

2012

Indonesia Provincial Commercial Business Opportunities



Embassy Jakarta, Economic Section
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This report provides an overview of provincial commercial opportunities in Indonesia for U.S. firms. As the first in what we plan to be a series of analyses of commercial potential outside the Jakarta area, we focus on three provinces: South Sumatra, East Kalimantan, and East Java. To assist U.S. firms in realizing potential new opportunities, the U.S. Embassy will lead trade missions to the three target provinces in late 2012.

Indonesia Economic and Business Opportunity Overview

“Indonesia is the next great economic story;” was the remark of a visiting senior executive from a global investment bank, “China and India have had their turns. Now we are turning our resources towards Indonesia.” This enthusiasm is understandable. Indonesia’s economy grew at a 6.5% rate in 2011 and has grown at better than 4.5%/year for the past decade. Its 241 million people make Indonesia the world’s 4th most populous country and the 3rd largest democracy. With a per capita income of about \$3,500, there is a fast-growing middle class of more than 120 million people hungry for consumer goods and a conservative, stable banking and finance system that is supplying credit to these consumers. Bank loans and deposits are growing at double digit rates but, as a result of the lessons learned in the 1998 Asian financial crisis, businesses and individuals have been extremely conservative in their borrowing. This applies to the Government of Indonesia as well which enjoys a debt/GDP ratio of about 25% and a budget deficit of less than 3%.

This growth was kicked off by a boom in commodities over the last ten years. Indonesia is a leading global producer and exporter of such resources as palm oil, copper, nickel, rubber, coffee, cocoa, tin, coal, and LNG. Yet exports contribute only about 25% of the nation’s GDP. Almost 60% of GDP is from domestic consumption, due to the factors described above. The next great economic driver is expected to be investment, especially in the area of infrastructure. Indonesia spends about twice as much on logistics as its neighbors due to lack of seaports, roads, airports, water supply, agriculture product handling and storage, electricity generation and distribution, railroads, and modern communications systems. In 2011, the Indonesian government published a “Master Plan” for infrastructure development to address these shortcomings and President Yudhoyono has made achieving this plan a key goal of his administration. The “Master Plan” includes more than 500 projects throughout the country as well as six development corridors aimed at creating economic clusters in various industrial sectors. Our analysis of the “Master Plan” is that it is more of a statement of intent than a program that will be fully implemented soon. This is reflected in the government’s stated intention to create public-private partnerships and empower Indonesian state-owned enterprises as the means to achieve plan implementation (as opposed to the government acting on its own). On the other hand, this also means that almost any project that can be deemed as infrastructure will have a base of support within the government. U.S. firms are welcome to either lead such projects or participate with another firm (especially an Indonesian one) as the lead.

For big projects, financing often plays an especially significant role in the decision-making process. Relatively inexpensive and easily obtainable export-credit financing from U.S. competitors is often a deciding factor in a purchase decision. So too is availability of a full-spectrum package of services. We have been told by senior officials of a major Indonesian entity that they prefer to purchase all aspects of a complex project, including financing, from a single general contractor rather than putting a package together themselves. To counteract this situation, we are working across agencies in Washington to form a “Team USA” approach that combines the efforts of U.S. EXIM Bank, OPIC, and Trade Development Agency along with the efforts of Mission Jakarta.

Indonesians generally regard American products and services as extremely desirable; of very high quality -- and high cost. However, we are seeing a growing number of entities in Indonesia that are choosing not to buy less expensive products from other nations because of bad experience with the reliability and

after-sales service associated with these goods. As indicated in the below chart, Indonesian statistics show U.S. exports to Indonesia increased 52.6% from 2009-2011 – although we have been losing market share – and the United States is the 4th largest source of Indonesia’s imports and third most important export destination.

Major Indonesia Trading Partners

Sources: Central Bureau of Statistics (BPS)

In Millions of USD

	2009	2010	2011	Share (%)
Exports	116,510.0	157,779.1	203,496.9	
Japan	18,574.7	25,781.8	33,714.7	16.6
China	11,499.3	15,692.6	22,957.9	11.3
United States	10,850.0	14,266.6	16,459.1	8.1
South Korea	8,145.2	12,574.6	16,388.8	8.1
India	7,432.9	9,915.0	13,335.8	6.6
Australia	3,264.2	4,244.4	5,582.5	2.7

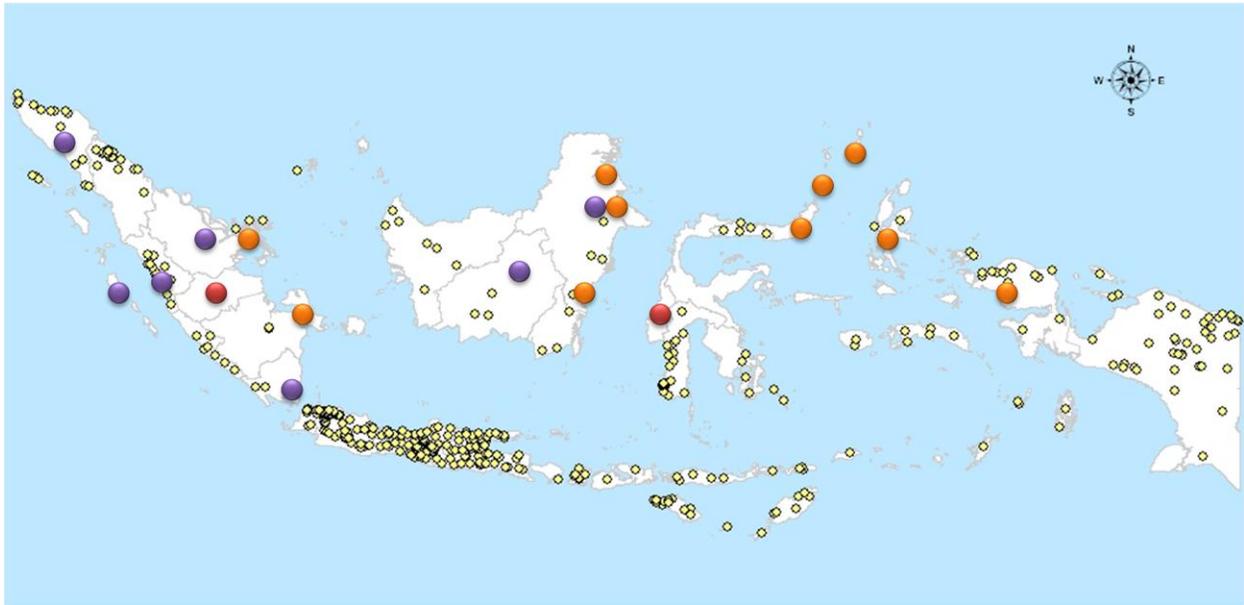
	2009	2010	2011	Share (%)
Imports	96,829.2	135,663.3	177,435.6	
China	14,002.2	20,424.2	26,212.2	14.8
Japan	9,843.7	16,965.8	19,436.6	11.0
South Korea	4,742.3	7,703.0	12,999.7	7.3
United States	7,083.9	9,399.2	10,813.2	6.1
Australia	3,436.0	4,099.0	5,177.1	2.9
India	2,209.4	3,294.8	4,322.0	2.4

Opportunities in the Provinces

Implicit in the “Master Plan” is the need for greater economic development off the island of Java. Java is home to more than half of the country’s population despite comprising less than 15% of Indonesia’s land mass. Government policy has long been to encourage outward migration from overcrowded Java and a better distribution of economic activity across the archipelago. With the advent of decentralization, considerable political power has devolved to the 33 provinces and even to the regency (county) level. The political authorities at these levels have their own priorities for economic and infrastructure development and can often move more quickly in making decisions than the Jakarta bureaucracy. Due to the commodity boom described above, as well as substantial funds that are channeled to the provinces from the central government, the provincial authorities and provincial consumers enjoy increasing economic autonomy and buying power even though their infrastructure remains generally less advanced than West Java’s.

