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**MEMORANDUM OF THE PRESIDENT**  
**OF THE**  
**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**  
**THE INTERNATIONAL DEVELOPMENT ASSOCIATION**  
**AND THE**  
**INTERNATIONAL FINANCE CORPORATION**  
**TO THE**  
**EXECUTIVE DIRECTORS**  
**ON A**  
**COUNTRY ASSISTANCE STRATEGY**  
**OF THE WORLD BANK GROUP**  
**FOR**  
**INDONESIA**

**January 4, 2001**

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The last Country Assistance Strategy for Indonesia was discussed on July 7, 1997 (R97-152[IFC/R97-53]).

### CURRENCY EQUIVALENTS

Currency unit: Rupiah (Rp) as of December 1, 2000  
\$1 = Rp 9,420

### FISCAL YEAR

Until March 31, 2000: April 1 to March 31  
Until December 31, 2000: April 1 to December 31  
From January 1, 2001: January 1 to December 31

### ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Activities	IDA	International Development Association
ADB	Asian Development Bank	IFC	International Finance Corporation
APL	Adaptable Program Loan	IMF	International Monetary Fund
BPS	Central Bureau of Statistics	JBIC	Japan Bank for International Cooperation
CAS	Country Assistance Strategy	JITF	Jakarta Initiative Task Force
CGI	Consultative Group for Indonesia	LOI	Letter of Intent
CFAA	Country Financial Accountability Assessment	MIGA	Multilateral Investment Guarantee Agency
CPAR	Country Procurement Assessment Report	MPR	People's Consultative Assembly
CPPR	Country Portfolio Performance Review	NGO	Non-governmental Organization
CSO	Civil Society Organization	OCS	Operational Core Services
DFID	Department for International Development (United Kingdom)	OED	Operations Evaluation Department
EU	European Union	PROPENAS	GOI five-year plan—FY2001-05
FDI	Foreign Direct Investment	PRSP	Poverty Reduction Strategy Paper
FY	Fiscal Year	SME	Small- and Medium-size Enterprise
GDP	Gross Domestic Product	SOE	State-Owned Enterprise
GEF	Global Environment Facility	SSNAL	Social Safety Net Adjustment Loan
GOI	Government of Indonesia	UNHCR	United Nations High Commission for Refugees
GTZ	Gesellschaft Für Technische Zusammenarbeit (Germany)	USAID	United States Agency for International Development
IBRA	Indonesian Bank Restructuring Agency	WBG	World Bank Group
IBRD	International Bank for Reconstruction And Development	WHO	World Health Organization

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## EXECUTIVE SUMMARY

- i. *Indonesia is striving to emerge from a severe economic crisis, complete its transition to a democratic society, and embark on an ambitious program of decentralization.* Each one of these challenges would test any country. Together, they constitute a highly complex agenda for Indonesia. Yet, Indonesia's move to democracy and decentralization also hold its only promise of building the institutions necessary for sustainable growth and development. The future for Indonesia, therefore, holds enormous opportunities, but also immense risk. The stakes are high—not just for Indonesia but also for the international community. This mix of opportunity and risk forms the recurrent background theme to this Country Assistance Strategy for the World Bank Group.
- ii. *The new Government of President Wahid inherited an economy with deep structural flaws, weak institutions, and an entrenched bureaucracy.* Corruption is still rampant and infects the very institutions (the police and judiciary) that are supposed to tackle it. Regional unrest, growing nationalism, and political and ethnic tensions threaten national unity and continue to preoccupy the Government. Poor implementation of the far-reaching decentralization program may threaten fiscal stability and disrupt the delivery of public services. Investors remain wary of political uncertainty, the weak legal and judicial system, and uneven policy implementation.
- iii. *Yet the very process of political transition and decentralization, while creating acute uncertainties in the short term, also provides Indonesia greater hope for sustainable progress on poverty reduction in the long term.* There is now much more open debate in Indonesia over key development issues such as debt, corruption and the participation of civil society in public policy formulation. Greater transparency in politics and government is building pressure for reform. A free press keeps a watchful eye on the political process and on the courts. If properly managed, decentralization can help build local democratic institutions and give people greater control over their lives.
- iv. *The Bank Group sees Indonesia's future with excitement—and concern.* In a democratizing and decentralizing political and economic system, the opportunities for sustainable development are immense, but so are the risks and constraints. Despite the Bank's association with the past, the new Government still sees the Bank Group as an important development partner going forward—and has asked for an expanded International Development Association (IDA) program. And despite reduced lending levels, the Bank plays an influential role in key policy areas of the economic recovery program—in close association with the International Monetary Fund (IMF) and the Asian Development Bank (ADB). Many other donor agencies are committed to supporting Indonesia, and the Bank has developed close partnerships with them across a broad spectrum of development priorities.
- v. This CAS has also been informed by *public consultations* with civil society organizations. They expressed serious concern with high levels of debt and corruption. They recommended the Bank to focus on poverty reduction through “bottom-up” community development, and to involve civil society more actively in future programs. The *private sector strategy* (distributed along with the CAS) also benefited from consultations with private sector representatives. They pointed out the main weaknesses in the current investment climate in Indonesia, which are holding back recovery and job creation for the poor.

vi. *The overarching goal of the World Bank Group in Indonesia will be to support efforts to reduce poverty and vulnerability in a more democratic and decentralized environment.* The number of poor has fallen from crisis levels, but half of all Indonesians remain vulnerable to poverty. Accordingly, the Bank Group's strategy will focus on the following three broad priority areas:

- *Sustaining economic recovery and promoting broad-based growth.* In the short run, this requires macroeconomic stability and accelerated bank and corporate restructuring. In the medium term, it will involve policies and public expenditures aimed at poverty reduction, efficient private sector growth, and human capital and infrastructure development to improve competitiveness;
- *Building national institutions for accountable government,* which includes legal and judicial reforms, civil service reforms, better public financial management and procurement, effective decentralization, and close attention to sustainable management of the rapidly depleting natural resource base of the country; and
- *Delivering better public services to the poor,* which involves assistance to help define government roles and responsibilities as functions are decentralized, support for improved public service delivery by sub-national governments which have demonstrated pro-poor, pro-growth reform, as well as promoting community development and selective assistance to post-conflict areas.

vii. The “*base case*”—considered to be the most likely scenario—presumes the current “muddle-through” situation will continue, with some slippage in structural reforms, but with continued macroeconomic stability that would help sustain poverty reduction. This is not a desirable scenario, providing a fragile foundation for external support to Indonesia, and even harbors risks to the Bank's portfolio as fiduciary standards may slip in a decentralized system. At the same time, the Bank is one of Indonesia's long-term development partners and cannot disassociate itself from this fledgling democracy. The CAS base case program is expected to be robust to most downside risks, while at the same time positioning the Bank for possible upside opportunities. Minimum conditions for the base case would be maintenance of macroeconomic stability, including prudent debt management and progress on asset sales and privatization, minimum fiduciary safeguards for delivery of public services with decentralization, and establishment of organizational arrangements, scope, process, and schedule for developing a broad-based poverty reduction strategy. The key elements for fiscal years (FY) 01-03 are as follows:

- The Bank's portfolio will continue to shrink and stabilize around 50 to 55 projects by FY03. Portfolio management will focus on continued quality improvement and further strengthening of fiduciary controls. The Bank will also step up its support of government efforts to strengthen procurement and financial management, which is at risk of deterioration as public service delivery is decentralized.
- The Bank's Analytical and Advisory Activities (AAA) program will continue to emphasize advisory services, supported by a small but growing body of analytical work, and increased attention to regional issues. This will include its leading role in bank and corporate

restructuring and sectoral reforms. The balance of AAA work will shift from crisis response to longer-term development concerns over the CAS period. The Bank will continue assistance in development and implementation of Government's broad-based poverty strategy.

- A core Bank lending program of up to \$400 million a year—less than one third of pre-crisis levels (around \$1.3 billion a year during FY90-97). The average IBRD/IDA blend would be 65:35 over the CAS period. This is consistent with Indonesia's current IDA-12 allocation. IBRD exposure would be reduced from \$11.8 billion at the end of FY00 to \$10.7 billion by the end of FY03.
- The lending program will focus on projects supporting social services and basic infrastructure for the poor, working increasingly with local governments and communities in regions where the leadership supports open and accountable government, promotes growth, and adopts pro-poor policies. No adjustment lending is foreseen in the base case.

viii. The *high case* signals the Bank's willingness to provide more support if policy performance improves. If reforms accelerate, and in line with the Government's request, the CAS foresees raising lending to about \$1 billion a year from FY02. This would include a temporary increase in access to IDA resources, as discussed with the IDA Deputies in Lisbon. There could also be a small amount of adjustment lending, if needed. The program anticipates a move toward programmatic lending in support of governance and sectoral programs as capacity and fiduciary controls improve at the sub-national level. Key up-front actions include: prudent monetary, fiscal and debt management; accelerated bank and corporate restructuring and privatization; agreement on a policy framework for rice; progress on agreed actions to reform procurement and financial management systems; and initial steps on preparation of a broad-based poverty reduction strategy. Regular semiannual policy assessments will be made to determine continued eligibility for the high case and to set performance targets for the next six months.

ix. Unfortunately, there is also a significant *possibility of a crisis scenario*. A breakdown in the Government's Extended Arrangement with the IMF as a result of major policy slippage, including inadequate progress on bank and corporate restructuring, could lead to a rapid erosion of market confidence and deterioration in economic conditions. A similar outcome could result from political instability or a widespread breakdown in law and order. In such adverse situations, the Bank would cease all new lending but undertake more crisis-related AAA work. In the event of another macroeconomic shock, the Bank may be asked to contribute to an international rescue effort. But the Bank's response this time around will be limited by the Government's high debt burden and risks associated with IBRD's high exposure to Indonesia.

x. The CAS also outlines the current plans of *IFC and MIGA* in Indonesia, and how they fit into the overall Bank Group strategy. The recently prepared private sector strategy, together with joint management of Bank and IFC private sector activities, allow for considerable synergies between the Bank Group's policy and transactions work (e.g., on SMEs), while carefully managing potential conflicts of interest. Beyond the restructuring of its existing clients, IFC will focus on interventions with strong demonstration effects and positive impact on market perceptions. It will also support SME development, resource-based industries and private

participation in infrastructure. MIGA has suspended its guarantee activities in Indonesia, pending settlement of an outstanding claim by the Government.

xi. The following issues are suggested for Board discussion:

- Is the assistance program responsive to Indonesia's major development challenges?
- Is the Bank Group's response appropriate for an important partner country going through a major political and economic transition?
- Do the lending scenarios, including a relatively small, poverty-focused base case program, the proposed lending triggers and increased IDA in the high case, and a possible crisis scenario, respond well to the country conditions?
- Are the partnership arrangements and proposed AAA appropriate?
- Have the risks been appropriately identified and addressed?

