WORLD BANK ACCELERATING COAL DEVELOPMENT IN INDONESIA

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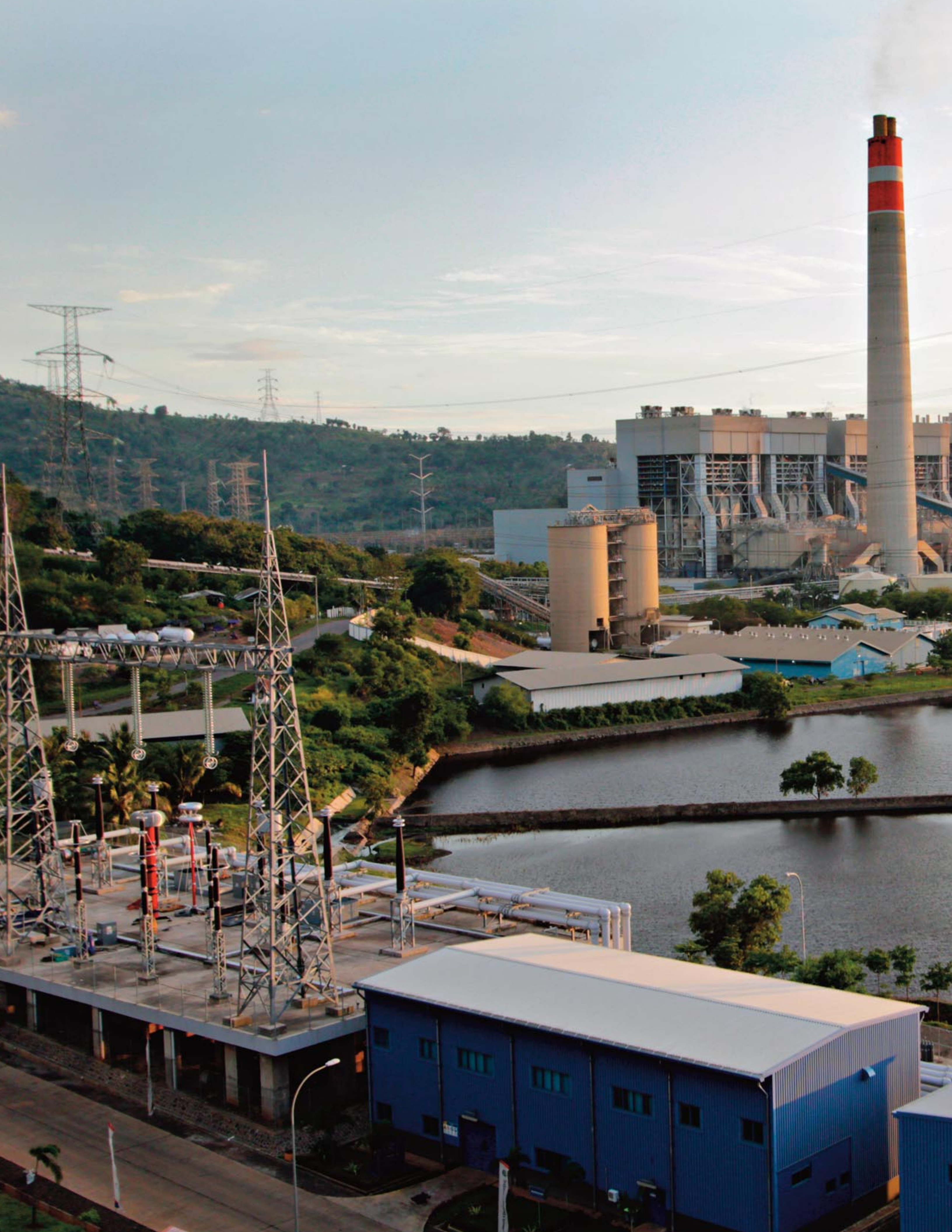


SUMMARY

In July, the World Bank Group (WBG) released its Energy Directions paper, in which the Bank pledged to limit coal lending to rare circumstances – only in countries with no feasible alternatives to coal. In order for this pledge to have any significance, the World Bank must immediately reverse its active support for massive coal developments in Indonesia. The World Bank's infrastructure program in Indonesia stipulates policies and government subsidies that promote the accelerated development of over 16 GW of coal power projects in the country ahead of developing feasible renewable alternatives.