Embassy Jakarta has embarked on a comprehensive plan to promote U.S. business in provincial Indonesia. To begin, we mapped where the U.S. Government has undertaken assistance programs across the country in the belief that these efforts have built-up goodwill which can be leveraged by American firms. The following map is one example of our mapping exercise.

U.S. Government Climate Change and Environment Partnerships



● USAID ● TFCA ● ICITAP ● MCC

Next, we utilized a Regional Autonomy Monitoring Committee (KPPOD) study of the quality of governance at the regional level and made a matrix of areas where there was significant U.S. assistance, relatively good governance, and above average provincial GDP growth. This approach led us to send survey teams to three provinces, South Sumatra, East Kalimantan, and East Java, and the resulting reports form the basis of this study. The survey teams met with provincial and regency level business leaders as well as key regional political figures. The teams heard the plans of the economic and political leadership of these regions for future economic and infrastructure development and their uniformly keen interest for more interaction with U.S. companies.

Next Steps

The Embassy Provincial Commercial Outreach Teams will continue to maintain active communication with their contacts in the various target provinces. As we gather new commercial information, we will make it available on the US Embassy Jakarta business pages:

<http://jakarta.usembassy.gov/business.html> as well as the Foreign Commercial Service website:

<http://export.gov/indonesia/>

Beginning in Q3 2012 our survey teams will lead trade missions to the target provinces. The focus of these missions will vary depending on the commercial opportunities identified and feedback from potential U.S. private sector participants. Please do not hesitate to contact us with any questions at businessindonesia@state.gov.

South Sumatra

1. Background: Demographics and Geography

South Sumatra is a large (slightly larger than South Carolina) province on Sumatra, one of the country's major outer islands (Figure 1). According to the 2010 census, the province was home to about 7.5 million people from a variety of ethnic groups, 80% of whom live in rural areas. South Sumatra has significant natural resources such as forests, oil, gas, coal, and other minerals, and produces many agricultural products, resulting in high amounts of petroleum, palm oil, and rubber exports. Value-added products from the Pertamina refinery and the immense Pupuk Sriwijaya fertilizer plant are also produced and exported from South Sumatra.



Figure 1. Province of South Sumatra Map

South Sumatra consists of four municipalities - Palembang, Lubuklinggau, Parbumulih and Pagar Alam – and eleven districts, with Palembang its capital and gateway to the province. Three airports including an international airport in Palembang connects the province to Medan, Batam, Padang, Jakarta, Singapore, Malaysia and other neighboring Asia-Pacific nations. Air-conditioned buses from points north and west of Palembang are also regularly available, as well as from major cities in Java and Bali (Figure 2). In addition to its air and road connections, South Sumatra is connected by nine rivers that can be used for transportation.

Palembang today commands greater national and regional attention and power than a provincial capital warrants. It continues to be one of the wealthiest cities per capita in Indonesia with exceptional

opportunities for growth in the coming decades. Approximately 20% of South Sumatra's population lives in the Palembang municipality, making it the district/municipality with the highest population in the province.

In 2011, Palembang successfully co-hosted the biannual Southeast Asian Games. The local government transformed a swampy area into "Sports City," comprised of 22 sports venues for over 4,000 athletes, in just 10 months. It plans to bid for the 2019 Asian Games.

2. Provincial Economy and Governance

South Sumatra's Gross Regional Domestic Product (GRDP) has steadily increased. The province's GRDP grew 6.9% in the first quarter of 2012 and has averaged 5.3% annual growth from 2008 to 2011. The main contributors to the region's economic growth in 2011 were: the transport and communication sector; the trade, hotel and restaurant sector; the construction sector; and the services sector. According to the Indonesian Central Bureau of Statistic (BPS), South Sumatra ranks ninth in per capita regional GDP (2010) at \$900.

In the World Bank's subnational rankings of its "Doing Business" survey, Palembang ranks third out of 20 Indonesia cities for dealing with construction permits and registering a property but 11th for starting a business. The procedures and time needed as well as the cost to start a business in Palembang were slightly better than the average for East Asia and Pacific countries. In August 2011, SWA Magazine ranked Palembang as the 20th most recommended city for business.

Reflecting its relative overall prosperity, U.S. government presence and assistance has been small in the past. South Sumatra is a candidate province for the Millennium Challenge Corporation's green prosperity programs and USAID has two justice reform programs and an urban water and sanitation program there.

South Sumatra: Key Advantages

South Sumatra's productive-aged population continues to increase. South Sumatra's workforce of 5.3 million has increased from year to year due to migration from other provinces, with 74% of the population in the working age group. Almost 64% of the workforce is engaged in the agriculture sector (defined as farming, forestry, livestock and fisheries).

Free education has been one of current Governor Alex Noerdin's most important achievements. As of 2010, the literacy rate for the region is almost at 100%. Average duration of study is eight years with almost two-thirds of eligible students attending junior high. Nevertheless, skilled and semi-skilled labor is in demand with the mining industry relying on employees with higher skills coming from other provinces. South Sumatra is home to Sriwidjaya University, which enjoys a high reputation among national universities especially in medicine and civil engineering.

South Sumatra's geographic position is very strategic: Lying in the center of Sumatra, near Singapore and Malaysia, and at the tip of the Malacca Straits (Figure 2), South Sumatra has the potential to become a transport hub for intra-Indonesia trade as well as international trade between Indonesia and the neighboring countries as well as with the more developed Asia-Pacific nations to the north.

South Sumatra is located on the axis of one of the six economic corridors identified in the Government of Indonesia's Masterplan of Acceleration and Expansion of Indonesia Economic Development 2011 – 2025 (MP3EI), and is expected to be a growth center to boost Indonesia's economic development.



Figure 2. Strategic position of South Sumatra

3. Sectors of business opportunities for South Sumatra

Energy and Utilities

a. Coal including Coal Bed Methane (CBM)

South Sumatra has the largest coal resources and reserves in Indonesia, accounting for 40% of Indonesia's coal resources and reserves, primarily in the form of lignite. According to the Mining and Energy Service Office of South Sumatra, the province holds 22.24 billion tons of coal resources, compared to 19.56 billion tons in East Kalimantan, and 8.67 billion tons of resources in Central Kalimantan. In addition, South Sumatra has the largest CBM reserves in the country with a potential 183 trillion cubic feet (Tcf) compared to 105 Tcf of resources in South Kalimantan and 106.4 Tcf of resources in East Kalimantan. Although lignite is not yet suitable for conventional power generation and is not traded in the energy market due to its high total moisture and low calorific value, opportunities exist for the utilization of lignite for mine mouth coal-fired power generation, coal upgrading, coal gasification and liquefaction.