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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT,  
THE INTERNATIONAL DEVELOPMENT ASSOCIATION  
AND THE INTERNATIONAL FINANCE CORPORATION  
TO THE EXECUTIVE DIRECTORS ON A  
COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP  
FOR INDONESIA**

**1. COUNTRY CONTEXT**

**POLITICAL TRANSITION**

1. **Indonesia is in the midst of a major political transition toward a democratic society.** The country held its first free and open elections since the 1950s in June 1999. Moderate Muslim leader Abdurrahman Wahid emerged as the new President from a multiparty post-election negotiation process—overtaking Megawati Sukarnoputri who became Vice-President after her party had won a plurality of seats in the legislature. Much has been achieved in the first year of the Wahid government. It has begun to restore democratic freedoms and civil rights and tackle the tough issue of the role of the military in politics. The new parliament ceded independence to East Timor in November 1999. The Government has started a dialogue with a number of regions pressing for greater autonomy. Preparations are under way for a major program of decentralization—due to go into effect in January 2001, designed to reverse the extreme centralization of government in Jakarta. Parliament is no longer a rubber stamp, there is a lively and free press, an increasingly vocal and active civil society, and a growing free trade union movement. The forthcoming regional autonomy makes local governments increasingly active, and local legislatures are starting to control their executive branches.

2. **But the transition is beset with tensions and uncertainty.** The initial governing coalition did not hold and a new more unified cabinet was announced following the annual August session of the People's Consultative Assembly (MPR). But the President has a tenuous relationship with Parliament—as reflected by two recent attempts at his impeachment—which affects Government's ability to maintain the momentum of reform. The military retains a political role, albeit a limited one, and a constitutional amendment has reduced chances of them being prosecuted for past wrongdoings. Public impatience and cynicism are being fed by inefficient law enforcement and the slow prosecution of corruption cases, stymied by an entrenched and corrupt bureaucracy, police and judiciary. The new freedoms have brought to the surface long suppressed ethnic divisions, a deterioration in law and order, and communal violence, particularly in Maluku. Secessionist movements have become increasingly active in Aceh and Irian Jaya. While greater autonomy is contemplated for these regions, tensions have mounted as local aspirations for self-rule are met by determination of the central government and military to maintain Indonesia's territorial integrity. These issues have absorbed most of the Government's energy, leaving policymakers little time for developing policy and strategy.

3. **And the far-reaching decentralization program will have major implications.** Decentralization is a strong political imperative to counter the centrifugal forces within the country. It also makes good economic sense, as Indonesia is unusually centralized for a country

of its size and diversity. But if managed badly, the transition to a decentralized Indonesia could not only derail macroeconomic stability, but also seriously affect the delivery of government services. And with implementation scheduled to start in January 2001, much needs to be worked out (see Box 1.1 for main features of the decentralization program).

### **Box 1.1: Main Features of the Decentralization Program**

**Administrative aspects:** Law 22 of 1999 devolves most functions of government to Indonesia's regions—28 provinces and over 350 districts and cities. The key exceptions are national defense, international relations, justice, police, monetary, development planning, religion, and finance. The districts must perform important functions, including health, education, environmental and infrastructure services. The province has only a minor role, mainly in coordination, and backstopping districts and cities that cannot yet perform their functions—which may be an opening for an expanded provincial role. The province will also continue to perform deconcentrated central tasks. Implementing regulations further specify the remaining roles of the central and provincial governments, including setting standards for service delivery. The central government can annul regional bylaws and regulations that conflict with national laws and regulations, but the regions can appeal to the supreme court against the center's decision. The intergovernmental regional autonomy advisory board with representatives from the center and the regions is to advise the President on issues concerning decentralization.

**Fiscal aspects:** The legal framework (Laws 22 and 25 of 1999) will drastically increase the regional share of general government spending. Preliminary estimates suggest that when decentralization is fully implemented, the regions will spend some 8 to 9 percent of gross domestic product (GDP), or well over 40 percent of general government spending, and over double what they spend now. The bulk of this will be controlled by the districts and cities. The center will share some of the resource revenues with the regions—for 2001 amounting to some 1.3 percent of GDP—but this will only benefit a few regions with natural resources.

For most regions, the general grant will be the main source of revenues. This grant will be a minimum of 25 percent of central government revenues—some 4 percent of GDP for 2001. The general grant will be distributed by a formula that has some equalizing elements, but guarantees a grant at least equal to the recurrent and development grants received in the past—irrespective of other income. The equalization formula does not adequately consider expenditure needs for minimal service provision and thus, poorer regions could be shortchanged. Furthermore, the center can grant special grants but the amounts are small given the current budget environment and their allocation has been given little attention so far.

Regional governments will also be allowed to borrow, but borrowing will be limited by a formula for total debt, by individual Ministry of Finance (MOF) approval for foreign loans, but without the guarantee of central government. The Government can put further limits on regional borrowing, and plans to prohibit regional borrowing for FY2001, except from the central government. Bank and other donor lending to the regions will for now be able to make use of an existing onlending mechanism.

Government has issued regulations on financial management and procurement of the regions. These regulations would allow the regions to largely determine their own financial management, accounting, and procurement system within (broad) guidelines from the central government. This arrangement risks a weakening of the country's fiduciary environment, and a fragmentation of the market for government procurement, as local procurement regulations could favor local suppliers.

To strengthen local own revenue sources the Government has revised the Law 18 of 1997 on regional taxes and levies. The revised law allows regions to establish taxes as long as they obey certain principles. While these principles are sound, the weak monitoring and enforcement capacity of the center risks a return to the pre-1997 days in which local taxes became a serious barrier for internal trade.

