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The Nusantara Project in Progress: Risks and Challenges

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This picture taken on 11 July 2024 shows an aerial view of Indonesia's future Presidential Palace at the future Capital City of Nusantara in Penajam Paser Utara, East Kalimantan. The new city is scheduled to begin operating as the country's new political centre on August 17, Indonesia's independence day. (Photo by AFP).

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EXECUTIVE SUMMARY

- The construction of Indonesia's new administrative capital, Nusantara (IKN), has been slow due to various factors, including poor weather conditions and uncertainties over the priorities of the Prabowo government. Phase I of the project – covering the development of basic infrastructure, the Presidential Palace complex, key ministerial buildings and residences for civil servants, has fallen behind schedule, thus forcing President Joko Widodo to postpone his plan to move to IKN.
- Notwithstanding written pledges by international investors in the IKN project, there has not been much realisation on the ground. Most of the ongoing investment still rely on the State's budget and on local players. The resignations of the Head of IKN Authority and his deputy have aggravated the sense of uncertainty over the future of the project.
- It will be very challenging to overcome the vicious circle of inter-connected problems – investors are wary of low demand arising from insufficient population density, which is unlikely to improve quickly unless there is a steady build-up of facilities and connectivities with other urban centres, which in turn requires faster injection of investment funds.
- It is important for the government to avoid rushing the IKN project. Relocation of state personnel without good preparation will have an adverse impact on their performance. It also needs to carefully consider the financial and non-financial implications of various incentives given to investors and civil servants.

INTRODUCTION

Ever since this project was mandated in the National Medium-term Plan (RPJMN) 2020-2024, the Indonesian government has pledged to develop the new capital Nusantara (IKN) in East Kalimantan province. The commitment was also given by Prabowo Subianto during his campaign and after he secured the 2024 presidential election. The IKN or Nusantara project is thus seen as Indonesia's long-term strategy to reduce geographical and economic imbalances in the archipelago.

Kalimantan is an island rich in natural resources (mining, oil and plantations) but has the lowest population density, and shares land borders with Malaysia and Brunei in the north. One of the reasons for locating the new capital there is that it is less prone to volcanic activity and earthquakes compared to Indonesia's other main islands. It is also expected to become a future growth centre outside crowded Java, which could help promote more equitable economic development across Indonesia.¹

Despite all the good reasons stated by the government, many stakeholders are unsure about the future of the project. The resignation of the Head of Nusantara Capital City Authority (OIKN), Bambang Susantono and his deputy, Dhony Rahajoe has fueled uncertainty particularly among foreign investors, with some wondering if there could be potential disruptions to the construction phases.² Moreover, Jokowi's recent decision to postpone his move to IKN due to a lack of utilities infrastructure to supply clean water and electricity signals that it is not reasonable to expect the completion of IKN to be on time.³

This paper provides an update on the IKN project and examines the progress of key developments in the core areas, highlighting the challenges faced during the construction stages. This paper will also elaborate on the potential risks going forward, especially in light of the IKN senior executives' resignations.

CURRENT PROGRESS OF NUSANTARA

According to the Presidential Regulation (Perpres) No. 63 of 2022 on the IKN Master Plan, the Nusantara development consists of five stages, starting in 2022 and ending in 2045.⁴ Phase I (2022-2024) focuses on the basic infrastructure while Phase II (2025-2029) will deal with infrastructure development in the core government area. Phase III (2030-2034) will work on IKN development beyond the government area and promote economic clusters while anticipating population growth in these regions. Phase IV (2035-2039) will support the development of infrastructure and ecosystems for three cities, i.e., Nusantara, Balikpapan and Samarinda, to accelerate Kalimantan's overall development. The last stage, Phase V, which is targeted to be completed within the 2040-2045 period, focuses on turning IKN into an internationally competitive city.

