

Public-Private Partnership in Indonesia: Solutions and corruption loopholes

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Abstract: We need to better understand Public-Private Partnership (PPP), since most people perceive PPP as a riskless solution for government, as it involves private sector funding. In Indonesia, infrastructure development is one of the top priority sectors for Joko Widodo's administration, and PPP has become a viable option due to budgetary constraints. However, PPP is not an impeccable solution, as there are weaknesses and loopholes for corruption to be aware of. In this literature review, we combine our previous study on Indonesia's toll road PPP with other PPP studies to identify the weaknesses and corruption loopholes in PPP practices in Indonesia. There is clear evidence that PPP projects could end up as "white elephants",¹ indicating misallocation of resources and poor planning. PPP could also be used to create "fiscal illusion"² to deceive public by the government. We also discovered that toll road PPP contracts in Indonesia remain vulnerable, potentially creating room for loopholes and corruption.

Keywords: PPP; Corruption; Public Infrastructure; White Elephant; Fiscal Illusion; Toll Road

How to Cite: Adiasma, D., Mulyanto, D., Nurza, F., & Alatas, H. (2023). Public-Private Partnership in Indonesia: Solutions and corruption loopholes. *Integritas: Jurnal Antikorupsi*, 9(2), 183-194. <http://dx.doi.org/10.32697/integritas.v9i2.1006>



Introduction

The concept of PPP has long been implemented since the Roman Empire. The private sector has been involved in development of many public infrastructure projects such as theatres, canals, public roads, and drainage systems. These projects are financed through user fees, municipal funds, or donations from the rich. What is interesting is that donors who finance public infrastructure have the option of having his or her name displayed on the facility. The purpose of this is to gain popularity and hopefully be elected to their desired position on the local council (World-Bank, 2017).

Over the past decades, PPP has become popular again in many countries, including in Indonesia. However, Indonesia has a slightly different definition of PPP as compared to other countries. The World Bank defines PPP as a long-term contract between government and the private sector to deliver public infrastructure, in which the private party is responsible for most of the project risks. Similarly to the World Bank, Organisation for Economic Co-operation and Development (OECD) identifies PPP as a long-term agreement between the government and the private partner where the private partner provides and funds public services through a capital investment, sharing the associated risks. Meanwhile, Indonesia describes PPP as the cooperation between government and business entities to provide public infrastructure based on specifications set by Ministers/Head of Government Bodies/Head of Regions/State Owned Enterprises, using the "business entity's" resources with regard to the allocated risks between the parties.³ "Business entity" includes State Owned Enterprises (SOE), Regional Owned Enterprises (ROE), and private entities in the form of Limited Liability Companies, foreign entities, or cooperatives.

The main difference between Indonesian PPP as compared to others is the private partner, who is defined as a "business entity" and not just a private party. Therefore, many SOEs/ROEs are

¹ something that is unproductive or troublesome, particularly if it is costly to maintain or difficult to dispose of

² the amount of government expenditure is not accurately perceived

³ Presidential Regulation no. 38 of 2015

involved in PPP projects in Indonesia.⁴ However, the involvement of SOEs/ ROEs in PPP projects may raise other issues. The benefits of risk-sharing in PPP may be reduced with the involvement of SOEs/ROEs as they are still connected to the government as a majority shareholder. In other words, any risk bore by the SOEs/ROEs during PPP projects could be returned to the government.

The worst possible risk for the SOEs/ROEs during a PPP project would be financial loss due to cost overruns, low demand, or other factors. Suffering a loss from a PPP project might cause financial turbulence for the SOE/ROE's, which could have implication for shareholders. As a result, shareholders might need to intervene to save the future of the company. In Indonesia, common government intervention schemes for the SOEs rely on additional capital injection (*Penyertaan Modal Negara/ PMN*),⁵ or mandatory convertible bonds.

Methods

There are various studies about PPP, however only a few of them discuss the risks of PPP. We combine our prior analysis on Indonesia's toll road PPP with other PPP studies in this literature review to uncover the vulnerabilities and loopholes for corruption in PPP practices in Indonesia. The purpose of this paper is to give a better understanding of PPP, since most perceive it as a riskless solution for the government due to the involvement of private sector funding.

Result and Discussion

Indonesian PPP Regulations

There are two kinds of PPP regulations in Indonesia, namely public road PPP regulations and PPP for infrastructure regulations. The first PPP regulation was enacted through Law Number 38 of 2004 detailing public roads. Meanwhile, more general regulations about PPP for infrastructure were introduced through Presidential Regulation Number 67 of 2005. Due to this timeline, Indonesian PPP regulations for toll roads differ from those for other PPP projects as shown in Figure 1

