started in 2006, financed by foreign investments using project finance model. The contract was signed by a consortium led by CCR (Companhia de Concessoes Rodvarias, Benito Roggio Transportes SA (a Buenos Aires Subway concessionaire), and RATP Developpment SA (Paris Subway). Mitsui (Japan) and Banif Group (Portugal) also involve in the project. The agreement was signed in 29 November 2006, and the project is scheduled for completion in 32 years. As a sponsored concession project, the private partner will be compensated by the payment of user fee of suing the subway and payments from public partner.[91] The guarantee for this project is provided by the CPP, and wide range of assets are used as the guarantee such as government bonds, real estate property, public assets, treasury titles and other rights with equity value.[92]

This project also applies a demand guarantee provision, which is used for the first time in Brazil to mitigate the demand risk. The calculation is based on the minimum and maximum level of demand which will determine the amount of revenue adjustment between the government and the concessionaire (private sectors). The minimum range of demand that is not guaranteed ranging around $\pm$ 10% of the projected demand. In addition, there are also two bands of demand protection for this contract, the first is when the demand is between $\pm$ 10% and $\pm$ 20% of the projected demand, and the second layer is when the demand is between $\pm$ 20% and $\pm$ 40% of the projected demand.[93] With this guarantee provision, if the actual demand is more than the projected demands, the concessionaire (private sectors) gives the excess in revenue to the government. To the contrary, if the actual demand is below the projected demand, the concessionaire receives additional revenue guaranteed by the government.[94]

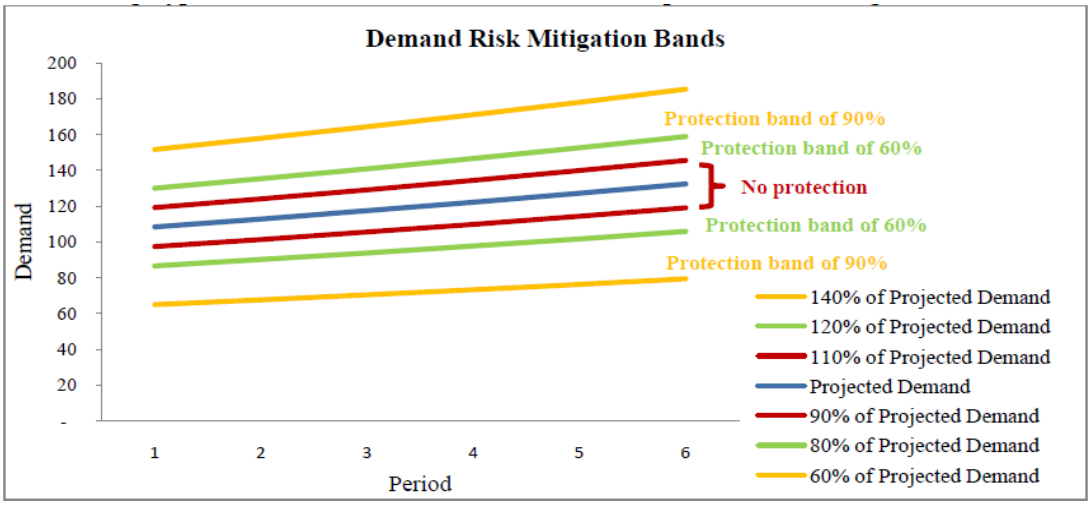
In this project, the demand risk is considered necessary to be shared between the state government and the private partner, for the following reasons: first, without sharing the risk, the private sector the private partner will have difficulties to obtain the financing as the finance model is very sensitive to demand. Second, there are factors that are not controlled by the

[91] World Bank Institute, *supra note at 94*.
[92] World Bank Institute, *supra note at 95*.
[93] Id.
[94] Frances F. Blank et al., "*Real Options In Public Private Partnership Case Of A Toll Road Concession*."2007, 6.

private sector and state's jurisdiction, for instance actions and policies on other transportation modes (eg. buses).[95]

The works of the demand guarantee provision are shown in table 3 below and table 4 will provide the general information of the Line 4 Yellow Line Project.

Table 3 Demand Risk Mitigation Bands




Source: www.realoptions.org/papers2009/37.pdf

Table 4 Line 4 Yellow Line Project

| | |
|---|---|
| **State Owned** | Sao Paolo |
| **Value** | Total of R$ 2.68 billion (US1.608 billion), being R$ 1.96 billion (US 1,3 billion) from the public partner (civil works) and R$ 720 million (US 475,2 million) from the private partner (rolling stock and system operation). |
| **Purpose** | Exploitation of subway passenger services for Line 4 – Yellow, 13 km of extension, serving 11 stations (from Luz to Taboão da Serra station), in three phases:<br><br>PHASE I:<br>Operation with 6 stations and maintenance yard, 14 trains and one |