The Ministry of Public Works and Housing (PUPR) has been under immense pressure to accelerate the development of the Presidential Palace Area, which is part of Phase I key deliverables. The Presidential Palace Area located in the Central Core Government Area (KIPP) (see Figure 1) consists of the presidential palace, presidential office, ceremonial field,

presidential secretariat office and state secretariat office. As of June 2024, the physical development of the presidential office and the state palace had reached 90 and 80 per cent, respectively.⁵

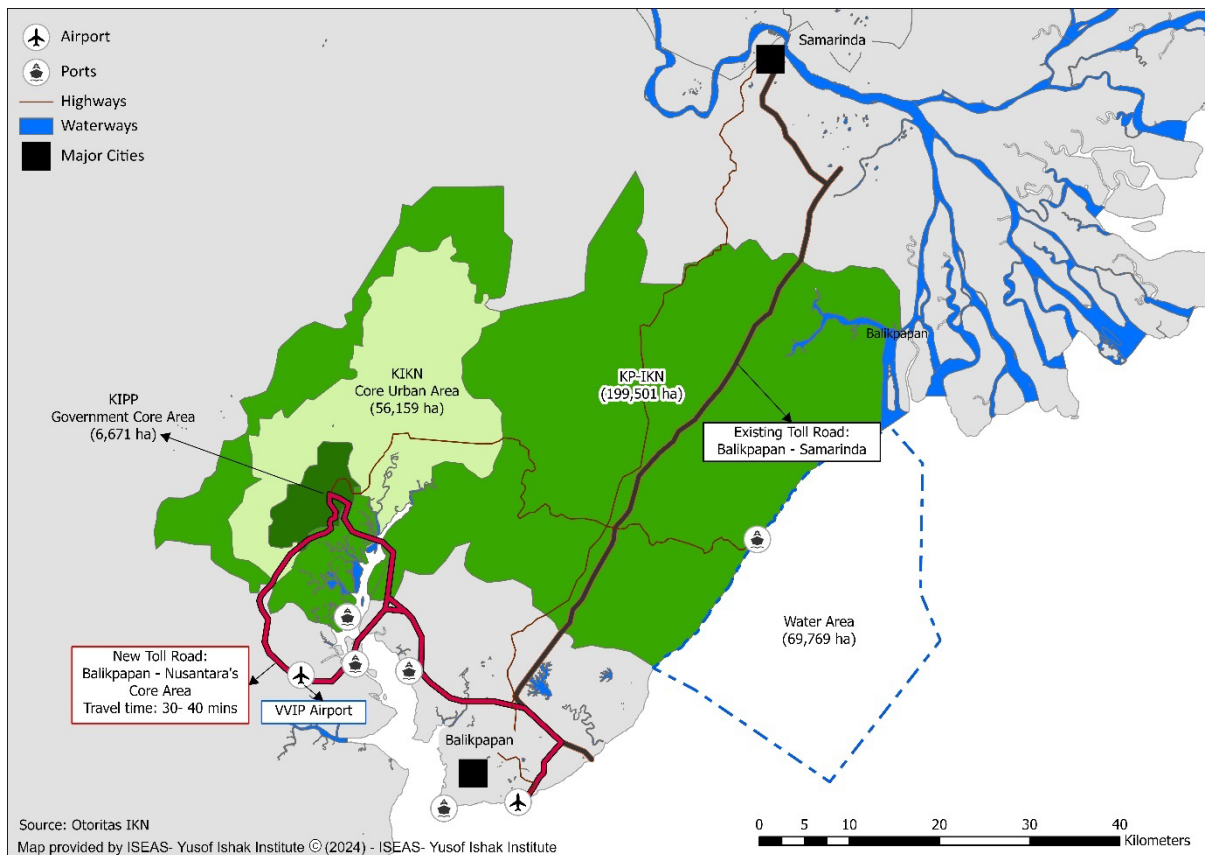


Figure 1: IKN map (Source: Otoritas IKN)

Phase I also includes the construction of flats for civil servants (ASN), military and police (TNI/Polri), intelligence (BIN), and the President’s security force (Paspampres). According to the Public Works and Housing Ministry, the progress of ministerial houses in IKN had reached 80 per cent as of April 16, 2024.⁶ As many as 12 of a total of 47 apartment towers designed for civil servants were to be completed by July 2024,⁷ to accommodate officers attending the 79th Independence Day Ceremony scheduled to be held in the IKN’s core area on August 17, 2024. Phase I development also includes the construction of utilities infrastructure such as pipes for distributing drinking water, cables for electricity distribution, as well as waste management systems for the city. As of July, the total investment in IKN had reached Rp 83.4 trillion (US\$62 billion), which is about 15 per cent of the estimated total investment needed.⁸

President Jokowi has also instructed the Ministry of Public Works to expedite the construction of the new airport and Balikpapan-IKN toll road (Figure 2). These two projects are deemed crucial for opening up access to the location, making them key factors in attracting investment into IKN.