Since 2008, the South Sumatra government has encouraged participation of international coal companies in the country's coal sector. International companies have a significant presence in the upstream and coal distribution sectors and plenty of opportunities exist for additional investment.

To attract CBM investment, the South Sumatran government is committed to improve the investment climate. It has worked closely with the tax authorities, the Ministry of Energy and Natural Resources, and BPMigas, the oil and gas regulatory agency, to improve the commercial viability of CBM projects and address operational issues of land access, permits, approvals, and water disposal.

Recent coal mining investments include:

- Reliance Power, an Indian firm, will invest as much as \$5 billion to develop three coal mines and a railway in South Sumatra. The government has offered fiscal concessions, including land to Reliance Power to make it attractive for them to invest in Indonesia. The company plans to build a 230-km long railway that will link its coal production base in Batang Hari to Tanjung Api-Api port.
- NuEnergy, an Australian mining company, started coal production in 2011. The location comprises a combined area of 1,861 km² containing between 10 m and 40 m thick, low rank coal seams ranging in depth from 350m to 1,300m. They have a joint operating agreement with PT Pertamina. The concession also appears robust for CBM development containing thick sections of coal at optimal depths and located close to existing oil and gas infrastructure.

b. Power Generation, Transmission, and Distribution

South Sumatra has existing energy infrastructure such as power grids to North Sumatra and Greater Jakarta as well as gas pipelines to West Java. This available infrastructure provides South Sumatra access to the rest of Sumatra, Java, and Asia-Pacific nations. Gas pipelines owned and operated by state-owned gas company Perusahaan Gas Negara (PGN) span Sumatra to western Java.

Electrical systems in South Sumatra are well interconnected with neighboring Bengkulu and Jambi provinces through 150 kV transmission networks in the so-called South Sumatra, Jambi and Bengkulu Region System (S2JB). However, the ratio of the electrification in South Sumatra is only 56.39% in 2011. The PLN waiting list has reached 54,845 customers requests for 62.3 MVA (million volt-amperes).

South Sumatra's total geothermal energy potential is equivalent to 1,911 MW or 6.8% of national capacity.

In an effort to meet the electricity needs of the S2JB region, Java and Bali, state-owned utility company PLN has plans to build 713km of power transmission lines and a 2,100 MVA Substation. PLN has also awarded contracts to three joint-venture companies for the construction of three coal-fired power plants with a combined capacity of 2,140 megawatts (MW). PT DSSP Power South Sumatra will produce 300 MW of electricity; a joint-venture between a Korean company and DH Energy of Indonesia will generate 600 MW; and the consortium between state-owned coal company PT Bukit Asam and China Huadian will build a 1,240 MW power plant. With the difficulty of finding suitable locations for power plants in Java and Bali, PLN hopes that these plants will help meet the expected 9% growth in Java and Bali and PLN's expected additional capacity needs of 3,500 MW per year.

Indonesia plans to launch the construction of the Java-Sumatra Interconnection Transmission Line for low carbon power supply development. It will connect the Bangko Tengah substation in South Sumatra and X-Bogor substation near Jakarta, crossing the Sunda Straits. The undersea cable will be able to transmit power with a total capacity of up to 3,000 MW from Sumatra to Java.

c. Natural Gas

South Sumatra has large potential reserves of natural gas resources. The South Sumatra - West Java gas pipeline can be used for distribution of natural gas produced in the province to Indonesia's industrial and population centers in the Jakarta area.

According to the Mining and Energy Service Office of South Sumatra, South Sumatra has 24 trillion cubic feet (Tcf) of potential natural gas reserves. South Sumatra has an existing 300-km gas pipeline to supply the domestic market including to Java and an additional 177-km natural gas pipeline to Singapore.

Conoco Phillips is one of the major gas producers in South Sumatra, with gas production from its Suban Field. Discovered in 1998, Suban Field has gas-in-place estimates in excess of 7 trillion cubic feet.

Indonesia, the world's third-largest exporter of liquefied natural gas (LNG), after Qatar and Malaysia, sells more than 60% of its output to countries such as Japan and South Korea. Opportunities exist for U.S. businesses for LNG development in South Sumatra.

Infrastructure

a. Railways

South Sumatra has prioritized the development of port and railways development to transport large volumes of minerals to port terminals for either domestic or international exports and to reduce the high transportation costs in the region. Upgrading and expanding current rail lines to international heavy-haul standards and constructing new rail lines are critical to the development of the South Sumatra economy.

The prospects for railways in South Sumatra are very promising. The existing railway carries more than 10 million tons per year but this is not considered sufficient to meet the future needs of the provincial coal industry. Mining companies have proposed major investments to expand existing mining operations in the province. Railways will be the mode of choice to transport coal from these new mines with an expected need for 25-ton design axle loads permitting higher payloads, and fast loading/discharging wagon designs, powered by high-HP multiple unit diesel-electric locomotives tied together to pull long trains of 7,000 tons or more.

A number of plans for railway projects currently exist including:

- State-owned coal company PT Bukit Asam and PT Adani Global from India signed an agreement to build a 270-km, \$1.67 billion railway project to expedite the haulage of coal from Bukit Asam's coal mine to a coal terminal at the proposed Tanjung Api-Api port.
- PT Bukit Asam, Indonesian-owned PT Transpacific Railway Infrastructure, and China Railway Engineering Corporation plan to build a 300-km railway project and expand an existing railroad track to transport coal to neighboring Lampung.
- State-owned railway PT Kereta Api Indonesia plans to build a 100-km double track railway across the Prabumulih - Tanjung Enim Baru route in South Sumatera, which spans for 100 km and valued at Rp 800 billion.
- The Ministry of Transportation has invited the private sector to get involved in the 1650-km Trans Sumatra Railways project from Palembang to Rantau Prapat.

b. Port/Seaport

Palembang’s Boom Baru port on the Musi River is the largest river port on the island of Sumatra. The port has huge potential for additional investment including in the Lais River area. However, South Sumatra’s economy and development is constrained by the lack of a port with direct access to the sea.

In addition to railways, the South Sumatra government’s other main priority is upgrading and expanding its existing ports and constructing the new Tanjung Api-Api seaport and a connected special economic industrial zone on 9,913 hectares (Figure 3). A seaport would not only benefit South Sumatra’s commodity-based economy but also allow it to play a larger role in international trade due to its strategic location.