[95] Jorge Rebelo, "*Financing Mass Transit Projects: Sao Paulo Metro Line 4 PPP: Lessons Learned*," (The World Bank, Chennai Infrastructure Portfolio Workshop, 2012. The presentation slide can be accessed in http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0CE0QFjAB&url=http%3A%2F%2Ffinmin.nic.in%2Fthe_ministry%2Fdept_eco_affairs%2FMI%2Finfra_workshop%2FMetro_SaoPaulo_JorgeRebello.pdf&ei=-J7fT4TVGon68QORgt2uCw&usg=AFQjCNF5RMJvN1b0kfdwJq2_6TnM0cxJXQ

| | |
|---|---|
| | additional station (implemented by public partner).<br><br>PHASE II:<br>Operation with 11 stations and maintenance yard; operation of the segment between Vila Sônia and Taboão da Serra by bus; 15 subway trains of the rolling stock system (number of trains can be altered pursuant to demand re-projection study).<br><br>PHASE III:<br>Operation of the segment between Vila Sônia and Taboão da Serra by Trains; operation conditions determined along the agreement. |
| **Characteristics** | The Line 4 – Yellow has its entire way under the ground, from Luz to Vila Sônia Stations, being an integration route with the other subway lines, and w ith Line 7 – Celestial Blue, of Companhia Paulista de Trens Metropolitanos (CPTM). |
| **Term** | 32 years, from the signature. Total term, including maximum extension: 35 years from the execution, for obtaining a minimum 30-year operation term, from the beginning of the commercial operation of PHASE 1. Agreement executed on 29/11/2006. |
| **PPP Partners** | State of São Paulo and MetroQuatro Consortium, formed by CCR – Companhia de Concessões Rodoviárias, Benito Roggio Transportes S.A. (a Buenos Aires Subway concessionaire) and RATP Développement S.A. (Paris subway). |
| **Agreement Type** | Sponsored concession. |
| **Allocation of Risks** | The private partner is liable, for instance, for operational, financial and commercial risks, while the public partner answers for risks of changes in legislation and regulations influencing the agreement, sharing the demand and foreign exchange variance risks, among others. |
| **Fee Structure** | Fee fixed in R$ 2.08 per passenger conveyed on the base date of February 1, 2005. |
| **Fee Adjustment** | Time interval: on a yearly basis, having as reference the base date of |

| | |
|---|---|
| | February 1, 2005.<br>Criterion: formula considering the variance of General Price Index-Market (IGPM) and the consumer's Price Index (IPC) (within the first 15 years counted from the commercial start up) and variance of the Consumer's Price Index (IPC) for the remaining period). |
| **Additional Compensation Fee Paid by Public Partner** | 48 installments, divided into 2 groups of 24 equal and successive monthly installments. The adjustment follows the fee model. |
| **Guarantees Offered by Public Partner** | The PPP Program in São Paulo is based on a financing structure that relies on public and private investments. That is the reason why SP PPP Program has been implemented that enables the provision of guarantees by the CPP. The assets provided in guarantee are: government bonds, real state property, public assets, treasury titles and other rights with equity value. |

Table adapted from: Rocha and Horta P.54 as cited in World Bank Institute (2012)

B. Infrastructure Guarantee in Mexico

The government of Mexico understands that infrastructure holds important role in the country's competitiveness and economic growth. National Infrastructure Program 2007-2012 has been developed, which aim, among others, are to: (i) increase the coverage, quality, and competitiveness of infrastructure; (ii) transform Mexico into the world's logistic platforms; (iii) increasing access to public services; (iv) promoting a balanced development between regionals; (v) increasing the number of permanent jobs; and (vi) develop the country's touristic activity.[96]

To achieve the goals set in National Infrastructure Program, Mexico will need USD 234 billion of investment, in which (excluding the energy sector) 58% of that investment will be financed by private sectors. The government of Mexico subsequently established the financial strategy to achieve the to support the purpose of National Infrastructure Program by promoting long term

[96] Banobras, "*Infrastructure in Mexico*," Presentation given in Hannover, Germany, 2010. Presentation slides can be accessed at http://www.google.com/url?sa=t&rct=j&q=mexico%20infrastructure%20hannover%20germany&source=web&cd=1&ved=0CFIQFjAA&url=http%3A%2F%2Fwww.lateinamerikaverein.de%2Ffiles%2FLAV%2FVeranstaltungen%2FLAT_2010%2FGarcia_Tames_-_Banobras.pdf&ei=PuLLT6qBF4OX8QPz3dAN&usg=AFQjCNGTcmp8xfoJqw6DJhqO9bujUJo2_Q

domestic savings, establishing a mature local financial market, creating fiscal space to increase investment infrastructure, and guarantee economic and financial stability through sustainable fiscal and monetary policy. Simultaneously, several financial vehicles are also prepared by the government of Mexico directing resources to infrastructure investment. The main vehicle of the federal government created to encourage private investment in infrastructure is the National Infrastructure Fund (Fondo Nacional de Infraestructura – FONADIN). As a result, infrastructure investment has increased by 30% during current administration.[97]

The Mexican National Development Bank (Banobras) holds the leading role in Mexico infrastructure development. Firstly, Banobras is the trustee of FONADIN, and secondly Banobras also provides financial guarantee[98] in its capacity as a development bank.[99] The Mexican government considered the FONADIN as the key instrument to make the PPP project bankable and therefore able attract the private sectors. FONADIN offers equity support and subordinated debt to PPP projects that do not have sufficient financial strength due to limited support from the banks or no access to capital markets, such as greenfield toll road.[100]

In addition, FONADIN also offers financial guarantees by providing credit enhancement to increase access to the banks or capital markets. The types of financial guarantees offered are:[101]

- First loss, whereby FONADIN would assume the first loss and make the payment upon the insufficient of funds, prior to the disbursement of other guarantee.
- Pari Passu, whereby FONADIN only disburse a portion of the insufficiency of funds, which portion has been agreed with other lenders and guarantors.
- Last Payment, whereby FONADIN will disburse the insufficient amount after other guarantees have been paid.
- Mixed guarantees, is a combination of first loss and pari passu guarantees. The limit of this guarantee is 50% of the guaranteed obligation.