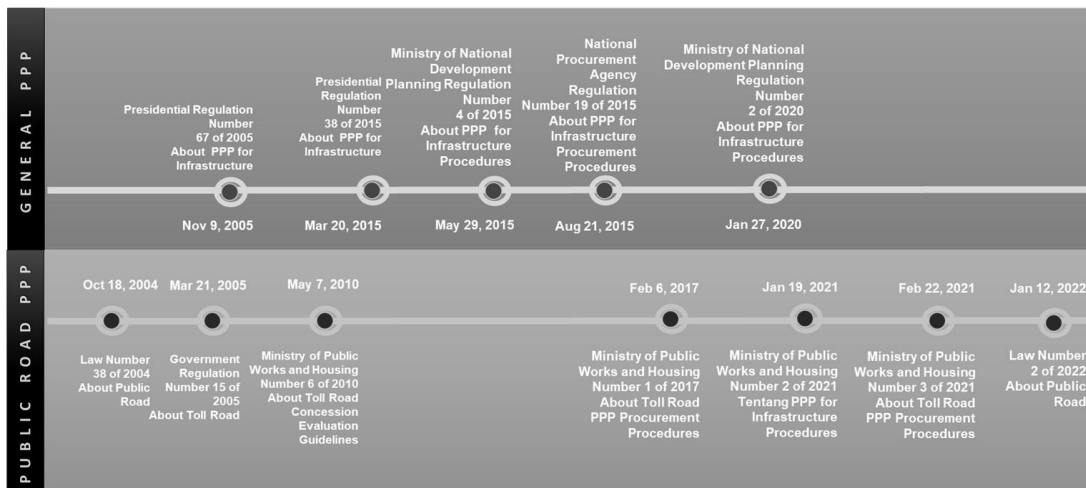


Figure 1. Consequently, there are some differences in PPP toll road procedures as compared to other PPP projects, such as feasibility study documents, PPP tender evaluations, and performance bond requirements.

⁴ in 2022, the Indonesian Toll Road Regulator Body (BPJT) recorded that 61.9% of all non-assignment toll road investors were Indonesian state-owned companies.

⁵ in 2021, the Indonesian government provided an additional capital injection to one of its SOE, PT Waskita Karya (Persero), of 7.9 trillion rupiah (more than USD500,000) due to losses suffered from toll road PPP investment projects.

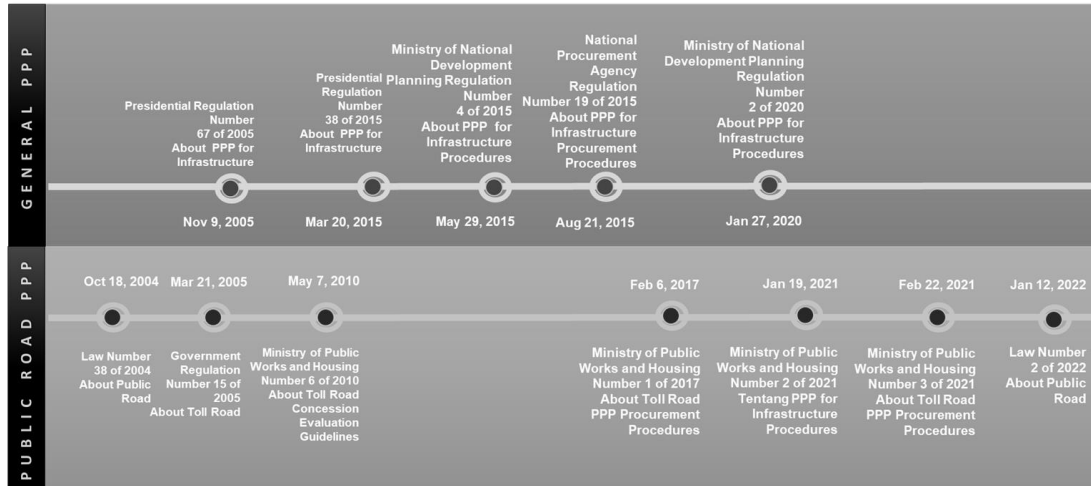


Figure 1. Indonesian PPP regulations

Advantages of PPP

PPP is one innovative method of financing Indonesia’s infrastructural development, and it has become the current administration’s top priority. Despite the fact that it is now a top priority, the current government’s infrastructure budget is still insufficient to carry out the policy. The Indonesian Ministry of Finance stated that the government’s budget can only cover 37% of the total budget needed for infrastructure (Pratama, 2022). Therefore, the PPP scheme is the best solution considering the government’s budgetary constraints. As a result, the PPP scheme has already been adopted by many Indonesian infrastructure projects, such as toll roads, water systems, satellite services, and also Indonesia’s new Kalimantan capital project (Nugraheny & Meiliana, 2021). Figure 2 shows Indonesia’s infrastructure budget growth during 2012 – 2023.