The World Bank-created and financially backed Indonesia Infrastructure Guarantee Fund (IIGF) awarded its first government guarantee of US$33.9 million to the Central Java Power Project, a 2000 MW ultra-super critical coal plant. The Bank states that the guarantee is critical for obtaining long-term infrastructure finance. Moreover, the WBG served as the transaction advisor to this mega coal project, in which role the Bank arranged financing for the project, promoted the project to investors, and supported the project's expansion to become one of the largest coal plants in Southeast Asia.

This huge coal project has incited strong local opposition including a lawsuit and multiple protests by thousands of local residents resulting in violent clashes with project security and the military. There is still time for the World Bank to do the right thing and halt this dirty coal project as well as further WBG support of coal development more generally. On October 6, 2013, the project finance will go forward unless it is disrupted such as by the cancellation of the government guarantee.

To avoid locking Indonesia into a future of dirty, climate-destroying coal and making a mockery of its Energy Directions' pledge to limit coal financing, the World Bank must:

- **Renounce support for the Central Java Power Project and insist the Government of Indonesia cancel the guarantee extended to the project.**

- **Stipulate that the World Bank-initiated infrastructure investment tax exemptions and government-provided guarantees and financing do not apply to any fossil fuel projects.**

- **Assist the Government of Indonesia to prioritize the development of alternatives, including significant geothermal resources, ahead of fossil fuel projects.**

- **Ensure that the limit on coal financing in the Energy Directions paper is comprehensive and applies to all forms of World Bank Group support, including development policy loans, financial intermediaries, and advisory services.**

BACKGROUND

Recent global assessments suggest that the rate and magnitude of the changes in the climate system are likely to be greater than suggested even five years ago, adding ever more urgency to bring the world into a truly low-carbon development pathway. Meanwhile, many countries continue to battle the challenge of access to energy for the poor, including Indonesia, where the electrification rate is only 73 percent.[i] Yet, the World Bank Group continues to fail in both demonstrating a low-carbon development approach, and in taking the most effective approach for scaling up access to energy for the world's poorest, as demonstrated by its recent activity in Indonesia.

Coal power exacerbates climate change and is not the most effective means of addressing energy poverty.[ii] However, instead of helping Indonesia to reduce or slow down the development of coal, the World Bank Group has been at the forefront of enabling accelerated and expanded coal growth by supporting the establishment of an investment scheme and financial intermediaries that provide incentives and subsidies for coal development. Furthermore, the World Bank Group has played a central role in advancing the Central Java Power Project, one of the largest coal plants in SE Asia despite strong local opposition to the project including violent clashes between project security and protesting villagers.

Since 2006, the Government of Indonesia (GOI) has been pursuing an accelerated energy infrastructure program, called Fast Track I, targeting more than 16 GW of coal-fired power generation. In 2010, the government announced the second phase of the program, i.e., Fast Track II, to develop an additional 10 GW of electricity generation. In addition to coal generation projects, Fast Track II also includes incentives and priority projects aimed at geothermal energy.[iii] The GOI's master plan for infrastructure also involves projects for coal rail links and ports aimed at increasing Indonesia's coal exports. Indonesia is already the world's largest coal exporter overtaking Australia in 2011.[iv] Increasing Indonesian coal exports drives further coal plant expansion across Asia, specifically in India and Vietnam, which are heavily dependent on Indonesian coal.

WORLD BANK POLICY LOANS AND FINANCIAL INTERMEDIARIES IN INDONESIA PROMOTE COAL

In support of the GOI's development of infrastructure, including the energy Fast Track program, since 2007 the World Bank has provided four Infrastructure Development Policy Loans (IDPL) totaling US$850 million. A central part of the World Bank IDPLs was the conceptualization and establishment of two government facilities aimed at providing long-term financing for infrastructure projects: the Indonesia Infrastructure Guarantee Fund (IIGF) and the Indonesia Infrastructure Financing Facility (IIFF).[v,vi]

The IIGF is mandated by the Ministry of Finance (MOF) to provide guarantees for infrastructure projects under the public-private partnership (PPP) scheme. In the case of power generation, IIGF supports the GOI's Fast Track projects. IIGF government guarantees provide insurance at lower cost and longer tenor than commercial insurance.[vii] By covering almost all the risks related to infrastructure projects at lower costs, the IIGF guarantees can turn infrastructure projects that would otherwise be financially unfeasible into attractive projects for private investors and creditworthy projects to bankers.[viii]