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[97] Id.
[98] World Bank Institute, *supra note 50*.
[99] Banobras, "*Financial Instruments of the Federal Government to Promote Foreign Investment in Mexico's Infrastructre*," presented in Infrastructure Conference Mexico 2010, COEX Exhibition Centre Seoul. Presentation slides can be accessed at http://www.google.com/url?sa=t&rct=j&q=financial%20instruments%20of%20the%20federal%20government%20to%20promote%20foreign%20investment%20in%20mexico%E2%80%99s%20infrastructre&source=web&cd=1&ved=0CE8QFjAA&url=http%3A%2F%2Fwww.banobras.gob.mx%2Fcentrodeinformacio4%2FEventos%2FConferencia%2520de%2520Infraestructura%2520de%2520M%25C3%25A9xico%25202010.%2520Se%25C3%25BAl%2C%2520Corea%2FDocuments%2F3._Banobras_ENG%2520Seoul.pdf&ei=KALMT9DrO6TS0QX6-fjiAQ&usg=AFQjCNHO6xx4ktE3j7QQlw4TWbxQG2Nh_Q
[100] World Bank Institute, *supra note 56*.
[101] World Bank Institute, *supra note at 56*.

- Performance guarantees and political risk guarantees, whereby FONADIN will cover maximum of 15% of the investment budget on the construction risks. This guarantee also covers the initial stage of operation of the project until the project has achieved 40% of the expected revenue.

Other than FONADIN, Banobras also offers Partial Credit Guarantee (PCG) and Contract Payment Enhancement Guarantee (CPEG). PCG is unconditional and irrevocable guarantees for timely payment of principal and interest. This guarantee maximum exposure amount is determined based on the level of credit enhancement that wants to be achieved. The size of guarantee is 50% of the principal amount of the guaranteed obligation. In order to obtain this guarantee, the PPP project has to achieve a minimum underlying rating in the investment grade category. With this guarantee, Banobras will eventually become the lender of the project, as Banobras will disburse funds to investors or banks to make debt service payments in the event of insufficient project cash flow.[102]

As to the CPEG, the guarantee given by Banobras to a government for a full and timely payment to a private sponsor under a PPP project. This guarantee is given to PPP project with the "Service Rendering Contract" (Proyectos de Prestacion de Servicios or PPS) scheme. Under this scheme, the private sector will perform the construction, operation, and maintenance of the infrastructure, and the government will provide the assurance of fixed payment in return to the services provided by the private sector.[103]

As this guarantee offers the private sector stability of their cash flow, the states and municipalities may be able to attract investors to work on their projects. On the other hand, the guarantee will also serve as credit enhancement for entities will lower credit rating.[104]

The use of the Banobras' PCG can be seen in the following case, where PCG increases the credit rating of the state and provide effective mitigation to political risk in tax securitization transactions.

[102] World Bank Institute, *supra note at 52*.
[103] Id.
[104] Id.

In Mexico, the subnational public sector has been very active in seeking financial support from banks and capital market. The financing from banks loans were backed by Federal Participation. Federal participation is the regular distribution received by each state and municipality from the Federal Government. However, as the loans are faced with high exposure of interest rate risk and potential changes in tax revenue, the banks will mostly require large collateral. As the consequence, public entities use most of their federal participation as collateral for the loans and therefore lost their financial flexibility. In response to this, tax securitization was seen as new alternative source of financing by some of public entities.[105]

State of Nuevo Leon was the first state using this transaction structure, by placing the future revenue of vehicle license plate fees in trust to back up the bond issuance. It was soon followed by other states such as Varecruz, Michoachan, Chiapas, and Oaxaca. The taxes that mostly used for this transaction are payroll tax, vehicle ownership tax, and vehicle license plate fees.[106]

The challenge in implementing this structure is that many states do not have sufficient rating to perform this capital market financing, which normally rated "AA" or higher. For the states with "BBB" or "A" ratings, the structure needs "credit enhancement" and in order to achieve higher ratings, the states have to comply with the requirements of rating agencies. Standard & Poor, Fitch Ratings, and HR Ratings have similar approach where the credit rating of a state will increase according to the level of coverage used in the financing structure. The following example will describe the relation between credit ratings and level of coverage. A state with "A" rating needs three notches up to achieve "AA" rating, in which each notch requires increases in debt service coverage ratio.[107] Higher ratio means higher ability to withstand the stress scenario in the project, so the state will have higher credit rating. Tax securitization will achieve a rating above the state rating, subject to the debt service coverage ratio level.[108] However, there is limitation to the maximum increases in credit rating notches which is normally 5 or 6 notches. The state with low rating, BBB- or below, will not be able to achieve sufficient rating needs to have capital market financing.[109]

[105] World Bank Institute, *supra note at 120*.
[106] Id.
[107] World Bank Institute, *supra note at 123*.
[108] Id.
[109] Id.