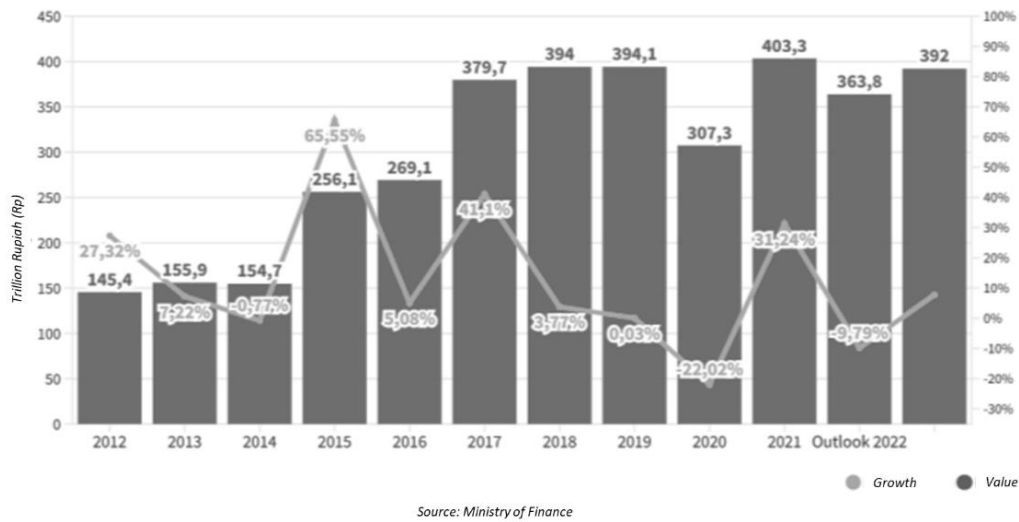


Figure 2. Indonesia’s Infrastructure Budget 2012 - 2023

The risk-sharing element of PPP is another advantage for the Indonesian government in providing public infrastructure. The government can share some risks through PPP, such as design risks, construction risks, operational risks, and demand risks, which are then allocated to experts to manage. However, due to the involvement of SOEs and ROEs, the benefits of risk-sharing in PPP projects for the Indonesian government are lower than for other countries.

Disadvantages of PPP

Despite the benefits, PPP still has many drawbacks that should be noted by the Indonesian government:

Investor Perspectives

Investor involvement is a key component of PPP. However, not all infrastructure initiatives are appealing to investors. Therefore, there is a lot that should be done by the government before offering a project to investors using a PPP scheme. Most investors are looking for projects that are financially feasible through indicators such as the internal rate of return (IRR), net present value (NPV), and payback period. In addition, risks attributed to the private sector in a PPP project should also be considered. In some cases, PPP projects still require governmental budgetary support to improve their financial feasibility as well as government guarantees to reduce risks. That is why deciding whether a project should use PPP is not an easy task.

Cases of Indonesian Toll Road PPP

Toll road PPP projects in Indonesia involve many domestic and foreign investors. Nevertheless, SOEs dominate among toll road investors in Indonesia. On the one hand, this could be a good sign, as the SOEs become more competitive with foreign investors. On the other hand, this can also be a bad sign, as fewer foreign investors are attracted to Indonesian toll road PPP projects. Unfortunately, the latter scenario seems to better describe Indonesian toll road PPP projects based on our previous findings.

Based on Indonesian toll road regulator (BPJT) data, state-owned construction companies dominate toll road investment in Indonesia (Direktorat Monitoring KPK, 2022). Meanwhile, only a few private investors are willing to invest in the greenfield⁶ toll road projects in Indonesia. The risk associated with land acquisition is one of many factors that discourage investors from entering Indonesia toll road projects. Consequently, the Indonesian governmental administration encourages the involvement of state-owned construction companies as investors in greenfield toll road projects. Given that most construction firms have a shorter cash flow cycle than investors, their strategy is to invest and then divest. Thus, construction companies are expected to sell their toll road projects once they have completed the construction stage.

The involvement of construction firms in Indonesian toll road PPP projects as investors raises some issues. First, selling toll roads to investors is not a quick and easy task, even after the construction phase is finished. As a result, the construction companies face cash flow shortages, making it difficult for them to invest in other toll road PPP projects. Second, construction efficiency is problematic, as most of the toll road investors in Indonesia appoint themselves as toll road contractors. Construction companies' primary objective is to generate margins from their core business of providing construction services. Hence, maximizing the return on toll road investments is not a primary concern.

White Elephant

The phrase "white elephant" refers to asset ownership with high maintenance costs, although the asset has little practical use (Robinson & Torvik, 2005). Even though this phenomenon could happen in any infrastructure development project, a white elephant in a PPP project deserves special attention. In theory, the PPP scheme should be able to reduce the likelihood that white elephants will occur (Daniel et al., 2019). Since business perspectives become the primary consideration in PPP, the chosen infrastructure project should confirm its economic and financial feasibility. Thus, the possibility of the PPP project becoming a white elephant should be low.

Numerous studies claim that political decisions are typically what lead to the "white elephant" phenomenon (Daniel et al., 2019; Mendoza et al., 2018; Robinson & Torvik, 2005; Turró & Penyalver, 2019). According to the literature, many PPP projects fall into the category of white elephants because the decision to move forward the project was based on political reasons rather than a proper feasibility study. This happens in many sectors of infrastructural development in Indonesia, where political motives are behind the initiative of many projects. Some examples of this include the decision to set the electrification target to 35,000 megawatt by (former) vice president Jusuf Kalla (Ninditya, 2015), the toll road development target of 2,500 KM within 2019–

⁶ previously undeveloped sites for commercial development or exploitation

2024 set by President Joko Widodo (Ulya & Setiawan, 2019), and the decision to choose the location for Kertajati Airport by the local provincial administration (Putra, 2022).

