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Insights

INDONESIA IN FOCUS NEWSLETTER- JULY EDITION

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Renewable energy and carbon reduction in Indonesia

Overview

Indonesia's efforts to achieve their Nationally Determined Contributions (**NDC**) established in accordance with the Paris Agreement are still considered by Climate Tracker to be "Highly Insufficient". Whilst this keeps them out of the lowest categorization of global nations (referred to as "Critically Insufficient"), this still places them within the bottom quartile of nations which have recently re-committed their NDC projections and five year plans under the Paris Agreement.

Indonesia does not yet have well established long term decarbonisation targets but they do have shorter term targets, having pledged to reduce greenhouse gas emissions by between 29% and 41% by 2030 (depending on a range of fluctuating factors including the extent of foreign assistance which is provided to Indonesia).

Traditionally, Indonesia has struggled even with these kinds of short term targets due to its continuing rise in energy demand and multiple structural and systemic issues such as the Government's insistence on supporting coal price regulation, deforestation and the legal and practical difficulties of deploying clean and renewable energy at scale across the archipelago.

More recently, within the second quarter of 2021, perhaps motivated in part by Indonesia's attendance at the upcoming supranational climate conference in the UK (COP26), Indonesia has declared that it is taking a range of additional measures designed to reduce carbon emissions and to expedite the development of clean and renewable energy production.

Carbon emission reduction

On 14 June 2021, Arifin Tasrif, the country's energy minister announced that all cars sold from 2050 will be electric vehicles. He also pledged to retire all coal-powered plants in Indonesia from operation by 2056.

On 17 June 2021, Perusahaan Listrik Negara (**PLN**), Indonesia's state-owned electricity company, announced plans to become carbon neutral by 2050. PLN has exclusive power over Indonesia's electricity supply, purchasing electricity from licensed independent power producers, who, under Indonesia's Electricity Law can sell their power solely to PLN.

The government is also working on an amendment to Indonesia's tax law. The implementation of a carbon tax means imposing an additional cost for goods and services which generate carbon emissions. The proposal is to tax at a rate of US$5.20 (Rp 75,000) per ton of CO_2 equivalent emissions. The draft amendment has been included in the priority national legislation programme with the aim of passing it into law expeditiously.

Development of alternative renewable energy sources

While Indonesia controls abundant sources of renewable energy, up to now, the exploitation of those resources has been limited. On current trends, Indonesia will only be able to produce one-fourth of the renewable energy capacity necessary to meet its 2025 target of having 23% of the energy generated from renewable sources.

Currently, hydropower contributes the most to Indonesia's renewable energy generation capacity and is supported by favourable government policies and regulations.

Geothermal energy generation has great (untapped) potential in Indonesia due to Indonesia's advantageous geographical location on the Pacific 'ring of fire'. However, upfront development costs for this type of energy generation are high.

Solar and wind power projects face technological and regulatory impediments to their scaled deployment in Indonesia. Current turbine technology is not compatible with local wind speeds and strict local sourcing requirements apply – meaning that it is often difficult, if not impossible, to obtain necessary services, materials and equipment at competitive rates. As such, these sources of renewable energy are expected to play a comparatively small role in the short term.

The Indonesian government provides financial incentives to support the exploitation of renewable energy resources. The Vice Minister of Finance, Suahasil Nazara, detailed the government's incentives during the 3rd Indonesia Energy Transition Dialogue 2020 on 7 December 2020. Key incentives include tax holidays and tax allowance for the renewable energy sector, VAT exemptions on selected equipment and materials, and property tax reductions for geothermal exploration. The government has also pledged to allocate funds to local governments to promote renewable energy development.

Recent initiatives by Indonesia Investment Authority (INA)

Following our coverage in the March edition of Indonesia in Focus newsletter, the INA with its partners has formed a US$3.75 billion (Rp 54.3 trillion) toll road fund (**Fund**) in May 2021. The Fund, formed by INA, Caisse de dépôt et placement du Québec (**CDPQ**), a Canadian institutional investor managing pension and insurance funds, APG Asset Management (**APG**), an international pension fund manager; and Abu Dhabi Investment Authority (**ADIA**), is established to attract foreign funds as co-investors and facilitate infrastructure projects.