Different with the above rating agencies, Moody's has its own consideration as it subjects its view on the political risks, specifically tax determination power of the state and tax revenue diversion by the state executive which may lower the cash flows running to the issuing trust, and as a consequence tax securitization cannot surpass the rating of the state, even with increase coverage level.[110]

The case above describes the fact that "external" credit enhancement, such as PCG, is required to will provide the financial support needed by the states or municipalities to achieve the rating required to have access for the capital market financing.[111]

C. Indonesia Infrastructure Guarantee Fund

Investment in Indonesia infrastructure fell from 5-6% of GDP to only 1% of GDP in 2000 as the result of 1997 crisis (World Bank, 2007). Since then, the number of investment has bounced up to around 3.5% of GDP, but the investment figure is still short compare to the government's target of GDP growth of 7.0-7.7% in 2014.[112] The government of Indonesia realized the importance of improving infrastructure and has made it as priorities. According to the National Development Planning Agency, the government of Indonesia estimation was that approximately USD 214 billion is needed for infrastructure, while the government will only able to finance about USD 140 billion. The funding gap of USD 74 billion was expected to be financed by the private sector.[113]

In order to achieve that, the government of Indonesia already taken further steps by reforming and improving the regulatory framework. During the period of 2001 – 2009, several laws which open up the infrastructure industry market for the private sector have been passed,[114] and recently the government of Indonesia also passed the Law no.2 of 2012 on the land acquisition. Further, the government encourages PPP through Presidential Regulation No.67/2005 on Public-

[110] Id.
[111] Id.
[112] Mauro Pisu, "*Tackling the Infrastructure Challenge in Indonesia*," (OECD Economic Department, Working Papers No.809, 2010), 5.
[113] Sinthya Roesly, "*The Role of Indonesia Infrastructure Guarantee Fund for PPP Projects Development in Indonesia*." Presentation given on PPP Days 2012 in Geneva from 21-24 February 2012, slide 4.
[114] The laws which has been passed during that period are: Law No.36/1999 regarding Telecommunication, Law No.22/2001 regarding Oil and Gas, Law No.7/2004 regarding Water, Law No.38/2004 regarding Road and Bridge, Law No.23/2007 regarding Railway, Law No.17/2008 regarding Sea Transport and Port, Law No.1/2009 regarding Air Transport and Airport, Law No.22/2009 regarding Land Transport, and Law No.30/2009 regarding Electricity.

Private Partnership in Infrastructure Development, setting principles for clearer, more transparent, and accountable, and competitive environment for the partnership.[115] Private participation is now expected to take part in wide range of infrastructure development in Indonesia.[116]

Other significant reform is the establishment of a state owned enterprise in infrastructure guarantee named as PT. Penjaminan Infrastruktur Indonesia (Persero) (Indonesia Infrastructure Guarantee Fund/IIGF) in 2009. The purposes of the IIGF are as follows: (i) to encourage the participation of private sector in infrastructure projects in Indonesia;[117] (ii) to improve credit worthiness of the infrastructure projects;[118] and (iii) to minimize exposure from contingent liabilities and sudden shock to the state budgets (ring fencing function).[119]

On the establishment of IIGF, the government of Indonesia subscribed IDR 1 billion. As the government of Indonesia deemed necessary to strengthen the capital structure of IIGF, they has twice increased IIGF capital, which now has IDR 3.5 billion as its capital structure.[120] By doing this, the government of Indonesia has giving positive signals to the investors of its commitment on the infrastructure projects.

Under current regulations, the infrastructure guarantee in Indonesia can be provided by either joint guarantee by the Ministry of Finance and IIGF or solely by IIGF. IIGF with the investor will enter into a Guarantee Agreement to provide guarantee against the risks allocated to the government contracting agency[121] in the PPP agreement. Under the guarantee agreement, IIGF will provide payment to the investor in case of the contracting agency fails to perform its obligation under the PPP agreement. At the same time, IIGF and the contracting agency also

[115] High Level Expert Group Meeting The United Nations Economic and Social Commission for Asia and The Pacific (UNESCAP), "*Indonesia: Public Private Partnership for Infrastructure Development*," (Country Paper, 2007), 18.
[116] Based on Article 4 of PP 67/2005, the infrastructure sectors that are open for PPP are transportation, roads, water supply, waste water, irrigation, telecommunication, electricity, and oil and gas.
[117] See point a of the consideration of Government Regulation No.35/2009 regarding The Republic of Indonesia State Equity Participation for the Establishment of a State Owned Enterprise in the Field of Infrastructure Guarantee (Government Regulation 35/2009).
[118] See point a of the consideration of Presidential Regulation No.78/2010 regarding Infrastructure Guarantee in Public Private Partnership Projects Provided Through the Infrastructure Guarantee Fund Entity (Presidential Regulation 78/2010).
[119] See Article 2 point a of the Presidential Regulation 78/2010.
[120] Based on Government Regulation No.35/2009 which has been severally amended as lastly by Government Regulation no.55/2011 regarding The Republic of Indonesia State Equity Participation for the Establishment of a State Owned Enterprise in the Field of Infrastructure Guarantee.
[121] Note: government contracting agency may be ministries, regional governments, or state owned enterprises.