There are at least three infrastructure projects in Indonesia that can be included in the white elephant category:

The Kertajati Airport Project

Located 178.3 kilometers (110.8 miles) from Indonesia's capital city, Jakarta, Kertajati Airport is one of Indonesia's infrastructure developments that used a PPP scheme. Kertajati Airport is managed by a special purpose vehicle named West Java International Airport, Ltd (PT BIJB). As shown in Figure 3

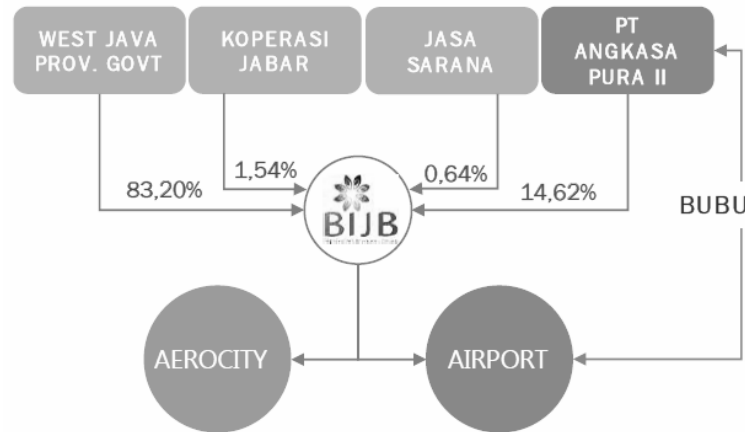


Figure 3, the main shareholder of PT BIJB is the local government in the West Java Province followed by the state-owned airport operator company, Angkasa Pura II. Meanwhile, the funding scheme for Kertajati Airport is 70% equity and 30% loan. The lender for this project is a syndicate of regional banks owned by regional governments.

The feasibility study document indicates that the projected IRR for the Kertajati Airport project was 20.29%, which is very promising (Domina, 2017). The airport's current situation, however, is not what was anticipated, as no regular commercial passenger flights stop there. Since it was formally opened on May 24, 2018, the airport has continued to incur losses. PT BIJB recorded financial losses as much as 280 billion rupiah (more than USD18 million) in 2019 and 191 billion rupiah (more than USD12 million) in 2020.⁷ Meanwhile, many observers believe that the airport's location was chosen without a proper study conducted, as it is still relatively too far away to include Bandung residents as a targeted population. Moreover, the pandemic in 2020-2022 made airport conditions even worse (Putra, 2022). As a result, Kertajati airport is considered a white elephant for the local government as majority shareholder. This happened due to the high operating costs of the airport, outweighing the benefits. However, selling the airport would not be easy, as the ministry of transport tried to sell Kertajati airport to Saudi Arabian and Indian investors in early 2023 (Sari & Sedayu, 2023).

⁷ PT BIJB financial report 2020

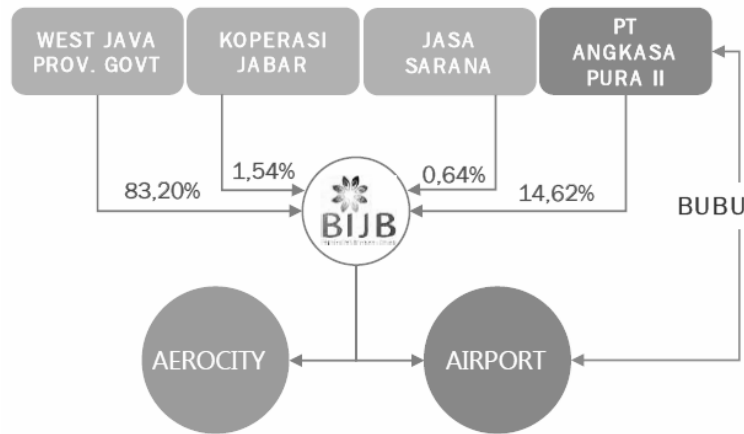


Figure 3. Kertajati Airport Business Entity Shareholders

Toll Road Project

The Manado–Bitung toll road is also considered to be a white elephant of Indonesia’s PPP. The toll road is part of the supporting infrastructure of the Bitung Special Economic Zone (SEZ), which was established through Presidential Regulation Number 3 of 2016. With a projected IRR of 12.23% and 40 years of PPP concession period, the Manado–Bitung toll road appears feasible to all investors. However, the toll road feasibility study was based on the expected growth of the SEZ Power Plant Project.

Currently, the SEZ is not growing as expected, and the average daily traffic on the Manado-Bitung toll road is very low (Yanwardhana, 2022). The SEZ is intended to generate traffic for the toll road, and therefore failure of the SEZ may lead to failure of the toll road project. Moreover, improvements in the capacity of public roads parallel to the Manado–Bitung toll road also contribute to the toll road’s low traffic (Direktorat Monitoring KPK, 2022). Low traffic means low revenue, and the Manado-Bitung toll road is losing money as a result of higher operating costs than toll revenue. The toll road operating company has projected an accumulated financial loss from 2022–2024 of as much as 1.04 trillion rupiah (USD69 million)⁸. The Manado–Bitung toll road is owned by an Indonesian State-Owned company consortium, namely Jasa Marga (the toll road operator company) with 64.99% ownership, followed by Wijaya Karya (WIKA) and PTTP (the construction companies) with 20.04% and 14.97% ownership, respectively. As a result, the Manado-Bitung toll road is regarded as a white elephant by the SOEs and the government, which owns the SOEs.