## **FRAGILE ECONOMIC RECOVERY**

**4. The nascent recovery from the crisis gained strength during the past year.** Indonesia's economy fared better than expected at the time of the CAS Progress Report. Growth

rebounded earlier than expected, and inflation came down more rapidly, and the country generated a higher than expected current account surplus (see Table 1.1). GDP growth in 2000 is expected to be in the 4-5 percent range. The recovery is becoming broader based, with investment growth overtaking consumption as a leading contributor. Exports are still growing rapidly, benefiting from the strong depreciation of the Rupiah and buoyant world trade. Encouragingly, non-oil exports did particularly well. Inflation, although accelerating somewhat, remains under control (see Figure 1.1).

**Table 1.1: Indonesia Key Economic Indicators: Projections and Actual, FY98/99-FY2000**

		FY98/99	FY99/00	FY00/01 <sup>a</sup>
GDP growth (%)	Projection <sup>b</sup>	-13	-1	3
	Actual	-14.1	3.5	4.0
Inflation (% increase in GDP deflator)	Projection	80	20	10
	Actual	75.3	3.1	6.8
Current Account (US\$ billion)	Projection	4.7	5.5	4.4
	Actual	4.6	6.6	5.3

<sup>a</sup> Actual 00/01 is preliminary actual for FY00, because of a change in Indonesia's fiscal year.

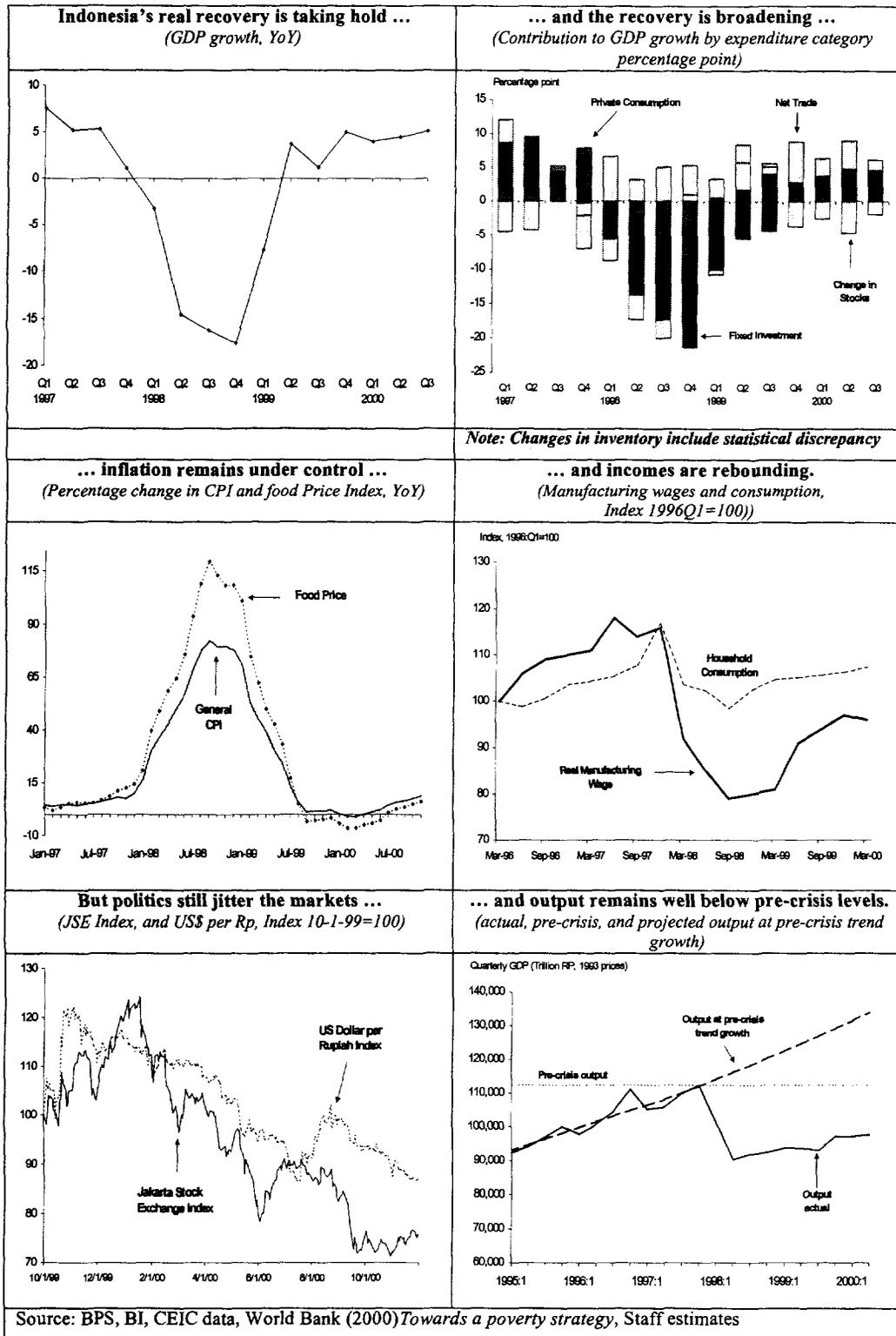
<sup>b</sup> Projections from the CAS Progress Report, February 1999.

Source: BPS, Bank Indonesia and Staff Estimates.