enter into recourse agreement, whereby IIGF will be reimbursed by the contracting agency for the payment made by IIGF against the investor's claim.[122]

In principle, there are 4 categories of risks that may be covered by IIGF as follows:

(i) risk that occur due to any action or inaction of Contracting Agency or the Government that is not a Contracting Agency, in issues which according to the laws and regulations, such Contracting Agency or the Government that is not a Contracting Agency has the power or the authority to perform action/inaction;

(ii) risks that occur due to the issuance of a policy of the Contracting Agency or the Government that is not a Contracting Agency;

(iii) risks that occur due to unilateral decision of the Contracting Agency or the Government that is not a Contracting Agency;

(iv) risks that occur due to inability of the Contracting Agency in performing its obligation under the PPP contract (breach of contract).[123]

The Regulation of Ministry of Finance No.260/PMK.011/2010 also states that IIGF shall issues Risk Allocation Guideline which will be used as reference by the contracting agency in preparing the PPP contract or in preparing the Guarantee Proposal for the PPP project, or used as a reference by the investor for participating in PPP project.[124] However, even though Risk Allocation Guideline contains details of risk category and risk allocation for several infrastructure sectors, such details should not be treated as an exhaustive list, the implementation of risk allocation on the project should be evaluated based on the individual nature of the project as the backgrounds and situations of each project will vary and depends on the actual project and/or sector specific requirements. In addition to that, the Risk Allocation Guideline is subject to improvement and periodic review to accommodate any changes in business conditions.[125]

The allocation principle adopted in the Risk Allocation Guideline calls for the risk to be allocated to the party who is able to manage it, or allocated to the party bearing the smallest cost in

[122] IIGF, "*PPP in Indonesia: Infrastructure Guarantee Provision Guideline*," (March 2011), 3 -4.
[123] Article 10 paragraph (1) of the Regulation of Ministry of Finance No.260/PMK.011/2010 regarding the Guideline on the Provision of Infrastructure Guarantee in PPP Projects (PMK 260/2010).
[124] Article 11 paragraph (2) of PMK 260/2010.
[125] IIGF, "*PPP in Indonesia: Risk Allocation Guideline*," (March 2011), *ii.*

managing that risk. The Risk Allocation Guideline further describes on the implementation of the principle as follows:[126]

(i) Risks which has been inadequately handled in the past, or which the agency has insufficient knowledge on the risk, are preferred to be allocated, subject to cost effectiveness, to the other party who has better influence or control of the risk;

(ii) Risks which cannot be managed or influenced by both party should be shared, for example: certain event of force majeure;

(iii) Retain the risks that the government has the ability and position to control, such as legislation risks;

(iv) For the risks that still posing an exposure to the public sector even such risks are already transferred, for instance is default risk on the sponsor, the government may need to step in as assume such risks. This approach is preferable for the key social infrastructure and related services.

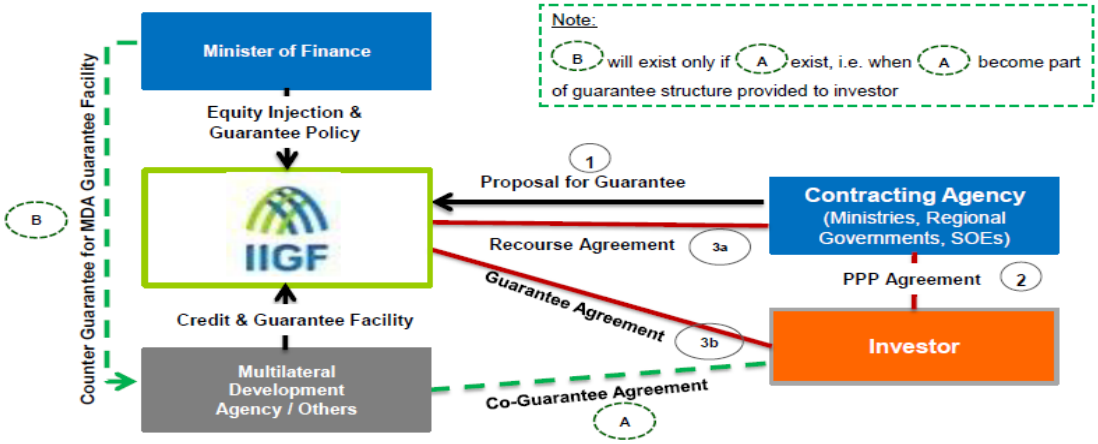
The government of Indonesia clearly states its position in the PMK 260/2010 that the provision of infrastructure guarantee through IIGF will be optimized in order to mitigate the risks of fiscal risk to the state budget. There are two steps available to achieve this plan, first IIGF is to have cooperation with multilateral financial institution or any party who has similar objectives, and second the government has commit to gradually and sufficiently strengthen the capital structure of IIGF.[127] Currently, IIGF already has a stand by facility approximately USD 480 million from the World Bank.[128] Under the current business model, the World Bank will provide partial guarantee to the investor (Table 5).[129]

In the event that IIGF does not has sufficient capital to provide infrastructure guarantee, or if IIGF does not have any cooperation with other multilateral financial institution, or there is a cooperation but with limitation on facility or coverage, or the capitalization of IIGF has yet to be performed, the government of Indonesia also provides joint infrastructure guarantee between

[126] IIGF, *supra note 125 at 17*.
[127] Article 4 of PMK 260/2010.
[128] Working Party of Senior Budget Officials, Public Government Committee OECD, "*PPP Governance in Indonesia: Policy, Process, and Structure*," (Paris, 2012), 14.
[129] IIGF, *supra note 122 at 7*.