Though the IIGF's own capital can be limited, co-guarantors and a World Bank standby facility of approximately US$480 million backstop it.[ix] In addition, the World Bank also provided a US$30 million loan to the IIGF and "a platform for ongoing engagement in the development and appraisal of PPP infrastructure operations."[x] For example, IIGF has MOU's with the World Bank and the Singapore Cooperation Enterprise (SCE) to develop the corporate governance structure and operations manual of IIGF and an MOU with the World Bank's MIGA to support IIGF in streamlining the underwriting and risk management framework.[xi]

Given that the GOI's Fast Track I power projects were predominantly coal plants, without significant changes to the Fast Track project list, it essentially dictated that WBG infrastructure assistance would further accelerate development of the coal industry. So far, the Fast Track I projects listed as "under development" include 40 coal power plants totaling 16.4 GW.[xii] In total, coal generation accounts for 94% of the Fast Track I generation capacity. Moreover, the first project to receive an IIGF guarantee in October 2011 was the huge coal-powered Central Java Power Project (or Jawa Tengah Power Plant). IIGF has also extended a guarantee to Puruk Cahu-Bangkuang Coal Railway, a US$3 billion, 385 km rail project to connect coal mines in northern Kalimantan to a port at Batanjung in southern Kalimantan.

INITIATIVES PROMOTED BY WORLD BANK GROUP SUPPORT CENTRAL JAVA COAL POWER PROJECT

The World Bank Group-supported IIGF provided a US$33.9 million guarantee for the risks related to the US$4 billion coal-fired power plant. The IIGF guarantee provides a tenor of 16 years for equity and 21 years for debt, much longer tenors than are typically provided commercially.[xiii] The Central Java Coal Power Plant is a 2,000 MW ultra-super critical power plant in Batang, Central Java. When completed, it will be one of the largest coal power plants in SE Asia. Given the mega size of the project, it was necessary for the MOF to add to the IIGF by providing an additional government guarantee.

J-Power and Itochu Corporation of Japan and Adaro Power of Indonesia won the bid for a 25-year contract to build, own, operate and transfer the new Central Java facility. The project includes the 2,000 MW power plant and transmission facilities. The consortium has secured a loan from Sumitomo Mitsui Banking Corporation and the Japan Bank for International Cooperation (JBIC) for financing of the US$4 billion plant.[xiv] The project's financial close, which stipulates that all the financial agreements are signed and all conditions for finance have been met for the transfer of funds to begin, is October 6, 2013.

WORLD BANK GROUP ACTS AS TRANSACTION ADVISOR TO CENTRAL JAVA COAL POWER PROJECT

In addition to enabling a government guarantee for the Central Java Power Project, which was key to obtaining project finance, the World Bank Group has played a central role in advancing the project as its Transaction Advisor. A grant was provided to the state power company (PLN) to pay for the International Finance Corporation's (IFC, the World Bank's private sector arm) advisory work.[xv] As a transaction advisor, IFC's work involves:[xvi]

- analyzing the project's fundamentals;
- providing financial modeling of the PPP project;
- promoting the project to investors and getting their feedback;
- preparing the PPP contract and tender procedures; and
- assisting in conducting the tender and selecting the winner.

SUMMARY OF WORLD BANK GROUP COAL MEASURES IN INDONESIA

World Bank Operation	Approval Dates	Funding* (US$ million)	Parts of Operation Relating to Coal	Coal Development Links
Infrastructure Development Policy Loans I-IV	2007 – 2010	$850	The loans put in place a Public-Private Partnership (PPP) Investment Framework that includes multiple **tax exemptions/incentives** for energy projects, including fossil fuels (e.g, power generation, transport, and mining). The loans supported the creation of the **Indonesia Infrastructure Guarantee Fund** (IIFG) and **Indonesia Infrastructure Investment Fund** (IIIF) that provides government subsidies to PPP energy projects. The loans support electricity tariff increase that reduces government subsidies to consumers.	GOI's Energy Fast Track Program (priority PPP projects) – first phase includes **16 GW of coal** (94% coal-based generation). **Central Java Coal Power Plant** (2,000 MW) is upheld as the model PPP project (see below). **IIGF guarantees** provided to coal generation and export (see below). PPP subsidies to fossil fuel projects undermines Indonesia's **G20 commitment** to phase out fossil fuel subsidies
Indonesia Infrastructure Guarantee Fund (IIGF)	September 2012	$29 / $480^	The IIGF provides government guarantees for infrastructure projects under the PPP scheme.	IIGF guarantees provided to **Central Java Coal Power Plant** ($33.9 million) and **Puruk Cahu-Bangkuang Coal Railway** for coal exports. Increasing **coal exports** drives coal plant expansion across Asia, specifically in **India** and **Vietnam**, which are dependent on Indonesian coal.
Central Java Coal Power Plant Transaction Advisor		Undisclosed off- budget amount	The IFC (World Bank's private sector arm) analyzed project fundamentals; promoted project to investors; and prepared the PPP contract.	Under WBG's advisory, Central Java grew from 800 MW to 2,000 MW, one of the largest coal plants in SE Asia.