Similar to the Manado–Bitung story is the Serang–Panimbang toll road. The Serang-Panimbang toll road, which is dedicated to supporting the Tanjung Lesung SEZ, currently faces an issue of low average daily traffic. This is caused by the SEZ’s inability to grow as expected and generate traffic for the Serang-Panimbang toll road. Consequently, the Serang-Panimbang toll road is expected to incur 1.11 trillion rupiah (USD74 million) financial loss between 2022 and 2024.⁹ The Serang-Panimbang toll road is similarly owned by a consortium of state-owned and private companies, including WIKA and PTTP (SOEs) with 83.42% and 15.64% shared ownership, respectively, and Jababeka (a private company) with 0.94%. Therefore, the consortium investors regard the Serang-Panimbang toll road as a white elephant.

Power Plant Project

The Indonesian electricity sector is also implementing a PPP scheme in its development of power plants, also known as independent power producers (IPPs). Different from the transportation sector, the contracting agency for the Indonesia electricity PPP is PT PLN, an Indonesian state-owned electricity company. Investors in the Indonesian electricity sector do not face demand risks

⁸ based on PT WIKA (Persero) Tbk. financial projection(Direktorat Monitoring KPK, 2022)

⁹ based on PT WIKA (Persero) Tbk. financial projection(Direktorat Monitoring KPK, 2022)

because PT PLN acts as an off taker of the electricity produced by IPP via a power purchase agreement (PPA).

Since the electricity supply business plan (RUPTL), involving 35,000 megawatts worth of power plant development, has already been signed, PT PLN faces the risk of dealing with a white elephant. Currently, PT PLN is experiencing an oversupply of electricity. As a result, the excess of electricity becomes an additional cost and financial burden for PT PLN (Pambagio, 2023). PT PLN, for example, was backed into a contract forcing them to receive additional electricity from a 2x1,000-megawatt coal-fired power plant at the end of 2022, despite the fact that the company is already oversupplied (Asmarini, 2022). The coal-fired power plant, known as PLTU Batang, is owned by Adaro Energy Indonesia (a private coal mining company), and cost 58.8 trillion rupiah (USD4.2 billion) to build (Setiawan, 2022).

Fiscal Illusion

Although known to many governments as a solution to fiscal restraints, PPP can cause another phenomenon called a fiscal illusion. A fiscal illusion can be described as a bias in government revenue or expenditure (Cepparulo et al., 2019). An example of a fiscal illusion from the expenditure side is when the government appears to have an unlimited budget to build public service infrastructure through a PPP scheme, despite the fact that these costs are paid directly by the community or by the next administration's budget.

Most governments prefer PPPs because they can be an alternative to off-balance sheet financing¹⁰ (Cepparulo et al., 2019; van den Hurk, 2018). A fiscal illusion arises as a result of a lack of transparency in the government's budget, caused by off-balance-sheet financing. Moreover, another study discovered that most people prefer governments with higher spending policies more generally (Turnbull, 1998). This circumstance demonstrates that only a few individuals are aware of the existence of fiscal illusions in governmental fiscal policies.

Fiscal illusions might have a negative impact on the economy or the public. A fiscal illusion's role in PPP can be explained as follows in each of the PPP investment return schemes:¹¹

Tariff Scheme

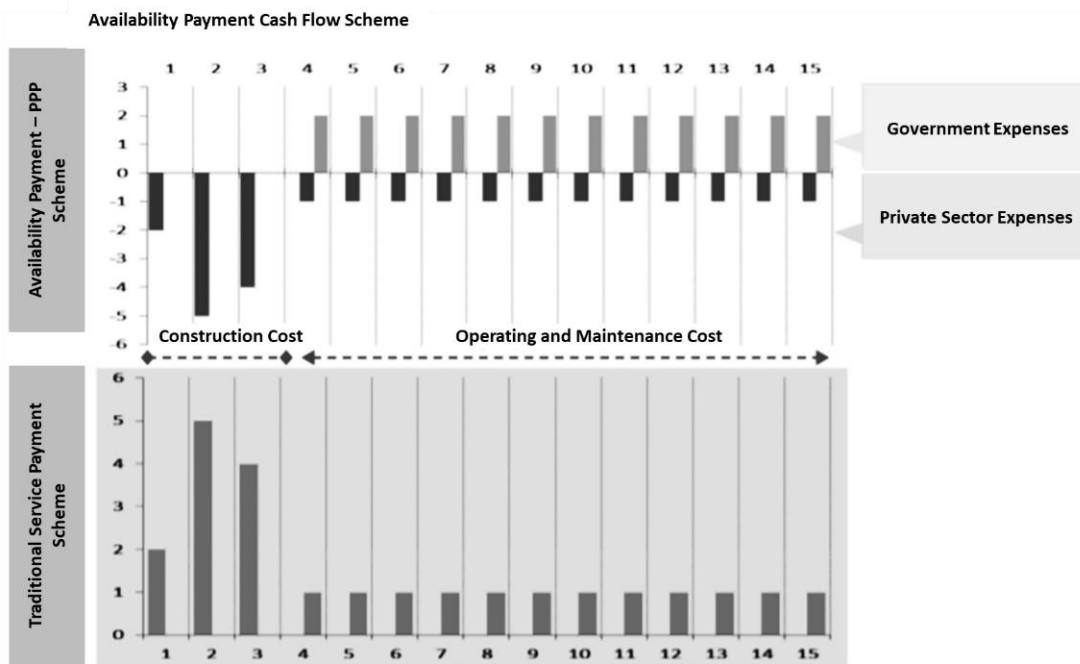
In PPP projects, the burden of financing public infrastructure is shifted from the government to the private sector. However, in a PPP tariff scheme, this burden is then shifted back to society as a user of public facilities. In this system, the government might appear to have successfully provided infrastructure for society, when in fact the majority of the financial burden for such infrastructure development is returned to the community. Moreover, the government also avoids its fiscal obligations in the development of public infrastructure. The more the PPP tariff regime is utilized, the more the community is faced with additional burdens. Ultimately, this may possibly lead to higher inflation.