Work is currently underway in three sections of the new Toll Road: Section 3A from Karangjoang to KKT Kariangau (13.4 km) is about 48 per cent completed; Section 3B from

KKT Kariangau to Simpang Tempadung (7.3 km), is around 57 per cent complete; and the 6.7 km section from Simpang Tempadung to Balang Island Bridge has reached about 67 per cent completion⁹ (Figure 2). The remaining sections are in their initial stages, either at the land acquisition or construction phases. Once completed, this new toll road will reduce travel time from Balikpapan to IKN Nusantara from two hours to 30-40 minutes by car. Based on the masterplan, Phase 1 of the Balikpapan-IKN Nusantara toll road is targeted to be completed by July 2024.

The construction of the IKN Nusantara airport, on the other hand, is to be completed by early August this year.¹⁰ The later deadline is intended to ensure that the airport is fully functional before the Anniversary ceremony so that VIP guests can fly directly from Jakarta to Nusantara. However, the current development of this airport is only around 50%, with heavy rainfall being the main reason for delaying the construction.¹¹ Despite that, Transportation Minister Budi Karya Sumadi said that the construction is still going according to plan, and will be ready for a trial run in July 2024.

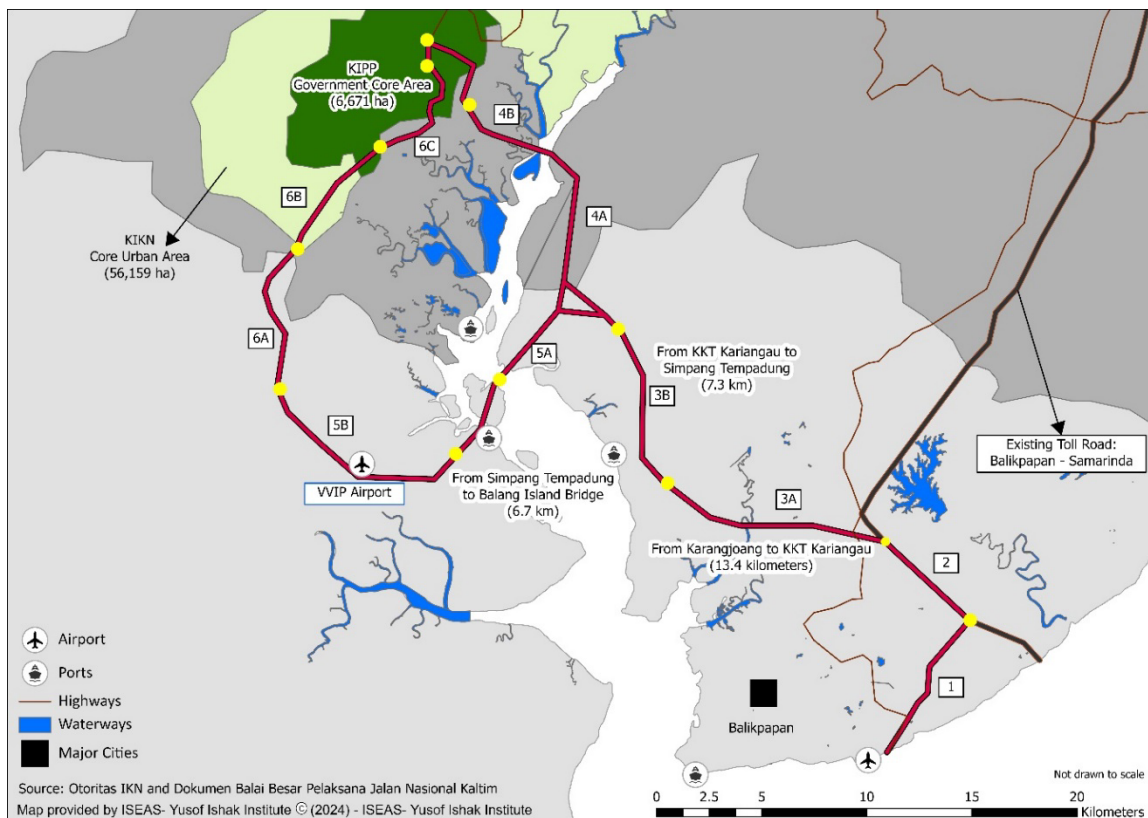


Figure 2: Balikpapan-IKN Nusantara toll road project
(Sources: Adapted from OIKN and Dokumen Balai Besar Pelaksana Jalan Nasional Kaltim)

CHALLENGES FOR NUSANTARA

Are Investors Really Coming?

In general, Nusantara has generated great interest ever since it was stipulated as a national priority programme by President Jokowi. Interest surged further following the official release

of election results confirming Prabowo Subianto as the country's next president. The IKN Authority has since received 369 letters of intent (LoI) from interested investors, with most of the foreign investment pledges originating from Singapore.¹² Apart from that, more than 130 government officials and businessmen from Singapore visited Nusantara in May last year. Delegations from countries like Kazakhstan, Malaysia and Finland have also visited the site, indicating international interest in Nusantara.

There has however not been much realisation of foreign investments on the ground. In fact, there is limited information about foreign companies that have gone beyond the written pledges and conducted groundwork onsite. As of 2024, only two Singapore investors, State Power Investment Corporation (SPIC) and JOE Green Pte Ltd have signed a non-disclosure agreement (NDA) with Nusantara National Capital Authority (OIKN).¹³ These two companies are mainly involved in renewable energy as well as waste management projects in Nusantara.