5. **But Indonesia's recovering economy was not reflected in improved financial markets.** The Rupiah exchange rate has continued to see wild gyrations over the last year. The capital markets fared little better. The Jakarta stock exchange drifted off its post-crisis peaks in October 1999, and one year later had dropped by 30 percent. Similarly, Indonesia's risk premium in international markets reversed its decline, and spreads on Indonesian US dollar denominated bonds are now more than 700 basis points over US treasury bonds. In contrast with other recovering Asian countries, private capital outflow continues. FY99/00 saw a \$9 billion net private capital outflow from Indonesia, of which \$4 billion was foreign direct investment (FDI) outflow.

6. **Bank and corporate restructuring needs to be accelerated,** because without new credit or investment the recovery will run out of steam. There is some promising progress: the first stage of bank recapitalization has been completed, non-performing loans are falling, new lending has resumed, albeit hesitantly, and a return to bank profitability is near. The Indonesian Bank Restructuring Agency's (IBRA's) governance has improved, and its recovery operations have started in earnest. Voluntary settlements on debt through the Jakarta Initiative Task Force (JITF) and between debtors and creditors have started to pick up. To nurture these tenuous beginnings, Government must complete bank recapitalization while continuing to restructure state banks, strengthen the banks' governance, develop a credit culture, and upgrade risk controls and systems. IBRA asset disposition should be accelerated within a transparent and competitive process to maximize returns, and minimize opportunities for corruption. And legal, regulatory and tax impediments against restructuring should be removed. Over time, Government needs to develop and implement a medium-term strategy to strengthen the entire financial sector. High on this agenda is the privatization of state banks.

**Figure 1.1: Indonesia's Fragile Recovery**



7. **And Government faces a major challenge in maintaining fiscal sustainability.** The crisis left the Government deeply in debt. After completing bank recapitalization, government debt will add up to a towering 100 percent of GDP, up from 23 percent of GDP before the crisis. And debt service, together with politically sensitive fuel subsidies and the wage bill take up more than four-fifths of government revenues. This puts severe pressure on the budget, and threatens to crowd out development spending. This pressure could well increase with the onset of decentralization next year. Reducing it will involve tough policy choices to raise revenues through better tax administration, phase out inefficient subsidies while protecting the poorest, improve fiscal management, and accelerate privatization and asset recovery.

#### POVERTY CONTINUES TO BE A CENTRAL ISSUE

8. **While poverty rose sharply in the crisis, the recovery has been decidedly pro-poor.** The crisis dramatically illustrated how much economic growth and stability matter to Indonesia's poor. In the two decades leading up to 1996 poverty levels fell from over 60 percent to less than 12 percent of the population,<sup>1</sup> though many hovered just above the poverty line and remained vulnerable to shocks. So when the economic crisis hit in 1997 following two drought years, and per capita GNP was halved to US\$580,<sup>2</sup> the expenditure poverty rate shot up—at least doubling from its pre-crisis low (in August 1997) to the peak 27 percent<sup>3</sup> in late 1998/early 1999. Indications are that poverty has since fallen substantially from the crisis peak, helped by increasing real wages and improving employment, and the sharp decline in food prices—especially rice. Box 1.2 provides a profile of the poor and vulnerable in 1999.

9. **But despite crisis recovery, various dimensions of poverty still affect half of all Indonesians.** Despite the good news on reductions in expenditure poverty from its crisis peak, Indonesians face startlingly high vulnerability to poverty. The Bank's recent poverty report<sup>4</sup> shows that over a three-year period between 30 to 60 percent of all Indonesians face a greater than 50-50 chance of periodically experiencing extreme poverty. And poverty takes many forms in addition to material poverty (those living in households with expenditures below the poverty line). Lack of access to basic education and adequate nutrition or of recourse to medical services makes people poor, as do inadequate or nonexistent basic infrastructure (safe water, adequate sanitation, transport and roads, electricity). People who are excluded from social community life or discriminated against experience yet another form of poverty. Important gender differences persist (see Box 1.3). When poverty is expanded to include all these dimensions of vulnerability and human well-being, then poverty in Indonesia is still an issue that concerns about half the population. Tackling poverty therefore will require that all policies, expenditures and programs are evaluated for their impact on the livelihoods of those struggling to escape poverty or who risk

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<sup>1</sup> Using head count index and national poverty line from *East Asia: Road to Recovery*, World Bank, 1998.

<sup>2</sup> In 1999, using the Atlas method, compared to US\$1,097 in 1997.

<sup>3</sup> The calculation method used by BPS, which also adopts a *new* poverty line to better match current consumption patterns (i.e., different from the national poverty line used in 1995), results in a lower estimate for the portion of the population living in poverty in February 1999 (23.5 percent).

<sup>4</sup> *Poverty Reduction in Indonesia: Constructing a New Strategy*, September 2000 (Draft).

### Box 1.2: Profile of Indonesia's Poor and Vulnerable in 1999

#### *Characteristics of those in expenditure poverty and where they live...*

- 87 percent of the poor live in households in which the head of household has only a primary education or less—only five percent of the poor have a secondary education or better.
- For almost 60 percent of the poor, agriculture provides the main source of income (whether from labor or land).
- More than 75 percent of the poor live in rural areas.
- Most of the poor (61 percent) live on Java.
- The poorest regions, all rural, are scattered and include parts of the eastern islands (Irian Jaya, East Nusa Tenggara, Maluku and West Nusa Tenggara), but also other areas (Southeast Sulawesi, East Java, Lampung, West Kalimantan, and Central Java).