Availability-Payment Scheme (PPP-AP)

The government collaborates with the business sector to provide public infrastructure through an availability-payment scheme. The government pays based on the performance of the private sector in providing public infrastructure or services. Figure 4 shows the differences of cash flow between PPP-AP schemes and conventional project schemes. In contrast to traditional payment schemes, the government is not required to provide funds during a construction period. Construction costs are provided by the investors, who are then reimbursed to the government gradually during the operating and maintenance period.

¹⁰ a method of documenting business or government assets or liabilities in such a way that they do not appear on the balance sheet.

¹¹ return on PPP investment, according to Indonesian Presidential Regulation Number 38 of 2015, Article 11 Paragraph 2, is payments by users in the form of tariffs, availability payments, and other forms, as long as they do not conflict with laws and regulations.



Source: Ministry of Public Works and Housing

Figure 4. Cashflow comparison between the PPP - Availability Payment Scheme vs. traditional scheme

Even though the government has an obligation to pay PPP investors according to the services provided, these obligations are generally not recorded as debt or called “off-balance sheet financing”. Moreover, in most cases, the PPP-AP contract scheme lasts longer than the term of the public officer who signed the PPP contract. This condition is analogous to shopping using a credit card, where expenses that have been made will be paid off by others in the future (Hodge & Greve, 2010). In the context of government, the current administration might escape the financial burden of providing infrastructural facilities, however the next administration will pay the financial obligations. Yet, if the current administration uses the PPP-AP model more aggressively, the next government will bear a greater financial burden.

Risk and Corruption Loopholes in PPP

In contrast to conventional procurement, it appears difficult to identify the factors that contribute to PPP corruption at a glance. This is due to the fact that the majority of the funds used for infrastructure development in PPP schemes are funded by the private sector. Furthermore, due to the smaller government budget involved in the PPP system, many auditors regard PPP as less risky than regular procurement.¹² This is due to a lack of understanding of Indonesia's corruption law, which perceives corruption as always involving state loss. However, despite the fact that the government's budget is smaller than the private sector's, most PPP projects still run the risk of state losses. In the case of a PPP project becoming a "white elephant" in Indonesia, the state's loss risk is not only based on the government's direct spending for the project, but from the loss of state-owned enterprises, which are often involved in PPP as investors.

Nevertheless, the footprint of corruption in PPP schemes can be determined by the project's efficiency level. The more inefficient a PPP project, the greater the risk that corruption will occur (Cuadrado-Ballesteros & Peña-Miguel, 2022; Schomaker, 2020). In the PPP-Tariff scheme, inefficiency can increase the public's burden, while in the PPP-AP scheme, inefficiency may increase the next government's financial obligations. Inefficiency may lower the "value for money"

¹² based on our previous toll road study (Direktorat Monitoring KPK, 2022).

factor of PPP schemes, which is the most important element to consider when deciding on a PPP approach.¹³

According to other studies, the contract is the most vulnerable component of a PPP scheme and might become a possible loophole for corruption (Iossa & Martimort, 2016; Klitgaard, 2012; Rybnicek et al., 2020). Figure 5 shows the risk factors for PPP mentioned in many studies. Nevertheless, corruption loopholes arise from poorly prepared PPP contracts, creating uncertainty for investors and making it more susceptible to change (Iossa & Martimort, 2016; Schomaker, 2020). Moreover, studies show that approximately 50% of all PPP contracts and 71% of PPPs in the transport sector have been subject to a contract renegotiation (Domingues & Sarmiento, 2016; Klitgaard, 2012). The study also mentions that contract renegotiations were identified as opening up discretionary space, contributing to corruption.¹⁴(Campos et al., 2021; Fatokun et al., 2015; Klitgaard, 2012)