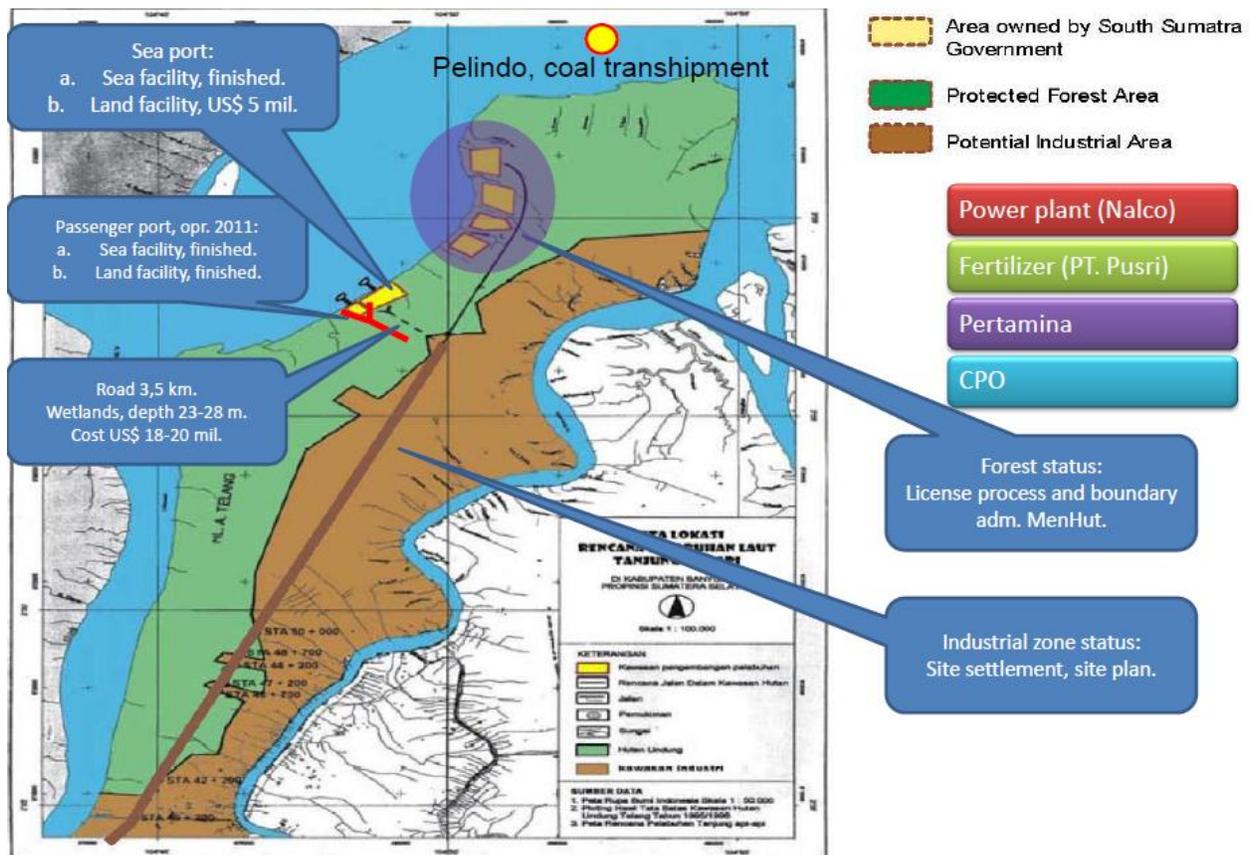


Figure3. Plan of Tanjung Api-Api seaport in South Sumatra

Tanjung Api-Api seaport will include an integrated industrial and logistics infrastructure including rail transport corridor and a deep water sea port to handle bulk and container cargoes. The industrial park could be used for metals refining, smelting and metal based fabrication industries, bio-technology, palm, rubber and other agro-base industries, captive power plants and supporting infrastructure.

In addition to Tanjung Api-Api, state-owned port company PT Pelabuhan Indonesia II (Pelindo II) plans to expand Boom Baru’s container stacking yard in 2012 to meet the expected increase in container traffic, which has reached 10 thousand TEUs per month. The stacking yard will be expanded by one hectare with additional capacity of 1,320 TEUs. It also has plans to develop Lais River port, located next to Boom Baru port, to meet the expected increase in demand for commodity exports, specifically palm oil and mined metals and ores. The Lais River port currently has a 230-square meter open warehouse

facility backed by a 16,700-square meter container yard. Pelindo II plans to expand the port's capacity and develop an attached industrial park to include manufacturing facilities.

Although foreign ownership of ports is limited, Pelindo II is open to build –operate-transfer models for its ports including in South Sumatra. Under this approach, Pelindo II would invite qualified shipyards to bid for the right to modernize and operate an existing yard (or establish a new shipyard) for a period of 20 years or more.

Agriculture

Agriculture is an important part of South Sumatra's economy, making a significant contribution to the province's exports and GRDP, and providing the largest number of jobs. Production per hectare has steadily risen since 2007. Main products of South Sumatra agriculture industry include palm oil, fruits, rice, vegetables, coffee, and sugarcane. The national government is focused on increasing investment that will create more downstream products from these inputs.

a. Cold storage

South Sumatra's lack of a seaport, reliance on a river port, and railway transportation to bring their agriculture products to market, and lack of cold-storage facilities results in significant wastage and loss to farmers. Opportunities exist to develop the cold chain infrastructure and supply chain network and provide logistical support services to get farm produce to market. In addition to supplying equipment, U.S. investors can be cold storage owners, owners of a fleet of refrigerated trucks or, as is becoming increasingly common, an integrated third party logistics firm that owns the entire network right from procurement to the final destination of the product.

b. Rubber

South Sumatra is rich in rubber. South Sumatra has the largest rubber plantations in Indonesia, producing 1.06 million tons in 2010. Rubber production is dominated by crumb rubber, with most of its natural rubber exported to international markets, including approximately 40% to the United States. Only a small portion is used domestically by the Indonesian tire industry. Farmers typically produce two categories of rubber. Class A is the higher quality rubber, which has a water content of around 9% by weight per block, while class B rubber contains 11% water by weight.

Demand for natural rubber is expected to grow in the future. In the next five years, new investment will be needed to build new processing plants or to upgrade existing facilities to meet the growing demand for rubber.

South Sumatra has a number of comparative advantages to produce rubber including the abundant availability of cheap labor and land suitable for rubber plantations.

The rubber industry is dominated by small producers. Opportunities exist to produce crumb rubber and rubber products on a large scale. The industry is dominated by small landholders and farmers that produce crumb rubber and small businesses producing rubber products but lack access to capital to produce on a large scale or produce industrial and technical rubber products that require high technology.

The local investors present in the rubber industry in South Sumatra include state-owned Perkebunan Negara (PTPN) VII, Sampoerna Agro Tbk, owned by the Sampoerna family, and London Sumatra

Indonesia Tbk, an Indonesian stock exchange listed company. PTPN VII has 65,800 hectares of rubber plantations. Sampoerna Agro has a 183-hectare rubber plantation. London Sumatra Indonesia is involved in plant breeding, planting, harvesting, processing, and selling rubber as well as palm and palm oil seeds, crude palm oil, cocoa, tea, coconut and coffee.

c. Crude Palm Oil (CPO)

South Sumatra plans to make available an additional 350,000 hectares available for CPO production. CPO production has grown 6-7% annually the last few years and is expected to continue to grow due to rising demand from China and India.

Hindoli, which was acquired by Cargill in 1995, is one of the major CPO producers in South Sumatra. Hindoli has 16,000 hectares and another 17,600 hectares of micro mills, with an annual output of 150,000 tons. They plan to increase palm oil production by 20% in 2012 through intensification and expansion of its plantations.

The majority of CPO production in South Sumatra is exported to foreign markets. Opportunities exist at each phase of the production process including plantations, refining, improving capacity, production, and efficiency of micro-mills and small plantation holders, and creating value-added products such as ole-chemical and bio-fuel.

Challenges

As Governor Alex Noerdin said, “Our province is one of the richest in Indonesia, but only in terms of potential.” The progress of South Sumatra’s development including the exploitation of its natural resources remains low due to the lack of transportation facilities, especially river transportation and roads, and the need for infrastructure, especially power grids and ports and supporting infrastructure such as access roads and railways.