#### *Other ways in which poverty is experienced...*

- Expenditure poor households are also much more likely to be “human investment” poor, but a significant share of the non-expenditure poor households also lag in human investment: 22 percent of poor children between 6 and 18 years who have yet to complete basic education are not enrolled in school, while for non-poor households the share is 9 percent.
- 78 percent of the poor, and 51 percent of non-poor, lack access to “improved” water sources. Access to sanitation is even more limited.
- When people are asked to define who are “the poor” in open-ended terms, the breadth and variety of responses is striking; from the common idea of not having enough to eat, to not having enough participation in community life, to being despondent or “having lost faith in God” (from *Consultations with the Poor in Indonesia*, 1999).

falling into it. And during the transition to decentralization special attention must be paid to the way it is carried out or the poor could well be left behind.

### GOVERNANCE IS THE WEAK LINK

10. **Governance is Indonesia's key medium-term development challenge.** Weak governance has, if not caused, at least aggravated the economic crisis out of which Indonesia is just emerging. The crisis brought to the surface the lack of accountability, transparency and rule of law in Indonesia, compounded by weak institutions unresponsive to the population at large, and the poor in particular. Indonesia scores consistently low in surveys on rule of law, corruption, and business environment. Illegal gains from corruption have mainly benefited the rich, and were a major factor in the downfall of the Suharto regime. Bad governance has affected the poor across the board, from lack of basic law and order, lack of mechanisms to influence budgetary choices, poor quality of services, and lack of transparency and accountability in the use of funds.

11. **The task of governance reform is huge.** The judiciary, civil service, government financial management, and the role of the state all affect governance. Under the New Order, the *judiciary* functioned largely as an instrument of the executive. The court system, from the judges down, was fundamentally corrupt, while prosecutors were considered facilitators of extortion and bribery. The lack of performance monitoring and sanctions on non-performing judges, lack of transparency of judgments, and absence of systemic jurisprudence all contribute to the perceived absence of rule of law. The slow process in corporate restructuring can at least partly be attributed to the questionable judicial process. The *civil service* suffers from the same lack of transparency, accountability and performance. Corruption has been widespread. It delivered top-

**Box 1.3: Gender Inequalities Persist in Indonesian Society...**

- Female illiteracy is still considerably higher than male (20 percent and 9 percent) although the gap has narrowed considerably and primary and junior secondary enrollments are nearly gender balanced. Still, stereotypical gender roles are reinforced through school books and the curriculum.
- As for jobs, women are concentrated in low-skill, low-paid employment—71 percent of workers officially recorded as “unpaid family workers” are women, and only 7 percent of the senior administrators and managers are women. Home based workers and those working overseas, both predominantly women, are deprived of basic rights, benefits, or job security, and wages are usually extremely low.
- Women are heavily underrepresented in public life—Parliament has only 10 percent women; women make up 35 percent of civil servants, but only 4 percent are in the highest two echelons; and just 2 percent of village heads are women.
- Women are often victims of violent crime (including State violence)—rape, harassment, or domestic violence, although the real incidence of these crimes is still unknown.

But these statistics do not give the full story. The inequalities are more deeply embedded and have been institutionalized. The main issue facing women in Indonesia is one of visibility and voice. Although the Constitution gives equal rights to women, successive state policy documents have defined separate roles for men and women: men as the heads of households and women as mothers and caretakers. And there is a concern that decentralization may reverse Government’s attention to gender issues.

down services to the public, which are now out of step with the new democratic realities. And *decentralization* will create a further challenge as up to 2.7 million civil servants will have to be reassigned, with major risks of disruptions in service delivery. The lack of sound *financial management and procurement systems* have contributed to the weak traditions of accountability in the public sector. There is no properly functioning system of checks and balances, and lack of transparency makes external performance monitoring virtually impossible. The forthcoming decentralization is likely to make things worse rather than better in the short run as there is little evidence that regional governments will have in place adequate fiduciary controls on local spending.

12. **Weak corporate governance affects the private sector.** Investor surveys show that Indonesia has among the worst corporate governance in East Asian countries. There is a lack of transparency and financial disclosure, accounting and auditing systems are weak, rights of minority investors are insufficient, and interlocking ownership between banks and corporates have contributed to the collapse of the bank and corporate sector during the crisis. Lack of transparency and weak regulatory frameworks also continue to impede private investment in infrastructure and other public services.

**POLICY RESPONSE HAS BEEN UNEVEN**

13. **Market confidence is affected by weak policy performance.** President Wahid’s first administration was quick to commit to reforms in January 2000 as part of its new three-year

SDR 3.6 billion Extended Arrangement with the IMF, supported by the World Bank and ADB.<sup>5</sup> But implementation of agreed reforms has been slow. Among others, the Government hesitated on actions to accelerate bank and corporate restructuring, postponed the fuel price increases and phase-out of tax exemptions, and reversed its stance on rice and import tariffs. Foreign investors were further taken aback by policy decisions to restrict foreign investment in a number of sectors. These decisions have since been reversed but at the expense of investor confidence.

**14. Government's medium-term policy directions emphasize the importance of improved governance and addressing social inequity and poverty as part of a sustainable and just economic recovery.** The State Policy Guidelines, adopted by the MPR after the June 1999 general elections, underline the supremacy of law and the protection of fundamental human rights. It promotes the development of a "people's economy" relying on fair market mechanisms and "empowering" small- and medium-size entrepreneurs and cooperatives linked to improved people's welfare through access to basic needs, thus moving away from the strong central authority and monopolistic business practices enjoyed by a privileged set of cronies in the Suharto era. Rather than the earlier top-down approaches, the intent is to empower communities as main agents of development. The Government's *Propenas* five-year plan (GOI FY2001-05) builds on these guidelines and is organized around five major priority areas: (1) building a democratic political system while maintaining national unity; (2) realizing the supremacy of law and clean governance; (3) accelerating economic recovery and building a sustainable and just development platform; (4) improving the development of people's welfare and cultural resilience, and (5) improving regional development. President Wahid underlined these principles in his MPR accountability speech in August 2000.