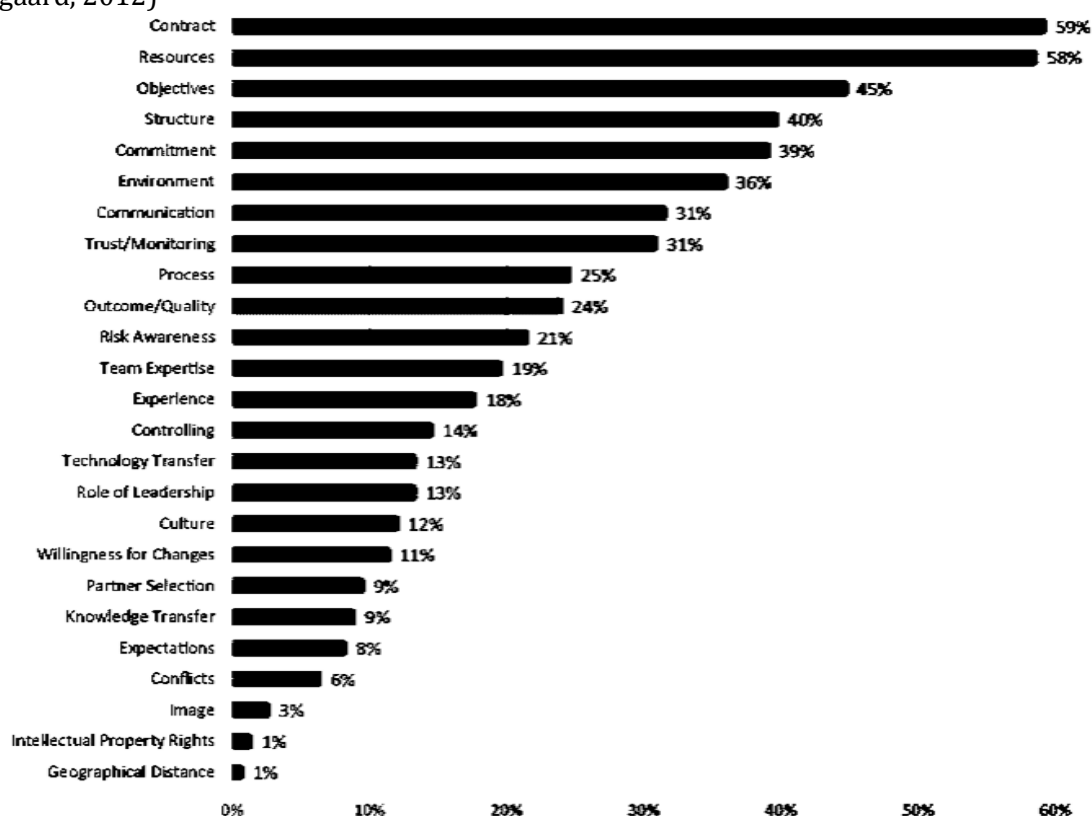


Figure 5. Risk Factors in PPP schemes (Rybnicek et al., 2020)

Meanwhile, opportunities for corruption loopholes in PPP schemes remain wide open in Indonesia, particularly in PPP toll road contracts. According to analyses, there are still numerous flaws in Indonesian PPP toll road contracts (Direktorat Monitoring KPK, 2022). Regulator is still powerless in enforcing contract clauses, leaving plenty of room for contract amendment. As a result, inefficient projects are more likely to undergo contract renegotiation in order to avoid investors' losses. Meanwhile, a contract revision that extends the PPP concession period or raises tariffs may be unfavorable to toll users.

According to data on toll road PPP projects in Indonesia, the majority of contracts extended the period of concessions and/or changed tariffs to make them more expensive. Figure 6 and Figure 7 shows contract amendment data history before 2015 and between 2015-2022.¹⁵ Since most Indonesian investors in toll roads are construction companies that are also involved in the

¹³ one of the considerations in choosing a PPP scheme in the construction of a project is "value for money", according to Presidential Decree 38 of 2015, article 21 paragraph 2.

¹⁴ Klitgaard's corruption formula $C = D + M - A$ (*Corruption = Discretion + Monopoly - Accountability*)

¹⁵ in 2015, Indonesia established the BPJT, a new toll road regulatory organization under MoPWH.

construction of the toll roads, cost overruns are inevitable in most Indonesian toll road projects. Samples of Indonesian toll road contract amendments due to cost overruns can be seen in Table 1.

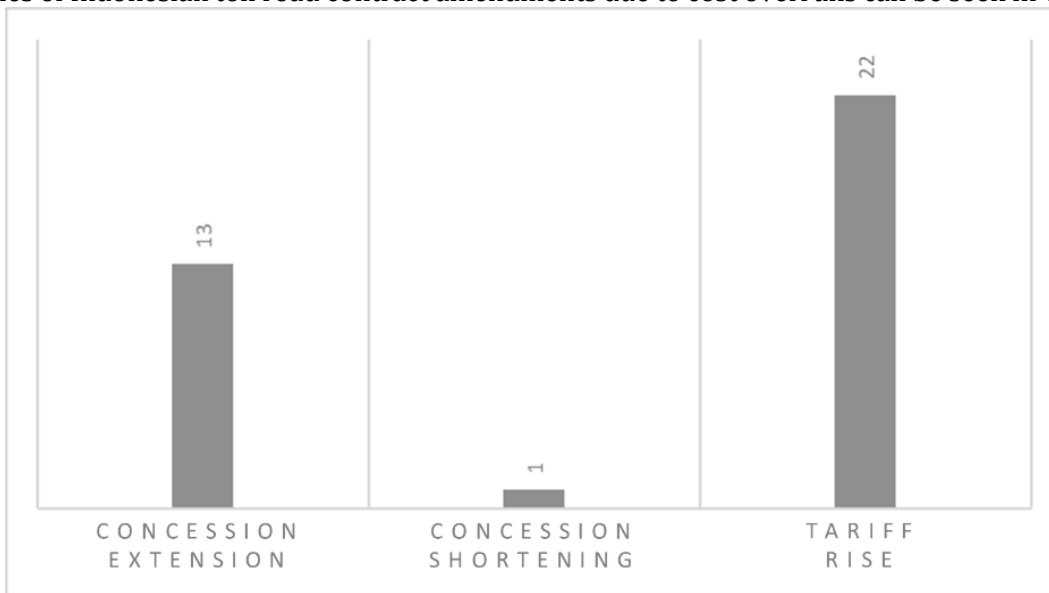


Figure 6. PPP toll road contract amendments in Indonesia before 2015 (Source: BPJT, MoPWH)

