The Role of Municipal Bond in Regional development

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The decision of DKI Jakarta Government's to issue bonds worth of IDR 1.7 trillion could become a major breakthrough for bond market in Indonesia. This issuance has been long waited by investors in the midst of improving Indonesian economy conditions. The issuance can be a trigger for other regional governments to follow suit. Newly upgraded Indonesia's credit rating to "*investment grade*" by two well-known international rating agencies, Fitch and Moody's, will open up opportunities as more funds from both foreigner and domestic are expected to over flow Indonesia. Current economic condition should be best utilized by the Government to attract more funds for national or regional development. The magnitude of the fund needed for regional development will require local governments to be more creative in exploring new funding sources. Municipal bonds can be an alternative financing for regional development as mandated by the Government Regulation No. 30 of 2011.

Although there is no official figure on how much real fund is needed for infrastructure development for all Indonesia regions, the need for infrastructure funding is clearly enormous. In 2012, Central Government had allocated IDR 7.7 trillion for regional infrastructure development. This fund has function as supplementary funds for regional governments in building their local infrastructure. Infrastructures in Indonesia's regions are still under developed due to financial shortage. Data from the Ministry of Public Works (PU) states that funding gap for infrastructure development in the year of 2012 is estimated to reach IDR 80.48 trillion. This gap shows that the availability of fund is far from sufficient to finance infrastructure development.
Extraordinary amounts needed to finance the infrastructure not only belong to Indonesia, but also belong to other developing countries in Asia. ADB (Asian Development Bank) has estimated that the funding needs of infrastructure development in Asia will reach U.S. $ 80 trillion.

Infrastructure Funding Gap

Financial Year	2012	2013	2014
Funding Gap [IDR Trillion]	80.84	77.95	63

Source : Ministry of Public Service

To overcome this funding deficiency, both central and regional government can actually encourage public to participate in the development through the ownership of the municipal bond. Municipal bond is a debenture issued by the local or regional governments that guarantee payment of interest and principal to the holders of such bonds. This could be a perfect timing for investors and local governments to issue municipal bonds. Municipal bonds provide an opportunity for the public to participate more actively in development. Public participation in local government projects by owning municipal bonds at the same time will require local government to be more careful in the implementation of the project and in financial management. For municipal bond to be more effective, local government must ensure that the result from the bond issuance should be used to finance the projects having positive impact and benefit for public as well as local economy.

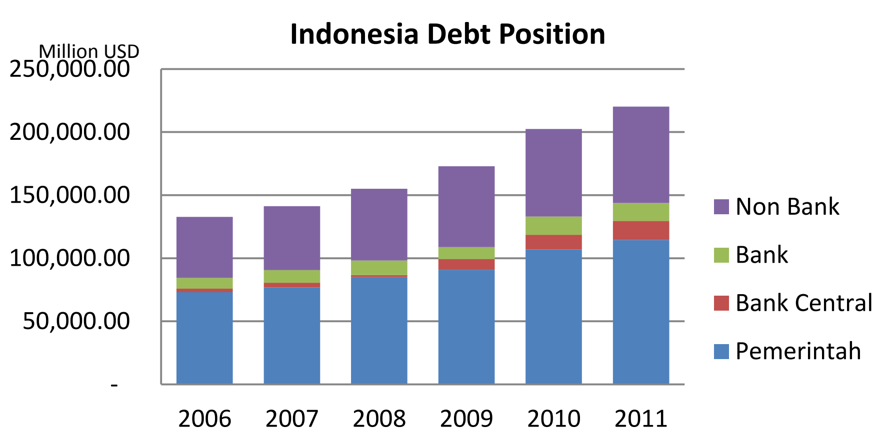
The word "debt" is still a trauma for the people of Indonesia, the economic crises plaguing Indonesia in the year of 1997/1998 had collapsed Indonesia's economy due to high debt proportion to GDP. During that year, banking industry in Indonesia was not in healthy condition, and total government debt to GDP reached 78%, mostly foreigner borrowing. Our debt position, however, is quite different this time, banking industry is in good condition and the latest data in 2011 on the Indonesian government debt, although nominally increasing, percentage of debt to GDP was about 24.5%. This ratio is quite low when compared to some other countries as depicted in the table below.
For sub national level, regional governments are not allowed to have direct loan agreement from foreign countries; the process should go through central government, in this case Ministry of Finance. Total regional governments debt to central government itself actually has a fairly low. Data from the Ministry of

Finance shows that local government debt to the central government until 2011, only about IDR 1.5 trillion, or about 0.09% of national GDP.