*It is important to note that the funding amount represents the total funding for the overall operation, which involves multiple sectors and measures. It is difficult to determine what amount of this funding can be attributed to coal development. It is provided as an indication of the scale of the World Bank operation.

^World Bank stand-by facility backstopping IIGF.

NO WORLD BANK GROUP COAL CRITERIA APPLIED TO CENTRAL JAVA POWER PROJECT

All of the World Bank Group's activities surrounding the Central Java Power Project add up to as much or more involvement than is typically expended for a direct project investment by the World Bank Group. However, because the World Bank Group has approached this project through back door means, i.e., financial intermediaries and off-budget grants for technical assistance, this mega coal project did not have to meet the World Bank Group's criteria for coal lending, including full consideration of alternatives, internalizing the cost of carbon, and optimizing energy efficiency and conservation measures.[xvii] Such an approach has also resulted in less international scrutiny and transparency than is typically involved in Bank-supported coal developments.

LOCAL OPPOSITION AND VIOLENCE PLAGUE CENTRAL JAVA COAL PLANT

There is strong local opposition to the Central Java Coal Power Project by residents who insist that the power plant will harm the environment and threaten their livelihoods. For over a year, multiple protests have been held by thousands of residents opposing the project.[xviii] The project is facing a lawsuit brought by local residents against the Batang regent for making a bylaw for the project that contradicted other regulations, including ones to protect the Marine Natural Park. Residents also allege that the project has not received the necessary environmental permits to begin construction.

Controversy and reports of violence against protestors also surround the project. On July 30, local residents reported that they were beaten by project security, military and police because of their involvement in a protest of approximately 500 residents attempting to halt construction operations. Local news reports 17 residents were injured, including 15 men and 2 women.[xix] Problems related to both local opposition and land acquisition have delayed the start of the project, pushing back the start-up of the plant to end-2017.[xx]

WORLD BANK INITIATIVES EXPAND COAL IN INDONESIA

Instead of the World Bank Group helping to curtail coal production in Indonesia, the World Bank Group's infrastructure initiatives have increased direct support for and the size of coal developments. The Central Java Coal Power Project, which received an IIGF guarantee, an MOF guarantee, and IFC assistance as Transaction Advisor, was originally slated to be a 600-800 MW plant to meet Java's energy demand. By the 2006 Infrastructure Summit in Bali the government had increased the public private partnership (PPP) model project's size to 1,200 MW. In the end, the final project offered up for bid under IFC advice grew to 2,000 MW.

In November 2012, the Puruk Cahu-Bangkuang Coal Railway, which received an IIGF guarantee, announced that the scope of the project had been widened to include an additional rail link to Lupak Dalam so that three coal centers, up from the original two, would be linked into the railway. So with the help of the World Bank, the world's largest coal exporter is becoming even larger.

WORLD BANK LACKING ASSISTANCE FOR RENEWABLES

For over a decade, Indonesia has publicized the opportunity to develop its vast geothermal resources, which stand at an estimated generation capacity of 28 GW of power – representing 40 percent of the world's geothermal reserves.[xxi] The World Bank has been slow and inadequate in its support for geothermal.[xxii] Thus, Indonesia's geothermal capacity is still largely untouched with only 1.2 GW so far developed or around 4% of its potential.[xxiii]

The development of geothermal resources is essential to assisting Indonesia towards a lower carbon development path as geothermal power can directly displace coal as a base load power source. As such, the World Bank should be assisting Indonesia to ensure that all potential geothermal power projects and other renewables are developed before locking Indonesia into 16+ GW of coal power for the next 50 years. It is important to note that geothermal projects, including those backed by the World Bank, can be associated with negative outcomes such as unfair land acquisition and environmental damage (e.g. deforestation and sulfur gas emissions). Such impacts must be carefully and appropriately resolved. Further on the renewables front, there is no effort by the Bank to support solar or wind power developments in Indonesia.