In agriculture, Sumatra is home to some 70% of Indonesia’s oil palm plantation area and 65% of natural rubber production, yet productivity is far below the productivity of its neighbors and competitors. This has been blamed on low seed quality, non-optimal land utilization, and inadequate use of fertilizers (two problems linked with small holders and their limited budgets) as well as long transport times. With approximately 42% of oil palm land and 80% of rubber tree plantations in the hands of small holders, it is clear that these hurdles must be addressed if Sumatra is to boost its production.

The coal bed methane industry in Indonesia especially in South Sumatra is still in its early stages. CBM investors face a range of challenges including uncertain regulatory environment, land access issues, potentially high-start up investment costs, and infrastructure issues.

4. Proposed Masterplan Projects for South Sumatra

The following is a listing of the masterplan projects identified for South Sumatra:

- Railway development from Kertapati to Tanjung Api-Api
- Coal Railway from South Sumatra to Lampung
- Railway development project from Muara Enim – Tanjung Carat (270 km) and coal port Tanjung Carat
- New railway development from Tanjung Enim – Lampung (300 km)
- Palembang – Indralaya 22 km Toll Road
- Road Improvement Wiralaga to Sp. Pematang (40 km)
- Development of Karya Jaya Multimode Terminal in Palembang
- Development of the Tanjung Api-Api port
- Port development in Palembang
- Mine Mouth Coal Fired Steam Power plant (2X600 MW)
- Mine Mouth Coal Fired Steam Power Plant (1X600 MW)
- Power plant Mulut Tambang 4X150 MW
- Power Plant Mulut Tamban 2X300 MW
- Power Plant Banjarsari 2X100 MW
- Power Plant PLTU Tanjung Enim 3X10 MW
- Power/Energy PLTP Lumut Balai Unit 1 and 2 (2X55 MW)
- Power/Energy PLTP Lumut Balai Unit 3 and 4 (2X55 MW)
- Power/Energy PLTU at Muara Enim Industrial Area (2X10 MW)
- Electricity development in South Sumatra province (21 spots)

APPENDIX 1 – Key Contact Information

U.S. Embassy Jakarta

Address: Jl. Medan Merdeka Selatan 5
Tel: (021) 3435-9000
Email: business.indonesia@state.gov

SOUTH SUMATRA PROVINCE

Planning and Development Agency

Address: Jl. Kapten A. Rivai No. 23, Palembang 30129
Tel/Fax: (0711) 356-118

Bank Indonesia Branch

Address: Jl. Jend. Sudirman No. 510, Palembang
Tel/Fax: (0711) 352-126

APPENDIX 2 – Statistical Information

Key Facts South Sumatra

- Total area: 109,254 square kilometers
- Population Density: 68 people/km² (2,000 people/sq mi)
- Population: 7,450,394 people (3.1% of total Indonesian population)
- Growth rate: 6.40% (2011)
- Inflation rate: 4.65% (2011)
- Exports of main products : 834 million USD (Dec 2011-Feb 2012)
 - Rubber: 639 million USD
 - Coal: 84 million USD
 - CPO: 76 million USD
- Minimum wage: 133 USD/month
- Growth rate of number of passengers through Sultan Mahmud Badaruddin II, International Airport: 16% (First quarter, 2012)
- Growth rate of container traffic at Boom Baru Port: 25% (First quarter, 2012)
- NPL ratio of local banks: 1.66%

East Java

1. Background: Demographics and Geography

East Java boasts the second largest population with over 37 million people (2010) and is roughly the size of West Virginia by land mass. Almost two thirds of all land in East Java is used for agricultural purposes and the majority of East Javanese are small farmers. However, East Java is increasingly a hub for international trade and a gateway for goods to much of Eastern Indonesia.

East Java is comprised of 38 regencies and cities, and borders Central Java to the West and Bali to the East. East Java is located between the Java Sea in the North, Indian Ocean in the South, and Bali and Madura Straits in the East (Figure 1).

Surabaya, East Java's capital city, is the second largest city in Indonesia with a population of 2,765,487 people. It is home to the main trading port in East Java, Tanjung Perak, and the majority of Surabaya's residents work in retail.



Figure 1. Province of East Java map

2. Provincial Economy and Governance

Economic growth in East Java hit 7.2% (yoy) in 2011, up from 6.7% (yoy) in 2010, and higher than Indonesia's national economic growth 6.5% (yoy) in 2011. According to Bank Indonesia, the Indonesian Central Bank, East Java ranks second in per capita regional GDP (2010) at \$2,234. Investment in East Java continues to increase with \$1.3 billion worth of foreign investments realized in 2011 (Investment Coordinating Board, BKPM).

Good governance and streamlined permit processes in East Java attract foreign investors. The East Java Investment Board provides electronic services for permits and guarantees that permits for foreign investors will be issued in 15 days or less. Eleven of the top 20 cities and regencies rated on local economic governance are located in East Java, according to a five-month survey conducted by the

Regional Autonomy Implementation Monitoring Committee of 245 cities and regencies throughout Indonesia August 2010 – January 2011.

3. East Java Key Advantages

Access to infrastructure is far better in East Java than much of Indonesia. East Java boasts the second busiest container port, Tanjung Perak, the third busiest international airport, Juanda International, and several kilometers of toll roads that are free of the levels of congestion seen in the Greater Jakarta area. Current peak electricity demand in East Java is approximately 4,100 MW, supported by power generation with capacity of over 6,670 MW.

Low wages (average monthly wage is 152 USD), few labor incidents (such as protests and demonstrations), strong financial markets, and a relatively low incremental capital output ratio (ICOR) of 3.2 compared to a national ICOR of 4.9 are beginning to draw foreign investors from the Jakarta area to East Java. Though the province of East Java does not yet offer tax incentives, the District of Sidoarjo offers VAT-free status to foreign investors for three years (starting at the operational phase) and import tax exemptions to investors in the fisheries and canning industries.

Currently, there are 19.8 million people in the work force in East Java, with 450,000-500,000 new workers entering each year. East Java has more than 300 private universities and 13 state universities, including top ranked Airlangga University (fourth in the country) and Institute Technology Surabaya (ITS), considered the best technology school after Institute Technology Bandung (ITB).

4. Sectors of business opportunities in East Java

Manufacturing

In 2011 East Java's manufacturing sector contributed 27.13% to East Java's GDP. Foreign and domestic companies manufacture a wide variety of products in East Java, including pharmaceuticals, electrical machinery and supplies, basic metals, furniture, textiles and garments, shoes, rubber and plastic products, and electronic products. East Java has several thousand acres of industrial estates in Lamongan, Gresik, Tuban, Sidoarjo, Mojokerto, and Surabaya that allow investors to bypass the difficult land acquisition process. Investors can choose to rent land, standard warehouses, or standard factories. Electricity, water and water treatment, gas, telephone, and in some cases internet, are provided.