Economic Growth and Government Debt Bonds

Countries	GDP Growth [%]		Oustanding Bond Value (OBV) [US$ Billion]	% OBV of GDP	% Govt Debt to GDP in 2011
	2010	2011f			
Japan	4	(-1) - (0.5)	11.991	203%	208.3
China	10.3	8.8 - 9.3	3190	45%	16.3
Korea	6.2	3.5 - 4.0	1273	114%	22.9
Malaysia	7.2	4.2 - 4.7	269	102%	57.9
Thailand	7.8	2.6 - 3.1	222	63%	45.6
Singapore	14.5	4.3 - 4.8	204	87%	96.3
Hong Kong	7	4.3 - 4.8	167	68%	10.1
Indonesia	6.1	6.1 - 6.6	118	14%	24.5
Philippines	7.6	4.1 - 4.6	75	32%	49.4
Vietnam	6.8	5.6 - 6.1	17	14%	54.5

Source : Standard and Poor's Market Outlook 2012



Sumber : Data BI

Risk and Rating of Municipal Bond

In bond issuance, whether the bonds issued by corporations or bonds to be issued by local governments, there are always risk factors that need to be considered. For investors, investing their funds in bonds is investment options with the expectation that their investment will produce high yields that are correspond to the level of risk. The risk is essentially the result of an investment decision. The risk is not always be the main consideration of the investors but also of the issuers. If not managed properly, the bonds will be a burden for the local government.
According to the current regulations (PP No. 30/2011), local government is only allowed to issue municipal bonds if the proceed of the issuance is intended to finance projects producing revenue for the regional government. With this provision, before the local government plans to issue bonds, the government previously had to be careful in selecting which projects that not only generates revenue but also benefits for the public. Utilizing municipal bonds to finance infrastructure projects is a suitable option to accelerate regional development when locally generated revenue or central government development fund are also lacking. Some of the concerns that municipal bonds can trigger uncontrollable growth of

regional debt are clearly understandable. This doubt on municipal bond should be taken very seriously by both local and central government so that they can be more prudent in determining which projects will be financed by bonds. In addition, local governments should be able to improve the ability of financial and debt management areas, by enhancing the ability of public employees in the field of finance.

Although Indonesia municipal bonds is not required to be rated, Investors generally utilize the results of rating agencies when calculating the risks of investing in a bond. To anticipate the risks of an investment in bonds, investors will rely on the credit ratings of the bonds. Rating agencies conduct independent analysis to provide ratings for entities or bonds to be issued by an entity. This rating gives investor an overview of the capabilities of an entity in fulfilling its obligations which is paying principal and interest in full and in a timely manner.
Indonesia Credit Rating Agency (PT PEFINDO) provides credit ratings service by evaluating regional government's credit profile and financial management. The rating output of PEFINDO's is in the range from very worthy investment or investment grade ($_{id}$AAA) to default ($_{id}$D). Investment grade rating gives the sense that the entity is able to fulfill the obligation to pay principal and interest on the bonds in full and in timely manner, meanwhile the default rating gives the sense that the entity is expected to be experiencing a failure to pay in full amount or in timely manner. Lack of capacity of regional governments to properly manage its financial is still an obstacle faced by local governments in Indonesia. Still less than 10% of regional government's financial statements in Indonesia earned Qualified Opinion from State Audit Agency (BPK/*Badan Pemeriksa Keuangan*). Another important element that determines regional government's credit rating is the institutional framework or public finance system prevailing in Indonesia at this time. Public finance system is mostly concerned with the policy and financial relations between central and regional government such as balance in revenue and expenditure, and central government support for the regional government.