Most investors are arguably still waiting to see what will happen to IKN under the new government. Interested companies would naturally carry out careful calculations regarding business investment viability in IKN. Moreover, the resignation of the former head of IKN Authority (OKIN), Bambang Susantono and his deputy, Dhony Rahajoe, has brought significant uncertainty to the project. Rumours of his resignation being linked to unattainable goals set by the outgoing President Jokowi sparked questions over the feasibility of the project goals.¹⁴ Investors could potentially be more hesitant to invest in the new capital given its current volatile state.

Another reason why attracting investors to IKN has been difficult is the fact that the current population size is too small to create greater commercial opportunities. Based on 2020 population census data, the population of the IKN region (Penajam Paser Utara district plus Kutai Kartanegara district) is under a million people.¹⁵ Even if the government's plan to move around 200,000 civil servants to IKN is successful, the population size in the region will remain too small to entice investors. The potential demand for goods or services will be relatively low compared to other provinces in Java.

Developing IKN as a full-fledged township, which connects to Balikpapan as a supporting city, may arguably augment the investment ecosystem. However, this requires good connectivity between IKN and Balikpapan. Currently, the prospect of such a solution is relatively low. In July 2024, President Jokowi passed Presidential Regulation (Perpres) No. 75 of 2024 concerning the acceleration of IKN development. The new regulation offers more incentives to potential investors in IKN, including granting up to 190 years of cultivation rights (HGU) and up to 160 years of building use rights (HGB).¹⁶ This new regulation is the latest addition to the existing incentive offers for potential IKN investors (Table 1).

These incentives would arguably make investing in Nusantara more attractive, yet many have criticised the policy as a desperate act by the President to lure investors, without considering the long-term implications for people living around Nusantara. Whichever the case, chances are that foreign investors will continue to wait, to see how the new administration chooses to relate to this megaproject.