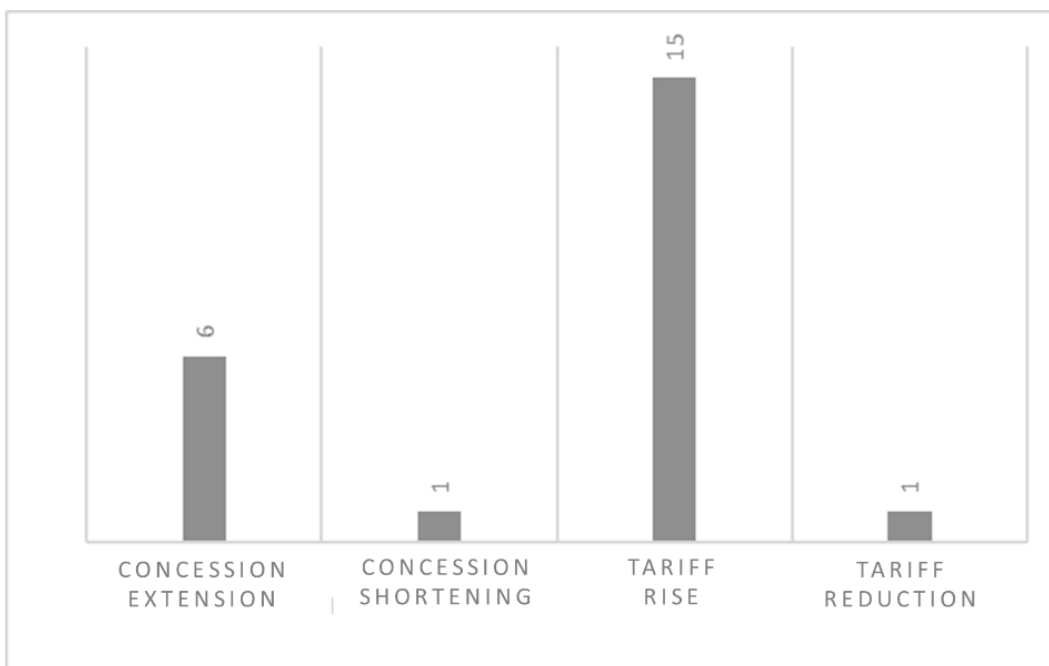


Figure 7. PPP toll road contract amendments in Indonesia 2015 - 2022 (Source: BPJT, MoPWH)

Table 1. Sample of Indonesian Toll Road Contract Amendment and Cost Overrun (Source: BPJT, MoPWH)

Toll Roads	Cost overruns (construction cost based on Basic Design vs DED)	Initial concession period	Concession period after amendment	Initial lowest tariff (IDR/ Km)	Lowest tariff after amendment (IDR/ Km)
Kayu Agung – Palembang – Betung	63%	40	50	833	1,336
Serpong – Balaraja	153%	40	40	800	1,388
Pandaan – Malang	15%	35	35	750	898
Batang – Semarang	30%	45	50	1,100	1,3217

Conclusions

PPP is an alternate solution for governments facing budgetary constraints in providing public service infrastructure. However, PPP schemes are not flawless solutions. PPP schemes still have a number of flaws and corruption loopholes. Therefore, prior to deciding on the adoption of a PPP scheme, adequate planning is essential. Meanwhile, dualism in Indonesian PPP regulation also contributes to the quality of PPP project planning.

Aside from the benefits of addressing budgetary constraints and risk-sharing between the government and private sector, PPP schemes still have certain drawbacks. One of the weaknesses is that not all infrastructure projects will be suitable for a PPP model. Since the engagement of private investors is essential in a PPP scheme, a project should be financially viable from an investor's standpoint, otherwise, no investor will be interested. However, there is a risk that the project will become a "white elephant" if it is not adequately planned out and forced to continue with limited viability. There are already a number of "white elephant" examples in Indonesian PPP projects. Meanwhile, because SOEs are involved as investors in PPP projects in Indonesia, the burden of "white elephant" projects sometimes falls back on the government. Another downside of the PPP system is that it can create a "fiscal illusion" that the government is successfully providing loads of public infrastructure, despite the fact that the majority of the infrastructure expenses are borne by the public.

Corruption loopholes can still be found in Indonesian PPP projects, particularly in toll road PPP contracts. Corruption loopholes emerge as a result of poorly designed PPP contracts, causing uncertainty for investors and making the contracts more susceptible to change. In most cases, inefficient projects are more likely to be renegotiated, especially for Indonesian toll road PPP. The inefficiency of the project could become the footprint of corruption in PPP projects.

Recommendations for the Indonesian government include: (1) To standardize PPP projects, the Indonesian government should consider consolidating PPP regulation; (2) "White elephant" projects should be evaluated to avoid similar issues with other PPP projects in Indonesia; and (3) Corruption loopholes in PPP contracts should be evaluated, particularly for toll road PPP.

Acknowledgments

This study is part of the KPK's (the Indonesian Anti-Corruption Commission's) responsibility in corruption prevention, which is to identify corruption gaps and make recommendations to close them.

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