WORLD BANK INCREASES FOSSIL FUEL SUBSIDIES FOR PRIVATE INVESTORS

A main thrust of the World Bank's IDPL program is the "establishment and activation of the regulatory and institutional framework for Public Private Partnership (PPP) transactions". The PPP investment framework provides a number of government incentives (aka subsidies), including: VAT tax exemptions, import duty exemptions, income tax rate reductions, accelerated rates of depreciation, land tax exemptions, building tax exemptions, land acquisition assistance, and the IIGF guarantees (as explained above). These are subsidies provided to the private investors that apply to most power projects whether fossil fuel-based or renewable.

With regard to consumer subsidies, the World Bank IDPL program has worked to reduce price subsidies with the aim of "generating additional budgetary savings and improving the financial footing of the energy sector". In Indonesia, the Public Service Obligation (PSO) is a price subsidy to consumers from the budget covering the difference between the cost of supply and the regulated tariffs for different consumer categories. In 2010, the GOI applied an electricity tariff increase, ranging from no increase for the low income users to 18 percent for the higher use categories.

Although a well-targeted reduction of price subsidies is welcome, these improvements are undermined by the increases in private investor subsidies to coal and gas projects. The anticipated increase in government revenue due to reduced price subsidies is diminished by the increase in investor subsidies. Moreover, the new government subsidies generated by the World Bank-designed PPP investment scheme undermine Indonesia's G20 commitment to phase out fossil fuel subsidies.[xxiv]

CONCLUSION AND RECOMMENDATIONS

The World Bank Group's policy lending, financial intermediaries, and advisory services in Indonesia have enabled accelerated and expanded coal growth both in Indonesia and, through coal exports, across Asia.

The Bank's infrastructure program in Indonesia supports the government's Fast Track energy projects, with a first phase comprising over 16 GW of coal or 94% of new power generation. In addition to designing an investment scheme involving numerous tax exemptions, the Bank's program set up and financially backed a government fund to provide guarantees to public-private partnerships (PPP) – guarantees critical to obtaining long-term project finance.

The first guarantee was granted to the Central Java Power Project, which when finished will be one of the largest coal plants in SE Asia. Further, the WBG took the lead in obtaining investors for the mega coal project as its Transaction Advisor. These WBG initiatives are locking Indonesia into a carbon intensive future – a future of climate destruction.

These World Bank Group climate-destroying initiatives need to stop. To avoid making a mockery of its Energy Directions' pledge to limit coal financing, the World Bank must:

- **Renounce support for the Central Java Power Project and insist the Government of Indonesia cancel the guarantees extended to this power plant and the Puruk Cahu-Bangkuang Coal Railway Project.**

- **Stipulate that the World Bank-initiated PPP investment framework tax exemptions and government-provided guarantees and financing do not apply to any fossil fuel projects.**

- **Assist the Government of Indonesia to prioritize the development of alternatives, including significant geothermal resources, ahead of fossil fuel projects.**

- **Ensure that the limit on coal financing in the Energy Directions paper is comprehensive and applies to all forms of World Bank Group support, including development policy loans, financial intermediaries, and advisory services.**

[i] Ministry of Energy and Mineral Resources, Indonesia. http://www.esdm.go.id/news-archives/electricity/46-electricity/5720-rural-electricity-increases-the-national-electrification-ratio-to-72-95-.html

[ii] Oil Change International, "Access to Energy for the Poor: The Clean Energy Option." http://priceofoil.org/content/uploads/2011/06/Access-to-Energy-for-the-

Poor-June-2011.pdf; and Oil Change International, "World Bank Group Energy Financing: Energy for the Poor?"

http://priceofoil.org/content/uploads/2010/12/EnergyforthePoor.pdf

[iii] The Fast Track programs are part of the Master Plan for the Acceleration and Expansion of Indonesia's Economic Development.

[iv] World Coal Association at http://www.worldcoal.org/resources/coal-statistics/

[v] For example, Action 6 in IDPL3: Issuance of Government Regulation establishing the Guarantee Fund, and Action 7 in IDPL4: Guarantee Fund established, including staffing of senior management and draft operating procedures.