Land	Up to 190 years (in two cycles of 95 years each) of land cultivation permits (HGU) and up to 160 years (in two cycles of 80 years each) of building use permit (HGB)
Fiscal/tax exemption	<ul style="list-style-type: none"> • Tax holidays of up to 30 years for companies operating in priority sector • 10-year full tax exemption for global companies moving their regional hubs to Nusantara • Up to 100% tax exemption for investment in priority sectors • Up to 100% tax exemption to financial service companies • Income tax exemption for Nusantara-based company employees • Value-added tax and import duties exemptions for priority items
Tax deduction	<ul style="list-style-type: none"> • Income tax deductible for investors conducting selected R&D activities • 0% corporate income tax rate for MSMEs in selected business activities

Table 1: Incentives Schemes in Nusantara

(Source: Government Regulation No. 12/2023 and Presidential Regulations No 75/2024)

Despite all the incentives for private-sector investors, IKN development may still have to rely on the state budget moving forward. Based on data from the Ministry of Finance, the IKN budget allocation in the 2022-2024 state budget reached Rp75.5 trillion (US\$ 4.6 billion), or about 14 per cent of the total estimated cost of the project, which is Rp 541 trillion (US\$ 35 billion).¹⁷ In 2024, the state budget allocation for IKN is around Rp39.6 trillion (Figure 2). However, as of May, the realisation of the IKN budget only reached Rp5.5 trillion, or 13.9 per cent of the total budget ceiling.¹⁸ In that sense, the investment rate into this project has been relatively slow, amid the many investors’ pledges reported by the government.¹⁹

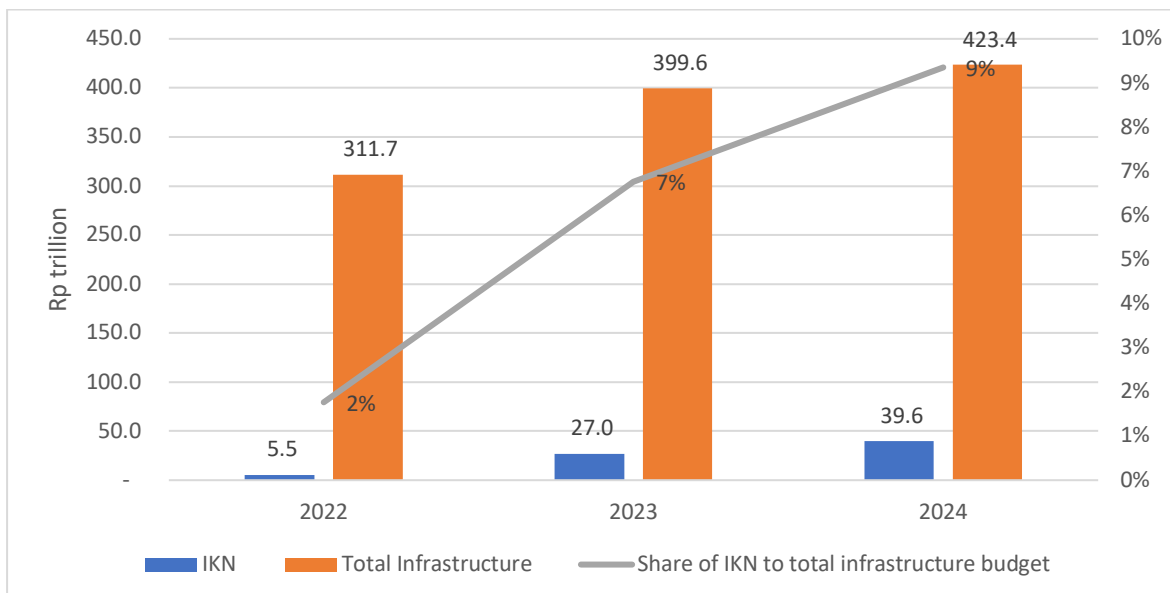


Figure 3: Spending on IKN vs infrastructure (Rp trillion)

(Source: Ministry of Finance, various sources)