Approximate Industrial Estate Rental Costs

Type	Price/m ² /month
Land	Rp. 6,250 (\$0.66)
Warehouse	Rp. 16,000 (\$1.70)
Factory	Rp. 22,000 (\$2.33)

Figure 2. Interview with Gresik Industrial Estate

Agriculture

More than half of East Java is dedicated to the agricultural sector and investments in agricultural processing services are welcomed by local governments. Tobacco, rice, milk, tapioca, corn, rubber, sugar, fish, and shrimp are grown or raised and processed in East Java. The national government is focused on increasing investment that will create more downstream products from these inputs.

a. Cold storage

Local officials in Lamongan, home of East Java's largest fishing port, state that 20-25% of fish harvest is destroyed due to a lack of cold storage facilities on fishing vessels. In addition to supplying cold storage equipment, U.S. investors can be cold storage owners, owners of a fleet of refrigerated trucks or, as is becoming increasingly common, an integrated third party logistics firm that owns the entire network from procurement to the final destination of the product.

b. Fisheries

East Java has over 90,000 ha of fish ponds, but current production is only at 33% capacity. Winrock International reports that fish farmers in East Java tend to buy fingerling from outside of East Java at a low quality and that fish farms lack both economies of scale and working capital.

Construction

East Java's housing market is booming as increased numbers of East Javanese enter the middle class. Credit is more widely available following a clamp down in 2006 after the Lapindo mudflow disaster in the District of Sidoarjo. Housing growth offers U.S. suppliers of housing materials ample opportunity to develop partnerships with real estate developers in Indonesia.

Energy and utilities

a. Oil and Natural Gas

A number of international oil and gas companies have presences in East Java. Gas supply, however, is still lacking and current gas supply (130 mmscfd) has not met demand (400 mmscfd) even though untapped oil and gas resources remain in East Java. According to the Indonesian Government, East Java has 6.4 trillion cubic feet of gas reserves and over 1000 mmstb of oil reserves.

Recent oil and natural gas investments include:

- Hess Indonesia Pangkah is developing 17 new gas wells in Gresik with a production capacity of 8 mmscfd. Exxon Mobil also has a large gas project in Cepu (Central Java), but is building a pipeline through East Java to Tuban.
- Australian Energy World Corporation plans to build an LNG Receiver Terminal capable of handling up to 420 mmscfd.

b. Power Generation, Transmission, and Distribution

In anticipation of growing electricity demand, the Government of East Java has invited foreign investors to build an additional 5971 MW in power plants by 2020. Though electricity supply is readily available, electricity connections are still lacking in some areas of East Java as electricity has reached 7,264,607 out of 9,862,111 households, or about 73.66%.

Infrastructure

a. Airports

Juanda International Airport, built to process 6 million passengers per year, saw over 11 million passengers pass through in 2010. A second runway and third terminal are a priority for the East Java Government and, according to Indonesia's Master Plan for Economic Development (MP3EI), the project will require an estimated investment of \$56 million.

b. Port/Seaport

Tanjung Perak port is the second busiest port in Indonesia, processing over 3 million twenty-foot containers (TEUs) in 2010. According to the Indonesia National Shipowners Association, Tanjung Perak is already operating at 80% capacity. In light of increasing port traffic, the Indonesian Government has identified four port projects in East Java under the MP3EI.

- Lamongan Port expansion – \$235 million investment
- Probolinggo port authority development – \$43 million investment
- Branta Port expansion – \$17 million investment
- Harbor pond dredging and development of container terminals at Teluk Lamong (part of Tanjung Perak Port expansion) – \$848 million investment

c. Water

Water is consistently cited as lacking by East Java officials and businessmen. The district of Lamongan plans to release a tender for a water treatment installation with an estimated project value of \$12 million in 2012. According to local officials, this project is undergoing a feasibility study with the Government of Japan.

d. Road and highways

The Pandaan - Malang Toll Road is a priority project under the MP3EI and is being offered as a build-operate-transfer (BOT) public private partnership (PPP) with a concession period of 35 years. The 37 km toll road is forecast to process 22 thousand vehicles per day.

5. Proposed Masterplan Projects for East Java

Indonesia's Master Plan for Economic Acceleration and Development (MP3EI) contains 25 projects for East Java, several of which will require private financing and development under a PPP model. East Java has already had a successful experience with the PPP framework in the form of Lamongan Integrated Shore Base, a majority Singaporean-owned oil and gas port on a 50 year BOT concession.

The following is a listing of the masterplan projects identified for East Java:

- Juanda Airport Improvement
- Lamongan Port expansion
- Branta Port expansion
- Probolinggo port authority development
- Harbor pond dredging and development of container terminals at Teluk Lamong (Tanjung Perak Port expansion)

- Umbulan water supply (4000 l/s)
- Surabaya innercity railway development (Surabaya - Pasar Turi - Bandara Juanda 26 km track - elevated)
- Development of Surabaya innercity railway (50 km)
- Probolinggo - Banyuwangi Toll Road(215 km)
- Waru-Wonokromo-Tj. Perak Toll Road (18.6 km)
- Pandaan – Malang Toll Road (37 km)
- Surabaya - Gempol - Pasuruan Toll Road (32 Km)
- Pasuruan - Probolinggo Toll Road(45.32 km)
- Gempol - Pandaan Toll Road (13.61 km)
- Steam Power Plant (PLTU) Tj. Awar-awar 700 MW
- Steam Power Plant (PLTU) Paiton 660 MW
- Steam Power Plant (PLTU) Pacitan 630 MW
- Gas/Steam Power Plant (PLTGU) Tuban/Cepu 1,500 MW
- Gas Power Plant (PLTG) Grati 800 MW
- Hydro Power Plant (PLTA) Kalikonto 62 MW
- Hydro Power Plant (PLTA) Kesamben 37 MW
- Power PS Grindulu 500 MW
- Power PS Grindulu 500 MW
- Power and Energy transmission development in East Java until 2015 (1,147 kms)

6. Challenges

The main challenge facing U.S. businesses in East Java may be unfamiliarity. Only a handful of U.S. companies already operate in East Java and many East Javanese perceive U.S. companies as overly cautious with very high standards of doing business. These perceptions are not necessarily negative though and many government officials view U.S. foreign investment is a status symbol.

Many East Java residents are still wary of new gas exploration after the disastrous Lapindo mudflow began in May 2006. Lapindo is the largest mud volcano in the world and was created by a blowout of a natural gas well drilled by an Indonesian oil and gas company. The initial eruption buried hundreds of homes and affected thousands of East Java residents.

Land acquisition also remains a serious challenge and most new investors criticize the lack of regulatory certainty, especially following district head and mayoral elections.