**15. Building on these principles, the new Cabinet has started to put in place its economic recovery program.** The economic team of President Wahid's second Cabinet appointed in August 2000 began strongly, developing a Ten-Point Economic Recovery Program that is the first statement of comprehensive economic policy in the new Indonesia (see Box 1.4). In September, the program was smoothly integrated in Government's Letter of Intent (LOI) related to its Extended Arrangement with the IMF (para. 13). But for now the program is more a statement of objectives rather

**Box 1.4: Ten-Point Economic Recovery Program**

- Create stability in the financial sector;
- Increase revenue levels from non-oil exports;
- Increase agricultural productivity and the welfare of farmers;
- Accelerate banking and private sector restructuring;
- Place priority on equity-based rather than loan-based recovery;
- Carry out a value-creation approach to privatization of state-owned assets;
- Meet economic decentralization target through an orderly and phased transition;
- Optimize utilization of natural resources;
- Expand the development of micro-, small- and medium-scale enterprises;
- Increase employment generation, particularly in the rural areas.

<sup>5</sup> The Bank currently works very closely with the IMF and the ADB in preparing the Letter of Intent (LOI) for the Government's Extended Arrangement with the IMF. Consistent with our respective institutional mandates, the IMF takes the lead on macroeconomic policy, the ADB on privatization and SMEs, and the World Bank on most other institutional, structural and social dimensions of development. The IMF, World Bank and ADB share joint responsibilities for financial sector issues.

than a plan, and much effort is required to underpin the objectives with a strategy and—more importantly—to take those actions that lend credibility to the program. In the short run, two issues are crucial to accelerating the recovery: intensifying bank and corporate restructuring, and maintaining fiscal sustainability. In the medium term, Government faces two critical issues. First, it must shift the focus of poverty reduction efforts from crisis response social safety nets to a broad-based strategy for attacking poverty and vulnerability in Indonesia. Second, to consolidate democracy, and to set the conditions for sustainable growth, it must change the way Indonesia is governed.

**16. The Government has also initiated steps to develop a comprehensive poverty reduction strategy.**

Based on the *Propenas* plan, the Government tabled a national statement on poverty reduction at the Consultative Group for Indonesia (CGI) meeting held in Tokyo in October 2000.<sup>6</sup> The statement's poverty reduction strategy is based on three pillars: promoting economic opportunities, empowering the poor, and enhancing the effectiveness of the social safety net (see Box 1.5). The statement also lays out the approach for high-level coordination of the poverty strategy: the Vice-President will have responsibility, supported by a task force headed by one or both

**Box 1.5: Main Elements of Indonesia's National Statement on Poverty Reduction Strategy for the CGI**

- (1) Promoting opportunities for the poor:
  - Achieving rapid, sustainable growth
  - Strengthening local governance
  - Providing effective core public services (health, education)
  - Building community infrastructure
- (2) Empowering the poor:
  - Strengthening community organization
  - Promoting sustainable rural development
  - Revitalizing small- and medium-size enterprises (SMEs)
- (3) Enhancing social security for the poorest:
  - Improving core social safety nets
  - Accelerating development in remote areas

Coordinating Ministers comprising members from Government, Parliament, civil society and donors. A separate stakeholder forum will be set up to monitor poverty reduction efforts.

**17. But it needs to follow-up with implementation suited to local government control of service delivery.** The Government will need to follow-through quickly on its ambitious plans to coordinate poverty programs and monitoring, and expand its CGI statement into a poverty strategy with broad-based buy-in from regional governments and civil society. Social sector spending shortfalls were pronounced during the crisis, while inefficient fuel subsidies increased their share dramatically and remain greater than the entire development budget in the draft 2001 budget. To make matters worse, recent funding for basic infrastructure and maintenance has been woefully inadequate—undermining Government's poverty efforts. Going forward toward decentralized public service delivery—when over 350 local governments will take charge of planning, budgeting and implementation—the central government will need to redefine its role to keep a national focus on poverty reduction, including a fiscal transfer framework that allows for rewards to sub-national reformers—those that are actively accountable and pro-poor—and targeted support to communities so that those with weaker governments are not left behind. The

<sup>6</sup> *Poverty Reduction Strategy In Indonesia*, prepared by the Government of Indonesia for the Consultative Group for Indonesia, Tokyo, October 2000.

central government will also need to revitalize monitoring, agree with regions on minimum service standards and poverty reduction goals, and support ways for local governments to learn from each other so that growth and development are broad-based. Once Government organizational arrangements for developing a broad-based poverty strategy (para. 16) are in place, the Bank will review with Government the preparation of a poverty reduction strategy paper (PRSP) to be completed in FY02.