The partnership is indicative of foreign investors' confidence regarding the long-term prospects for Indonesia's economy. "F*or CDPQ, Indonesia stands out as an attractive place to invest in, especially in the infrastructure sector... [and] to jointly build a portfolio of critical road assets in one of the fastest growing economies in the world, and [it] would allow us to combine INA's in-depth knowledge of the market and local networks with CDPQ, APG and ADIA's international infrastructure expertise.*", Emmanuel Jaclot, Executive Vice-President and Head of Infrastructure at CDPQ, said in a news release.

In June, INA announced its plan to purchase several toll roads owned by state-owned infrastructure developers. Potential targets include Waskita Karya, Hutama Karya, Wijaya Karya and Adhi Karya, as well as state-owned toll road operator Jasa Marga. The initiative would allow the developers to recoup their investments and repay their debts after receiving the payment from the INA and its partners. This would in turn facilitate future investment in new toll roads and related infrastructure.

The INA is also currently negotiating an investment deal for digital infrastructure. While details of the planned investment have not been revealed, INA Chief Executive Officer Ridha Wirakusumah has expressed interest in investment in unicorn start-ups (start-ups valued at more than US$1 billion (Rp 14.4 trillion)). Indonesia is currently the second-largest data centre market in Southeast Asia and demand for data centre services is likely to increase in light of the growth of the digital economy in Indonesia.

The recent initiatives by the INA suggest that Indonesian infrastructure development will continue to gain momentum. INA manages an initial capital of US$5 billion (Rp 72.4 trillion) invested by the Indonesian government when it launched in February 2021. The Indonesian government has set a target for the INA to expand its assets to US$20 billion (Rp 289 trillion) eventually by attracting co-investors.

Data centre growth

The Indonesian data centre sector continues to see high levels of growth.

In April 2021, Research and Markets, a research organisation based in Dublin, Ireland, estimated that the market value of Indonesia's data centre sector will reach US$3,354.41 million (Rp 48.6 trillion) by 2026, an annual growth rate of 11.4% between 2021 and 2026. Much of the development will occur in Jakarta, which is predicted to grow at an annual rate of over 20% between 2021 and 2025, according to Structure Research, an independent research firm based in Toronto.

The high growth rates are supported by the increasing digitalisation of Indonesia's economy - with a burgeoning startup ecosystem being a key driver to this transition. Notable start-ups include the on-demand multi-service platform Gojek (which provides a wide range of services, including ridesharing, taxi service, food delivery and medicine delivery), the digital payment application OVO and the travel-booking company Traveloka.

As more products and services are delivered using digital platforms, Indonesia's enterprise data is quickly migrating to the cloud, driving the demand for data centre services. Global cloud service giants such as Alibaba Cloud and Microsoft Azure are manoeuvering to win Indonesian market share, and are deploying accelerated development plans to implement the necessary data centre infrastructure to service Indonesia's developing market.

The growing strength of Indonesia's data centre sector can be seen in a number of recent transactions. In May 2021, ST Telemedia Global Data Centres, a leading data centre service provider headquartered in Singapore, announced a strategic partnership with Indonesian conglomerate Triputra Group and Temasek for a joint venture to develop a new data centre in Jakarta. The data centre is expected to have a 72MW capacity, and construction is expected to start in the second half of 2021 and be completed by the first quarter of 2023.

Separately, in June 2021, Digital Edge, a Singapore-based data centre company, acquired a majority stake in the Indonesian telecommunications company Indonet for a price of US$165 million (Rp 2.39 trillion). Indonet is a leading digital infrastructure service provider in Indonesia and has recently commissioned the development of a strategic 'edge' data centre at a central location in Jakarta. 'Edge' data centres are smaller facilities, usually connected to larger / central data centres, located in or near population centres to allow for more flexible data management and speedier transmissions times. This acquisition was made possible by the recent relaxation on foreign ownership restrictions applicable to Indonesia's telecommunications industry (Presidential Regulation No.10 of 2021). The new regulation, which went into effect on 4 March 2021, lifted the previous maximum foreign ownership limit of 67% in telecommunications-related business. This change is expected to drive foreign investment in the Indonesian telecommunication service market.

Developments on digital payment

Regulation on payment systems comes into effect

The Bank Indonesia Regulation No. 22/23/PBI/2020 of 2020 on Payment Systems (**Regulation**), issued by Bank of Indonesia on 29 December 2020, came into force on 1 July 2021. The Regulation places restrictions on foreign share ownership and capital investment in the payment services industry (amongst other measures). Further details on the implementation and enforcement of the Regulation should be available in the near future.