IIGF and direct government guarantee which is given through the Ministry of Finance as an alternative.[130]

Table 5 IIGF Basic Business Model




Source: *IIGF and CJPP Case Study* slide as presented by Syntia Roesly during APAP PPP and Infrastructure Summit 2012 in Singapore on March 2012.

In the first year of its operation, IIGF has successfully provided a guarantee to Central Java Power Plant (CJPP) Project. CJPP is a coal fired power plant with a total capacity of 2x1000 MW power project valuing more than USD 3 billion of investment aimed to improve access to electricity for 7.5 million people.[131] This project was structured under the Build-Operate-Transfer/BOT scheme concluded under the Power Purchase Agreement (PPA). The PPA was signed by PT. Perusahaan Listrik Negara (Persero) (Indonesian State Owned Electric Company/PLN) as the contracting agency and PT. Bhimasena Power Indonesia (Bhimasena Power) as the project company. Bhimasena Power is an Indonesian limited liability company, specifically incorporated by the consortium of the successful bidders of international competitive tender process for the CJPP project, namely Itochu Corporation, Electronic Power Development Co. Ltd (J-Power), and PT. Adaro Energy Tbk.

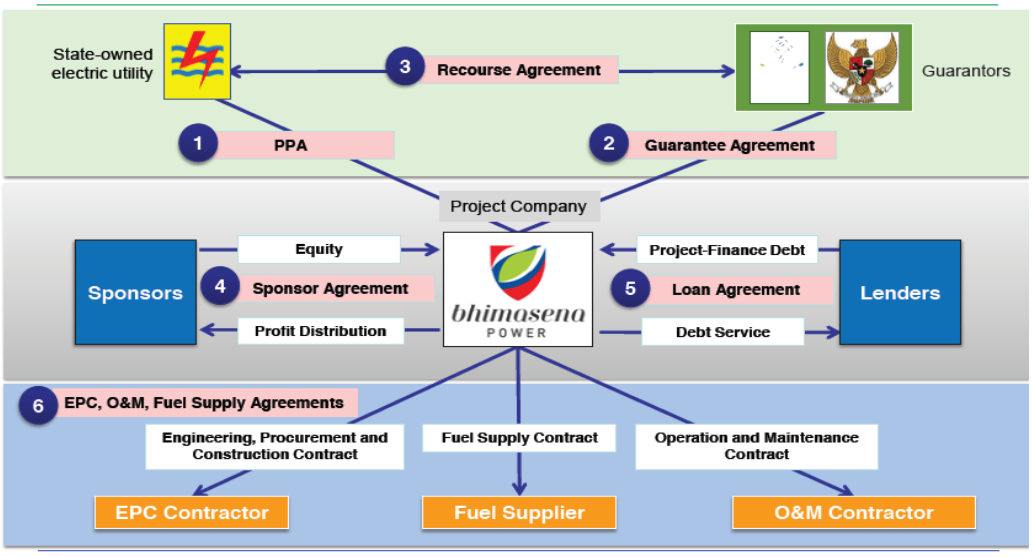
Under the BOT scheme, the project company is required to supply the electricity to PLN for 25 years[132] and subsequently at the end of the PPA, Bhimasena Power will transfer the plant to

[130] Article 5 of PMK 260/2010.
[131] International Finance Corporation (IFC), "*Success Stories: Public-Private Partnership*," (World Bank, 2012), 1.
[132] Itochu Coroporation, "*Execution of Long-Term Power Purchase Agreement for a New 2 GW Coal-Fired IPP Project in Indonesia —Indonesia's First High Efficiency (USC) Coal-Fired IPP Project and Amongst the Largest in Asia, News Release 2011*," available at http://www.itochu.co.jp/en/news/2011/111007.html.

PLN.[133] In addition to the PPA, Bhimasena Power also entered into a Guarantee Agreement with IIGF and the government of Indonesia which is represented by the Ministry of Finance. In this Guarantee Agreement, IIGF will provide the guarantee to cover PLN financial obligations to Bhimasena Power under the PPA, among others PLN obligation related to monthly electricity purchase from Bhimasena Power.[134]

The structure of a guarantee is a co-guarantee structure between IIGF and the government of Indonesia with amount sharing concept, whereby IIGF will provide the guarantee under the first loss basis on IIGF amount and the government of Indonesia will cover the remaining amount. However, the government of Indonesia will not provide back-up on IIGF amount unless upon IIGF insolvency which is resulted by the government of Indonesia action/inaction.[135] The Guarantee Agreement was supported by two recourse agreements, whereby the first was concluded by PLN and IIGF, and the second agreement was PLN and government of Indonesia. Under these recourse agreements, IIGF and the government of Indonesia will be able to reimburse to PLN for the claims made under the guarantee.[136] The following table (Table 6) describes the complete structure of CJPP Project:

Table 6 Structure of CJPP Project




Source: *IIGF and CJPP Case Study* slide as presented by Syntia Roesly during APAP PPP and Infrastructure Summit 2012 in Singapore on March 2012.