Civil Servants Relocation

Moving a large population of civil servants or ASNs from Jakarta to IKN will be a big challenge. The Minister for State Apparatus Utilization and Bureaucratic Reform is tasked to set up the plan and timeline for government officials to move to IKN, including the sequence order for relocating the various government agencies. As of now, the Ministry of Public Works and Housing will be the first ministry to move into Nusantara in July 2024, followed by the Office of the President of Indonesia.²⁰ A total of 11,916 ASN will be transferred as the first priority group, followed by the second and third priority group consisting of 6,774 people, and 14,237 people respectively.²¹ The first group of ASN will move by September this year. However, due to the lack of available apartments, only 6,000 ASNs will be transferred in phase one of the first priority groups. This number is likely to change following progress onsite. The targeted aim is to have at least 12,000 employees from 38 ministries/ agencies relocate to Nusantara by the end of December 2024.²²

Enforcing the move has also been difficult, given that many ASNs have expressed reluctance to move to Nusantara. The government has offered several incentives, including early career promotion, free housing facilities, spousal allowances and living allowances for pioneer ASNs. Even with these incentives, many ASNs have cited concerns over the move, with reasons such as family separation, lack of quality education for their children, and high opportunity costs for relocation. Many are unsure if working in IKN will improve their life compared to working in Jakarta. Moreover, ASNs are not the only ones unwilling to move to IKN. Parliament members have also signalled their reluctance. Not too long ago, a parliament member proposed to the government to grant Jakarta as the legislative capital of Indonesia.²³ This was seen as an attempt to keep some state institutions within Jakarta instead of moving them to Nusantara. Even though this proposal was eventually rejected by the Ministry of Home Affairs, it is a clear indication that there is still a huge reluctance regarding the move to Nusantara.

NUSANTARA UNDER THE NEW ADMINISTRATION

The future of Nusantara will depend on President-elect Prabowo Subianto's seriousness in convincing both public and private investors that his administration remains committed to this project. This is a key issue to watch in the months after his inauguration, i.e., whether he will sign the necessary Presidential Decree to move the administration from Jakarta to IKN. As of now, Prabowo has pledged to continue the policies of the Jokowi administration, including the IKN project. According to Member of the Expert Council of the Prabowo-Gibran National Campaign Team, Drajad Wibowo, Prabowo has in fact expressed hopes to complete the IKN project as quickly as possible.²⁴ Going forward, the new administration will most likely continue to source for alternative ways to increase investments for Nusantara, especially since the state budget will not be enough to support IKN's overall development.

That being said, there are still some risks for the IKN project being delayed under the new administration. Formal legalisation of the project makes it difficult for the new administration to completely remove it from Indonesia's long-term development plans.²⁵ President-elect Prabowo is thus required by law to continue with this project's development. But how it proceeds from here onwards depends on his political will to allocate resources and funding to IKN; after all, he has his own signature projects, such as the free school lunch programme,

which, if implemented on a full scale, can cost around US\$25-27 billion per year.²⁶ Given tight fiscal space, Prabowo will most likely become more pragmatic in his governance, maintaining a careful balance between his development strategies and populist ideas. He may eventually have to choose which programme to prioritise.

CONCLUSION

Despite the slow progress, the IKN project is expected to continue in the upcoming years, driven mainly by the state's investment. It will remain a key priority project in Indonesia's long-term development. That being said, its completion depends on the political commitment of subsequent presidents. President-elect Prabowo, being the next president, will potentially set the pace and directions on how this project would proceed.

Given the current situation, the government should avoid rushing the project, particularly the relocation of civil servants. It should take into account budget limitations and the reluctance of civil servants to move. Understandably, moving to a remote isolated area with limited basic infrastructure is not desirable for people used to living in Jakarta. It is critical to ensure all public facilities are ready before starting the relocation plan.

The government should also consider moving the ministries/agencies in several stages. It may start with ministries in charge of politics, law and security as well as the natural resource ministries (Maritime, Mining and Energy, Forestry and Environment, Agriculture and Plantations) and let them settle in before moving the other ministries. Finally, the government should focus on establishing good transport linkages between Balikpapan and IKN, including a local railway line. This is critical for ensuring the population of IKN has access to Balikpapan's better infrastructure and amenities, such as schools, hospitals and markets. People would thus be more assured to move to Nusantara, knowing that they have access to necessary amenities in order to live 'normally' in the new capital. In the long run, it will increase the attractiveness of the place for the incoming population moving to live in Nusantara.

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