[vi] Indonesia Infrastructure Finance (IIF) is a joint venture with the World Bank, Asian Development Bank, and German investment corporation DEG. IFC Project# 26443 PT Indonesia Infrastructure Finance Facility. $40 million equity, approved June 24, 2009. WB Project ID# P092218, Indonesia Infrastructure Finance Facility. $100 million loan, approved June 24, 2009. ADB Project ID: 42109-013: Indonesian Infrastructure Financing Facility Company Project. $100 million, approved March 31, 2009.

[vii] The length of tenor for a guarantee is the period of time for which the project is covered by the guarantee and thus, help to extend the tenors on project loans, which can be a key limitation if not long enough.

[viii] For example: delays or failure to secure licenses, changes in regulations or laws, offtake obligations for State Owned Enterprises and revenues that cannot be converted into foreign currency. The Jakarta Post, Editorial: Financing breakthrough. October 18, 2011.

[ix] OECD, 2012. OECD Reviews of Regulatory Reform - Indonesia, Private-Public Partnership Governance: Policy, Process and Structure. Organization for Economic Co-operation and Development, September 2012. http://www.oecd.org/gov/regulatory-policy/Chap%206%20PPPs.pdf

[x] Indonesia Infrastructure Guarantee Fund, Project ID# P118916, approved: September 2012. Qualifying projects will be those which are apprised by the WB and meet WB policies. In order to prevent the mingling of WB funding with IIGF capital, the WB loan proceeds will be disbursed at the time a claim is made and assessed as payable by IIGF for a WB-Supported IIGF-project.

[xi] MIGA is the World Bank's Multilateral Investment Guarantee Agency.

[xii] There are also 2 geothermal projects totaling 440 MW (both received IIGF guarantees) and 2 gas projects totaling 560 MW. PricewaterhouseCooper, 2011. Electricity in Indonesia: Investment and Taxation Guide 2011.

[xiii] Indonesia Infrastructure Guarantee Fund, 2012. The role of IIGF for PPP projects development in Indonesia. A presentation at PPP Days, Geneva, February 2012.

[xiv] Financing comprises of 20-30% equity of which 60% will be provided by Japanese investors, and 70-80% debt, including foreign investment. http://www.indii.co.id/news_daily_detail.php?id=4976

[xv] The grant is from Devco (Infrastructure Development Collaboration Partnership Fund), a multi-donor program affiliated with the Private Infrastructure Development Group funded by the United Kingdom's Department for International Development, the Dutch Ministry of Foreign Affairs, the Swedish International Development Agency, and the Austrian Development Agency.

[xvi] IFC, 2010. IFC Advisory Service in Public-Private Partnerships: Lessons from Our Work in Infrastructure, Health, and Education. International Finance Corporation, World Bank Group, 2010.

[xvii] The World Bank Group's *Strategic Framework for Development and Climate Change (SFDCC)* sets out six specific criteria that must be met before the World Bank can provide support for coal power projects.

[xviii] *Jakarta Post*, 2013. Thousands oppose steam power plant establishment in Batang. September 3, 2012.

http://www.thejakartapost.com/news/2012/09/03/thousands-oppose-steam-power-plant-establishment-batang.html-0

[xix] *Mongabay Indonesia*, 2013. Villagers clash with officials while rejecting power plant project drilling. July 30, 2013. http://www.mongabay.co.id/2013/07/31/warga-desa-bentrok-dengan-aparat-menolak-pengeboran-proyek-pltu-batang/

[xx] *Jakarta Post*, 2013. Protracted impediments hold back power plant expansions, April 23, 2013. http://www.thejakartapost.com/news/2013/04/23/protracted-impediments-hold-back-power-plant-expansions.html