[133] IFC, *supra note at 2*.
[134] Bambang Brodjonegoro, "*Pengamanan Fiskal Melalui Pola Pembagian Risiko Antara Pemerintah Dengan Swasta*," 2011, 4. The paper can be accessed through http://pusbinsdi.net/main.php?page=data&type=1
[135] Sintya Roesly, "*IIGF and CJPP Case Study*," as presented in APAP PPP and Infrastructure Summit 2012 in Singapore on March 2012.
[136] IIGF, *supra note at 2*.

## Chapter 4
## Overview of the Features of IIGF

In analyzing the features of IIGF, I will compare three main features of the government guarantee available in Brazil and Mexico. First, I am comparing the purpose of the guarantees in Brazil, Mexico, and Indonesia, to indicate the commitment of the government in encouraging PPP investors. Second is the comparison on the form of guarantee, which will describe the implication of the form of the guarantee to the state budget, and last part of this chapter is describing the application of the risk allocation principles which eventually determining how the guarantee is given in a project.

### A. The Purpose of IIGF

As we note in the previous chapter that the main purpose of the government guarantees is to make the PPP transactions bankable and attractive to private sectors. It can be achieve by way of enhancing the credit ratings of a country and safeguarding the PPP projects from default of the public sectors in performing its obligation under PPP contracts.

This purpose can also be seen in the creation of the Brazilian federal government guarantee FGP and CPP which is provided by the State of Sao Paolo. FGP is formed only to cover the government financial obligation to private investors, by securing the government payment obligation in infrastructure contract and also mitigating the risk of government insolvency. In this way, the investors will have the assurance on the continuity of government financial obligation related to the projects. The establishment of CPP by the State of Sao Paolo is based also on the background of providing performance guarantees to private sector. The use of these guarantees can be seen in Pontal Project and 4$^{th}$ Line of the Metro of Sao Paolo, which indicate the investors' confidence in taking the projects.

The same can be said about the PCG provided by Banobras in Mexico. The use of PCG as an external enhancement on the tax securitization scheme in the structured public finance transactions in subnational public sector in Mexico, are improving the state's credit ratings, and enable the states to have capital market financing.

Indonesia, who has struggled to develop its infrastructure due to the government financial constraints created the IIGF for the similar purpose. IIGF is designed to encourage the participation of private sector in infrastructure projects and to improve credit worthiness of the infrastructure projects. The commencement of the 2x1000 MW CJPP, as one of the largest greenfield project in Indonesia, significantly shows that the investors' confidence with the projects and the commitment of the government of Indonesia.

B. The Form of IIGF

One of the disadvantages of government guarantees is that it would shift the obligations of previous administrations to the next administrations as they create contingent liabilities for the government. It happened to Indonesia during the crisis period of 1997-1998, where the government's contractual liabilities and losses reached almost USD11 billion.[137] However, this case will happen only when the government provides direct guarantee.

With Brazil's FGP and the State of Sao Paolo's CPP, the government will not be exposed directly to the contingent liabilities risk. FGP is a legal entity under the public law having its own rights and obligation, and its assets are separate from the shareholders' assets. The same also applies to the CPP, which is a company having its own assets. The separation assets owned by FGP and CPP from the government's assets means that in the event of execution of the guarantees due to any default of the public sector in the PPP projects, the government does not have to bear the fiscal risk on its budget therefore limiting the risk for the a financial crisis.

IIGF, as a state owned company, also designed to have its own assets separated from the government budget. The design of IIGF serves the "ring fencing" function, which is to minimize exposure from contingent liabilities and sudden shock to the state budgets.[138] In this regards, the government of Indonesia will have more financial freedom in allocating its budgets, and more importantly safeguarding the government budgets from the exposure of fiscal risk arising from the default of the government contracting agency in performing its infrastructure contracts obligations and the risk of repeating the crisis in 1997-1998.

[137] Baietti, *supra note at 9*.
[138] See Article 2 point a of the Presidential Regulation 78/2010.

It should also be noted that the government of Indonesia will still provide direct guarantee through the Ministry of Finance in support of IIGF, if IIGF does not have sufficient capital strength to provide sole guarantee to PPP projects. Although, this direct guarantee will only be given in special cases[139], to some extent, the government of Indonesia will still exposed to fiscal risk of the infrastructure projects. However, this should not become an issue as the government of Indonesia has committed to gradually increase the financial strength of IIGF and IIGF will also cooperate with multilateral financial institution in order to be able to provide infrastructure guarantee without direct government support.

C. Allocation of Risks

The allocation of the demand risk in Line 4 Yellow Line of the Metro of Sao Paolo will provide good example on the implementation of risk allocation principles. In this project, the demand risks are shared to both the state government and the private sector. There are two possible reasons for this as identified by Rebello (2012)[140]: first, the demand risk in this project is too big for the private sector to handle by themself, which consequently will leave the private sector with no financial sponsors; and second, there are factors that are not controlled by either the private sector or state's jurisdiction, for instance actions and policies on other transportation modes. The demand risk sharing can be justified since both parties are unable to influence the risks factor by themselves, sharing the risk between them will provide the project with the advantage of enabling the private sector to obtain financing.