Cryptocurrency and central bank digital currencies

Cryptocurrency is to be discouraged as a payment tool within Indonesia, with the Governor of the Bank of Indonesia announcing on June 15, 2021, that the central bank will not permit Indonesian financial institutions to offer any cryptocurrency-related payments or financial services. The news follows the classification of cryptocurrency assets as commodities by the Commodity and Futures Trading Regulatory Agency of the Ministry of Trade back in 2019.

However, Indonesia has not completely turned its back on digital currencies. Instead, Indonesia's central bank is developing its own digital currencies (**CBDCs**). This follows in the footsteps of other Southeast Asian countries including Cambodia which launched its own CBDC the "Bakong" in October 2020, and Thailand which partnered with a German fintech firm to develop its own CBDC in June 2021. These developments have the potential to disrupt the banking industry in these jurisdictions – but are likely to give rise to commercial opportunities.

New bank initiatives on digital banking

Bank Neo Commerce (**BNC**) has recently partnered with Arash Digital, a fintech company specialising in cross-border payment, and Wallyt, a digital bank solutions provider, to expand its digital payment services. New key features proposed include the introduction of instant direct debit and QR payment processes.

Bank Negara Indonesia (**BNI**), an Indonesian state-owned bank, now allows its TapCash e-money (**TapCash**) to be topped up via GoPay. TapCash is electronic money introduced by BNI which can be used to purchase from BNI cooperation merchants, such as Lawson, TransJakarta Bus and Alfamart. Consumers can make top-ups of US$1.41 (Rp 20,000) to US$34.56 (Rp 500,000) via GoPay and can store up to the statutory limit of US$138.22 (Rp 2 million). Against the background of a low rate of bank penetration, BNI's collaboration with GoPay is indicative of the increased effort by institutional banks to compete with non-bank payment providers.

Strengthening ties with South Korea

Two recent meetings between Indonesian and South Korean officials highlight the growing economic importance of this relationship. Currently, South Korea is the third largest source of foreign direct investments in Q1 2021, following Singapore and China.

On Monday, 14 June 2021, Indonesian Transportation Minister Budi Karya Sumadi met with the South Korean Ambassador to Indonesia, Tae Sung Park, to discuss ongoing Indonesian-Korean cooperation in transport infrastructure development with a focus on the development of Light Rail Transit (**LRT**) in Bali.

The meeting follows on from the Memorandum of Understanding signed in January 2020 between Korea Overseas Infrastructure & Urban Development Corporation, the Korea Rail Network Authority (**KRNA**) and Indonesian state-owned construction firm Nindya Karya. A pre-feasibility study for the LRT has been completed, recommending that the construction of the 9.46-km Ngurah Rai Airport - Seminyak route should be split into two phases, a 5.3-km Phase 1-A starting and a 4.16-km Phase 1-B will reach to Seminyak.

The Bali provincial government and KRNA are still reviewing Phase 2 of the proposed LRT to run between Seminyak and Mengwitani, which will be the subject of a further feasibility study. This study will be delayed so as to account for the Urban Mobility Plan to be completed by Indonesia's National Development Agency (Bappenas), by the end of 2021.

The South Korean ambassador also expressed interest in other future projects such as MRT Jakarta's Phase 4 Fatmawati - TMII route, the Hang Nadim Airport in Batam, the development of the coal transportation railway line in Sumbagsel (Lahat - Tarahan), and the railway line in Central Kalimantan (Purukcahu - Bangkuang).

On Friday, 25 June 2021, Korean Foreign Minister Chung Eui-yong met with his Indonesian counterpart, Retno Marsudi in Jakarta. The discussion focused on Korea and Indonesia's joint development of the KF-21 fighter jet. Indonesia has committed to finance 20% of the fighter's US$7.8 billion (Rp 113 trillion) development cost. Indonesia will receive 50 out of a total of 170 jets to be built. The foreign ministers also discussed other areas of cooperation between the two countries in defence (Korea's Daewoo Shipbuilding & Marine Engineering is on track to construct a second submarine for the Indonesian Navy), health (South Korea intends to provide medical supplies including COVID-19 diagnostic kits) and the green economy (including the development of Indonesia's electric vehicle ecosystem).

The meeting was part of Chung Eui-yong's tour of Southeast Asia, visiting Vietnam, Singapore, and Indonesia as part of South Korea's New Southern Policy which aims to reinforce cooperation between South Korea and its key partners in the region.

MEET THE TEAM

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