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APPENDIX 2 – Key Facts

- Total area: 47,922 km² (18,503 sq mi)
- Population Density: 780 people/km² (2,000 people/sq mi)
- Population: 37,476,757 people (15.77 % of total Indonesian population)
- GDP Growth rate: 7.2 % (2011)
- Inflation rate: 4.3 % (2011)
- GRP per capita: 2234 USD
- Incremental Capital Output Ratio: 3.2 (national average is 4.6)
- Minimum wage: 78 USD/month
- Average wage: 152 USD/month
- Total enterprises: 742,671
- Number of passengers through Juanda International Airport: 11,139,149 (2010)
- Container traffic at Tanjung Perak Port (in thousand TEUs): 3040 (2010)
- NPL ratio at local bank: 0.52%
- Average internet speed: 1-2 mbps

East Kalimantan

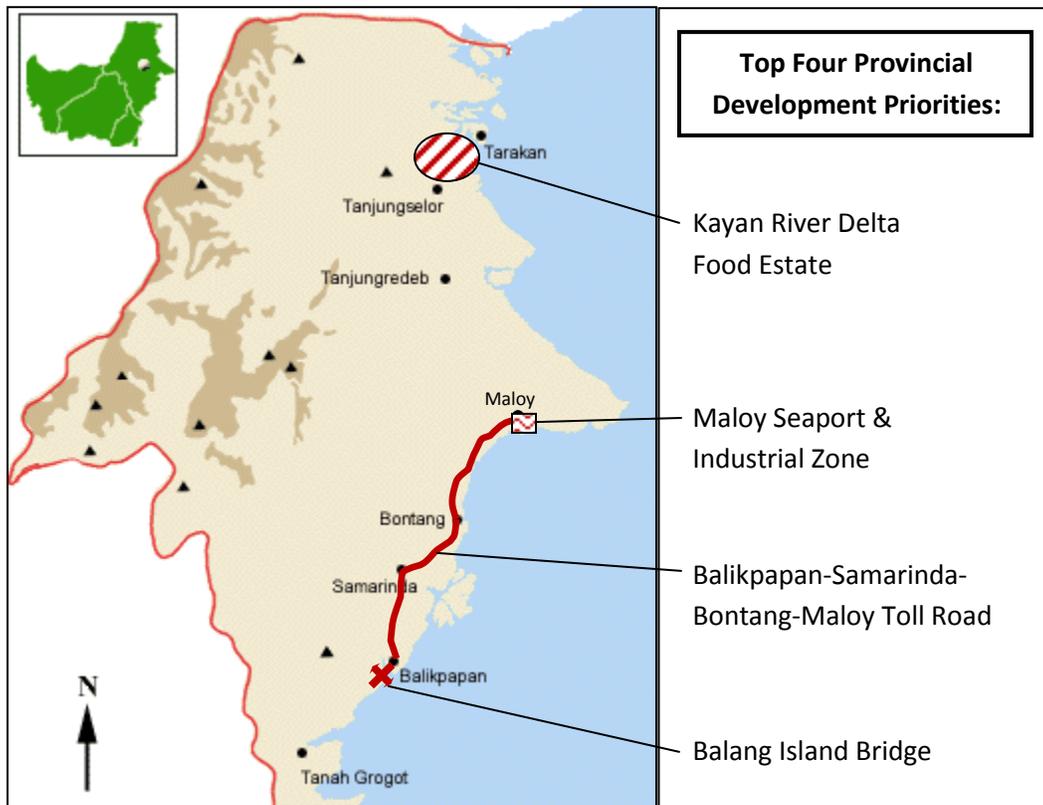
1. Background: Demographics and Geography

East Kalimantan is the second largest Indonesian province, with a total land area of more than 200,000 square kilometers (roughly the same size as Nebraska). Its population is relatively small for its size: just over 3.5 million per the 2010 census, giving it the fourth-lowest population density among Indonesian provinces (at 17 people per km², one-seventh the national average). A third of that population is concentrated in its two major cities: provincial capital Samarinda and industrial center Balikpapan, with populations of roughly 730,000 and 560,000 respectively.

East Kalimantan's considerable GDP (at 3.4 trillion IDR, the third-largest provincial GDP in Indonesia) is generated on the strength of a primarily extractive economy, with coal mining, offshore oil/gas exploration, and palm oil its key industries. The average population education level is vocational, but Balikpapan is developing a technical university (ITK) that it expects will become the third-largest of its kind in the country. Monthly minimum wage in Balikpapan is roughly 1 million rupiah.

East Kalimantan consists of four cities – Samarinda, Balikpapan, Tarakan and Bontang – and 10 regencies, with Samarinda and Balikpapan accounting for the lion's share of both population and provincial GDP. The international airport in Balikpapan handles 5.5 million passengers per year and offers connections to major domestic locations (Jakarta, Surabaya, Manado, and Denpasar) as well as flights to Kuala Lumpur and Singapore; other airports are smaller and serve regional destinations. Highway connectivity exists between Balikpapan and Samarinda, but roads elsewhere are limited and of poor quality (improvement of the regional highway network is a provincial government priority).

East Kalimantan Provincial Map



2. Provincial Economy and Governance

East Kalimantan produces 37% of Indonesia's natural gas and (at 120 million tons per year) nearly 70% of its coal; collectively, oil, gas, and mining contribute half of the province's GDP. Coal reserves represent more than a third of national stock, but as LNG production declines and coal mining is forced to move inland, the overall value of these industries will decline.

Tourism is a young industry, with some development around Berau and the Derawan Marine Preserve but little further investment. While some government officials (particularly in Balikpapan municipality) display admirable foresight in planning for green growth, it is likely that accelerated environmental degradation due to shipping, mining, logging, palm oil growth, and industrial activity will hamper opportunities to further develop natural tourist sites.

Governance

Transparency: On the provincial level, East Kalimantan has established e-procurement, e-APBD (regional budget), and e- One Gate Integrated Services for Investment (PTSP) in 8 of its 14 regencies/cities.

East Kalimantan's provincial leadership promises to be stable: the next gubernatorial election will be held in 2013, and based on an April 2012 Lingkaran Survey Indonesia, current Governor Awang showed 52.4% electability (nearly an order of magnitude better than his chief competitors: Rita Widyasari (7.1%), Isran Noor (3.9 %), and Yusuf SK (3.1%).

Locally, Balikpapan Regency is ranked in the top 3 in the World Bank's *Doing Business* survey of 20 regencies around Indonesia (criteria included starting a business, dealing with construction permits – where Balikpapan scored #1 – and registering a property). Balikpapan currently has an Integrated Permit System for permit handling, which they are working to streamline even further. Balikpapan has also established regulations on its land use, determining that 52% of the Balikpapan regency will be preserved as 'green', undeveloped terrain. New construction must reserve at least 60% green space over the project's total land area.

3. East Kalimantan: Key Advantages

Marketing to contractors yields returns. At Sepinggan airport in Balikpapan, the bid was tendered and won by Indonesian state-owned company PT Angkasa Pura I – which used GE electronics, Astrophysics X-ray machines, York chillers, and Caterpillar construction equipment. The firm cited the flexibility, high quality and easy cooperation with U.S. companies as key factors in its sourcing decisions. With limited resources to chase individual infrastructure tenders, partnering with key Indonesian contractors provides maximum return on effort.

The East Kalimantan government – and particularly the city of Balikpapan – has made green growth a priority. U.S. companies that bid on construction or support of major infrastructure projects will find that green considerations such as solid waste reduction (through recycling and methane capture) or renewable energy use are valuable components of a competitive tender.

While palm oil and timber harvesting across Indonesia are dominated by local companies, **opportunities exist for U.S. expertise in food agricultural production and post-harvest processing and storage technologies.** In addition, the relatively untapped forestry sector and keen interest of local government

in preservation may yield opportunities to partner with local firms for export of verified sustainable timber.

4. Sectors of business opportunity for East Kalimantan

The East Kalimantan Bappeda (regional planning agency) recognizes that the province's major GDP drivers – oil, coal, and gas – will run out in the next 15-20 years, and is working to develop a new economy based on renewable resources, secondary processing, and technology. East Kalimantan's key growth areas display a consequently mixed focus: some enhance the current extractive-based economy, while others lay the groundwork for longer-term sustainable development. The East Kalimantan government has identified three major clusters as focal points for industrial development: oleochemical and agricultural processing facilities in Maloy; oil, gas, and related industries in Bontang; and industrial estates in Kariangau.