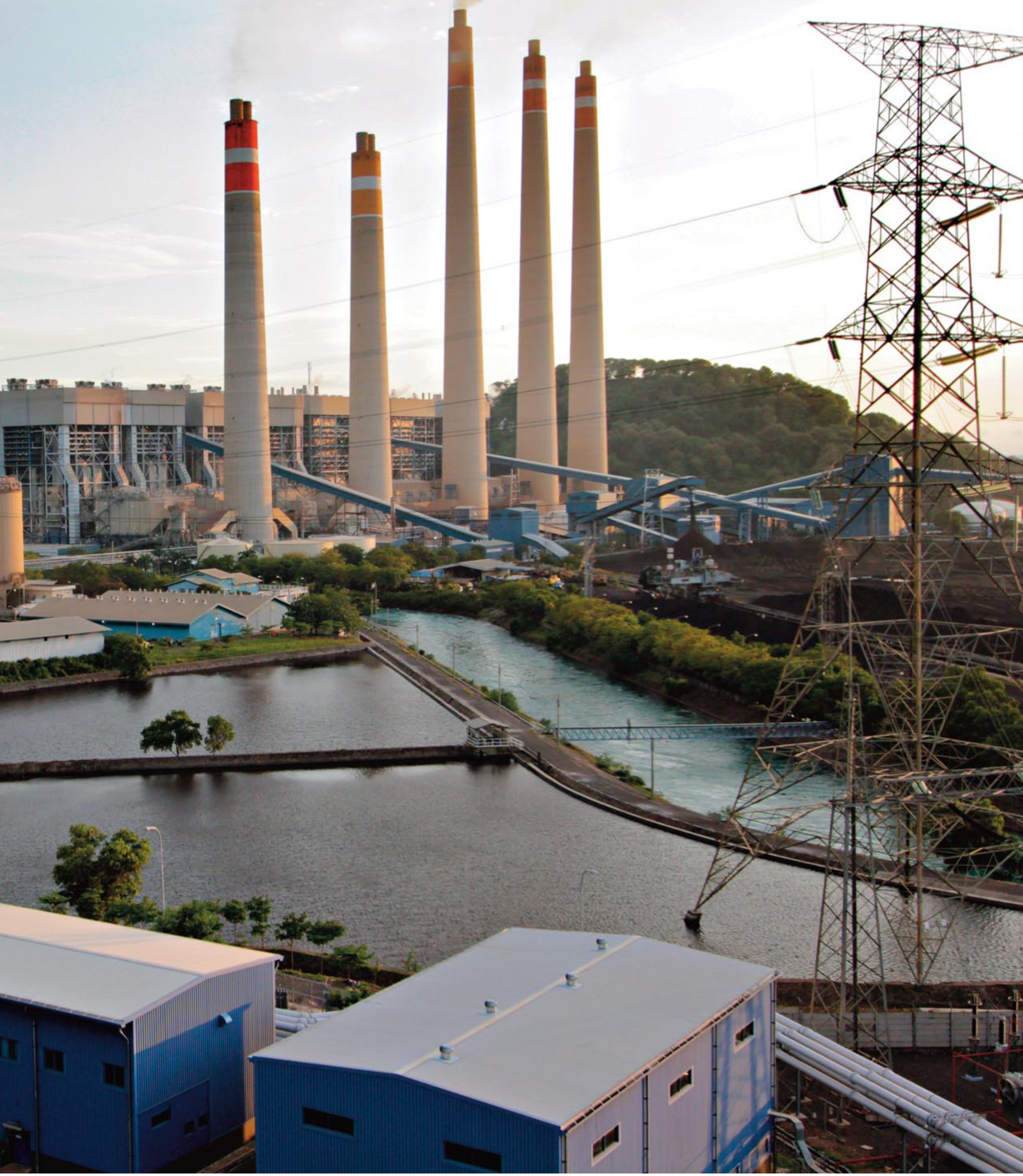
[xxi] PricewaterhouseCooper, 2011. Electricity in Indonesia: Investment and Taxation Guide 2011. Note: Approximately, 13 GW of this estimation are still considered to be speculative. Also, see http://awsassets.wwf.or.id/downloads/geothermal_report.pdf

[xxii] Geothermal is a special focus of Indonesia's US$400 million Clean Technology Fund co-financed by the World Bank and Asian Development Bank.

[xxiii] Eddy Satriya, "MP3EI: The Way We Are," Presentation at German and Indonesian Business Forum. February 11, 2012. http://www.scribd.com/doc/124882053/Presentation-on-German-and-Indonesia-Business-Forum-at-Bappenas-Jakarta-11-February-2012

[xxiv] G20 Leaders Statement The Pittsburgh Summit 2009, para 29; available at http://www.g20.utoronto.ca/2009/2009communique0925.html

COAL POWER EXACERBATES CLIMATE CHANGE AND IS NOT THE MOST EFFECTIVE MEANS OF ADDRESSING ENERGY POVERTY.



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