As the consequence of the demand risk sharing mechanism, the calculation of the guaranteed revenue is modified to compensate the actual maximum and minimum demand compare to the projected demand. In the event, the actual demand is higher than the projected demand by certain percentage, which percentage has been agreed in the contract, the private partner will give the revenue in excess to the government. To the contrary, if the actual demand is lower than the projected demand by certain percentage, the private partner receives additional revenue guaranteed by the government.[141]

[139] Please see page 34.
[140] Rebelo, *please see note 95*.
[141] Frances F. Blank et al., *supra note at 6*.

In case of CJPP Project, as the off-taker PLN has the financial obligation to the Bhimasena Power, which PLN will not be able to fully perform that obligation without joint support of the IIGF and the government through the Ministry of Finance. The payment default risk guarantee has been properly allocated to PLN as PLN is the party that has the ability to influence such risk, due to the fact that in Indonesia, the government is responsible to set the retails tariffs for electricity and PLN also receives state subsidy.

Aside of the CJPP Project, IIGF has already introduced Risk Allocation guideline that follows principles of risk allocations: (i) risks which has been inadequately handled in the past, or which the agency has insufficient knowledge on the risk, are preferred to be allocated, subject to cost effectiveness, to the other party who has better influence or control of the risk; (ii) risks which cannot be managed or influenced by both party should be shared, for example: certain event of force majeure; (iii) retain the risks that the government has the ability and position to control, such as legislation risks; (iv) for the risks that still posing an exposure to the public sector even such risks are already transferred, for instance is default risk on the sponsor, the government may need to step in as assume such risks. This approach is preferable for the key social infrastructure and related services. However, the Risk Allocation Guideline should not be considered as an exact approach to risk allocation for each project due to the difference of the background and nature of the project.

The above factors show us that the government guarantee is essential in the infrastructure development, as it signifies the government commitment, either by way of assuring on the continuity of government performance in the project, improving the credit worthiness, stability of the state budget, or clear implementation of the risk allocation principles. These factors are giving the private sectors (i.e. investors, private contractors, financial sponsors) more confidence to participate in a PPP project. However, it is also worth noted that the government guarantee depends on other factors such as political and economic stability. Any change on those two factors may influence the government's view and design of the government guarantees, which would in the end determining the success of a PPP project.

# Chapter 5
# Conclusion

Indonesia's experience in infrastructure development has been high and low during the past three decades. Infrastructure investments had reached to more than 6% of the GDP before 1998. During the 1998 – 2001, the government was busy reforming the fiscal and financial sector, when the infrastructure investments were then collapsed to 2% in 2000. The number had slightly increased to around 3% in 2001-2006.[142]

The government realizes that infrastructure development should be the backbone of national economic growth, were then undertook the reform on the legal framework on the infrastructure project, encouraging the participation and cooperation with private sectors in infrastructure development through the PPP scheme. Past experience on the crisis teaches that the government should be able to mitigate the fiscal risks of the infrastructure projects, and at the same time should also be able to convince investors to participate in the PPP projects by providing guarantee against their risks. IIGF are created to serve this purpose. However, do IIGF have sufficient features to perform this task?

As with Brazil and Mexico, they also created similar institutions with the same purpose as IIGF. Brazil and Mexico ability to execute projects shows the promise that investors are convinced to take part in the project and therefore, we can say that to some extent, the government guarantees provided by the government of Brazil and Mexico are able to sufficiently support their infrastructure project. In the case of IIGF, taking part in one of the largest power project in Asia was a good start. Although the guarantee in CJPP was provided jointly with the government of Indonesia, it was understandable since IIGF was a newly established guarantee scheme with limited capital structure.

With regard to the form of the guarantee, either in the form of public entity, private entity, or trust fund, such as Brazil's FGP, Sao Paolo's CPP, or Banobras' FONADIN respectively, they are created to screen the government budget from the contingent liability arising from their infrastructure projects. The same can be said with IIGF, which established also to "ring fencing" the state budget from the contingent liability risk, thus avoiding sudden shock in state budget in case of the government contracting agency's failure to honor the infrastructure contract.

[142] Asian Development Bank, "*Proposed Loan for Subprogram 3 Republic of Indonesia: Infrastructure Reform Sector Development Program*," 2010, 1.

Risk allocation has its own nature and highly depended on the projects background, the structuring of the transactions, and the negotiation results of the PPP projects. The approach of the State of Sao Paolo in 4th Line of the Metro Project was in line with the principles of risks allocation. For IIGF in CJPP Project, guaranteeing the payment risk default of PLN as PLN is the party that has the ability to influence such risk was the right approach. In addition, IIGF has also prepared the Risk Allocation Guideline that will be used as reference points in negotiating the future PPP projects.

In view of the above, IIGF, as a form of government guarantee, has started very well in its early operation years. IIGF certainly has the features to not only to attract investors to participate in the future PPP projects in Indonesia, but also able to provide protection to the government of Indonesia fiscal stability. Despite of these features, it is still too early to say that IIGF will achieve bigger success in the future of Indonesia PPP projects, as there are factors contributing to it such as political and economic stability. But for now, we can be sure that IIGF is an achievement.

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