Infrastructure Development

Expanded and improved road, rail, and port facilities are needed as coal mining moves inland and deposits of oil and gas become more difficult to access. The local government has made infrastructure development a top priority.

- The Balikpapan-Samarinda-Bontang-Maloy Toll Road will connect East Kalimantan's major population and industrial centers via a modern, high-capacity highway artery. Sections of this highway are already complete, but large portions – including the Samarinda-Maloy leg – have yet to be tendered. Operation of this road would be fully private sector. Samsung and 2 local companies are currently bidding.
- Balang Island Bridge, just outside of Balikpapan, is a key point in the north-south toll road intended to connect East Kalimantan's coastal industrial centers. A short span (470 meters) is already under construction by a joint Chinese/Indonesian venture, while the longer span (1.31km, 40m max water depth) has committed funding but no tenders to date.

Secondary Processing and Industrial Clusters

- Maloy Industrial Estate is an \$858 million, 5,305 hectare complex attached to a 63,911-hectare International Sea Port (MP3EI), intended to serve as a regional shipping hub (servicing ships traveling through the Makassar Strait) and as East Kalimantan's primary seaport and downstream processing facility for oleo-chemical production. The area will receive special economic status, and the local government has promised assistance in licensing and land acquisition for interested companies. Bakrie is exploring a bid, while other companies have already won permits: MEC INFRA (India) has a permit to develop a coal terminal, RMMI (UAE) will develop a railway, and MEC Coal and NALCO have invested \$1.5 billion for a 1,250 MW smelter (powered by its own 1400 MW plant).
- Kariangau Industrial Estate is an \$82 million, 3,540.30 hectare port and industrial complex currently under construction in Balikpapan. Financed through a combination of state, provincial and Balikpapan city budget funding, the container port will accommodate 125,000 containers per year. The industrial estate will cover an area of 2198 Ha, focusing on shipping and heavy industry (including agricultural processing and coal/petrochemical facilities). This is an MP3EI project.

Agricultural Production

As East Kalimantan's exports of oil, coal and gas begins to decline, a shift to crude palm oil production and timber harvesting is expected. The province's low population density and substantial land area make it an attractive site for timber, palm oil and agricultural production.

- Forest covers 70% of East Kalimantan's land area; roughly one third of that is production forest. East Kalimantan's timber industry is already the largest in Kalimantan, and plans are developing to invest a further \$1.6 billion in the timber and industrial forestry sector.
- Palm oil plantations, which already cover 10,000 km² (more than half of the total CPO area in Kalimantan), are another major resource, and will expand production as intermediate processing and export capacity improves in Maloy and elsewhere.
- The Kayan River Delta Food Estate in Bulungan Regency is a 50,000-hectare planned project for hydroelectric power generation and agricultural production. Local government welcomes US food investment, and has indicated that it will call for proposals for a 2000 MW hydroelectric project on the Kayan River.

Overall Outlook for U.S. Investment

Drawing from the opportunities highlighted above, we see three broad avenues for U.S. companies to succeed in East Kalimantan:

1. Working with construction contractors to provide U.S. equipment for infrastructure projects.
2. As easily-accessible sources of coal and oil are exhausted, leveraging U.S. expertise in coal and oil extraction to improve access to, or yields from, more difficult-to-reach locations.
3. Providing U.S. technology – particularly in low-energy, high-efficiency, or otherwise environmentally friendly applications – to local energy, infrastructure, and industrial projects.

5. Proposed Masterplan Projects for East Kalimantan

Type of Infrastructure	Project Name	Investment (IDR Tn)	Start Date	Finish Date	Name of SOE
Airport	Acceleration of new Samarinda Airport	1,200	2011	2015	
Airport	Balikpapan International Airport expansion (development of loading terminal Kariangau)	713	2008	2012	
Other	Development of Balang bentang Island bridge (1,314 m)	3,600	2013	2015	
Other	Pulau Balang Bentang Bridge Construction (470 km)	488	2008	2011	
Port	Capacity Expansion for Maloy Port	4,800	2011	2013	
Port	Temporary Working Units for construction of Penajam Pasir Port and Kariangau / Balikpapan seaport facilities	598	2015		
Port	Temporary Working Units for construction of Maloy / Sangkulirang seaport	357	2015		
Port	Sei Nyamuk Port Authority	192	2015		
Port	Tanjung Isuy Tongkang Port (90 km)	176	2015		
Port	Tanah Grogot Port	163	2015		
Port	Nunukan port Authority	152	2015		
Port	Banjarmasin loading terminal development	350	2012	2012	Pelindo
Power & Energy	Power Plant East Kalimantan - PLN	7,270	2011	2015	PLN
Power & Energy	Balikpapan Airport Power Station	1,600	2011	2014	PLN
Power & Energy	Development for electricity transmission facility at East Kalimantan - PLN	1,035	2011	2015	PLN
Power & Energy	Development for high voltage transmission network 150 KV Muara Teweh	350	2011	2013	PLN
Road	Development of Samarinda - Balikpapan Express Way	6,300	2010	2016	
Road	Road improvement Tj. Selor - Tj. Redeb - Maloy (523 km)	550	2011	2014	
Road	Road improvement Samarinda - Bontang, Sangatta-Maloy (287 km)	481	2011	2014	
Road	Road widening Samarinda - Tenggarong	400	2011	2015	
Road	Road widening to tourism area (30 km)	200	2011	2015	
Road	Road development in integrated tourism area (Destination development: Pulau	150	2011	2015	
Water Utility	Wain Dam Development	290	2015		

6. Challenges

Power – multiple sources cite power generation as a key issue inhibiting further development in East Kalimantan. Blackouts are a regular occurrence, and all major companies have generator facilities onsite. Power capacity is currently supplied primarily by coal-fired power plants, but the highest-quality locally-produced coal is shipped to export markets.

Infrastructure – road, rail, and port facilities, particularly for moving crops and other commodities, are not sufficient to support substantial further development.

Financing – available financing for major infrastructure projects is limited. In many cases, the local government has started 1/4 of each project and looks to the private sector to supply the remaining 3/4. Ownership is then mixed and complicated, but companies can operate and collect fees.

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APPENDIX 2 – Key Facts

- Total area: 204,534 km² (78,971 sq mi)
- Population Density: 17 people/km² (45 people/sq mi)
- Population: 3,550,586 people (1.49 % of total Indonesian population)
- GDP Growth rate: 4.95% (2010)
- GDP Growth rate (non oil and gas): 10.79% (2010)
- Inflation rate: 6.35 % (2011)
- Unemployment rate: 10.2% (2011)
- GRP per capita: 11258 USD (2009)
- Minimum wage: 1,084,000 IDR/month
- Average wage: 2,164,341 IDR/month
- Mean years of schooling: 8.8 (2010) (Indonesian average is 7.9)
- Number of passengers through Sepinggan International Airport: 5,105,031 (2010)
- Total cargo volume through East Kalimantan ports (thousands of tons): 58063 (2010)
note: does not include LNG
- Number of broadband connections: 37,992 (2009)