18. **Similarly on governance and anticorruption, the initial steps have been tentative and insufficient.** While the State Policy Guidelines call for a comprehensive reform program embracing the judiciary, civil service, corporate governance and reform at all levels of government, commitment to reform is at best uneven, and at worst weak, and hence the reform process in this area suffers from lack of coherent management, coordination and leadership. Yet public demands for reform are strong and its impatience is growing. The Government's credibility is increasingly at risk as the number of initiatives announced in response to such pressures outpaces its capacity to deliver. Government has, for instance, moved on a wide front of anticorruption measures, many of which were initiated under President Habibie, including an anticorruption law, establishment of a joint investigation team focusing initially on corruption in the judiciary, a national ombudsman commission, as well as preparations for an independent anticorruption agency. But these initiatives have been largely *ad hoc* and often overlap, some have faltered for lack of budget, and for most others the progress is slow. On the legal reform side, the initial efforts by the Law Reform Commission has found little resonance in Government. Considerable mistrust persists due to the failure to indict—until recently—any judge suspected of bribe-taking. Corruption in the Attorney General's office and the police is compounded by lack of capacity to carry out successful prosecution. On the civil service side, there is as yet little effort to address the longer-term issue of civil service reforms.

#### ECONOMIC OUTLOOK AND RISKS

19. **Indonesia's external environment is likely to become less favorable over the CAS period than it was in the year 2000.** World GDP growth is expected to gradually slow down from over 4 percent in 2000 to somewhat above 3 percent in 2003. Growth in the USA, Indonesia's largest trading partner, is to slow down more rapidly, but that of Japan—the second largest trading partner—will retain a modest 2 percent pace. Growth in world trade is likely to come down as well—from over 11 percent in 2000 to some 8 percent for the rest of the CAS period. This will put pressure on Indonesia's export-led recovery, and on the current account. The expected decline in oil prices—from \$28/barrel (bbl) in 2000 to under \$20/bbl in 2003—will further reduce Indonesia's current account surplus over time. While international interest rates are not expected to rise, Indonesia's risks premium—at present more than 700 basis points over US Treasuries—reflects continued negative sentiments of international investors towards the country.

20. **Several macroeconomic risks could affect Indonesia's prospects.** The high domestic and foreign debt, a weak banking and corporate sector, and a growth rate that is much lower than before the crisis make Indonesia particularly vulnerable to such risks. The key risks are a more rapid decline in oil prices, a further depreciation of the currency, and an increase in domestic interest rates. The Government's ambitious decentralization plan will exert fiscal risks as well.

- A more rapid decline in oil prices than that assumed in the economic base-case scenario (see below) would put pressure on the current account of the balance of payments. But because oil revenues will in future be shared with the regions and oil subsidies are still paid by the central government, the initial impact on the budget is fairly modest. For every dollar decline in oil price, the central budget deficit increases by about \$50 million, or less than 0.05 percent of GDP.
- A further depreciation of the Rupiah would hurt the budget more: although oil revenues will rise in Rupiah terms, the increase is shared with the regions, and the central government would face higher spending on foreign interest payments and imported goods. On a net basis, an exchange rate depreciation of 1,000 Rupiah/US dollar would add some 0.15-0.2 percent of GDP to the budget deficit. Equally, banks and corporations will both remain vulnerable to external shocks in exchange rates and interest rates, in view of the slow progress in financial and corporate restructuring. A weakening of their position may add to the bank recapitalization costs, and reduce revenues from IBRA recoveries.
- But the largest macroeconomic risk stems from the Government's high domestic debt, which is largely in the form of floating rate bonds. Higher domestic real interest rates—triggered by, for instance, political turmoil could cause fiscal havoc: a one percentage point increase in *real* interest rates would cost the Government some 0.3 percent of GDP, or \$500 million equivalent.
- And, despite safeguards, there are considerable risks to fiscal discipline associated with the decentralization program. For next year, the Government has included a contingency reserve of some 0.6 percent of GDP in the budget, and it aims to disallow regional borrowing for now (*except from the central government*). However, *failure to decentralize the civil service*, strong regional demands for extra resources, and a weakening of the no-borrowing rule could trigger fiscal pressures and macro-instability.

21. **The fragile political environment and its associated risks to the ongoing reform effort are reflected in the current economic outlook for the “muddle-through” base-case scenario.** Prospects for a sustainable recovery in Indonesia critically depend on progress in bank and corporate restructuring, smooth fiscal decentralization within a framework of overall fiscal consolidation, continued monetary stability and improved governance. But these are complex and far-reaching reforms which require effective government implementation and a sound legal environment—and so expectations of progress must be modest. The “muddle-through” base-case scenario—which represents our assessment of the most likely outcome—assumes that macroeconomic stability is maintained, but that structural reforms are implemented slowly, with frequent slippages and some policy reversals. Investor confidence and private investment (domestic and foreign) revive barely enough to keep GDP growth at about 4 percent a year during the period of the country assistance strategy (CAS, FY01-03). In the absence of decisive policy action, the fiscal position remains marginally sustainable, and the government debt-GDP ratio is expected to decline only modestly to about 88 percent by 2003.<sup>7</sup> External debt to GDP

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<sup>7</sup> Further debt restructuring is not assumed beyond what has already been obtained recently from the Paris Club and London Club.

will also marginally decline, because lackluster investment activity would limit pressure on the current account of the balance of payments. Table 1.2 shows key economic indicators for the base case and high case scenarios.

**Table 1.2: Indonesia: Key Economic Indicators—Base and High Case Projections**

	FY00 <sup>a</sup>	<i>Base case projections</i>			<i>High case projections</i>		
		2001	2002	2003	2001	2002	2003
GDP Growth (%)	4	4	4	4	4	5	6
Inflation (% change in GDP deflator)	6.8	8	8	8	5	5	5
Current Account Balance (\$ billion)	5.3	4.4	3.4	2.7	3.0	2.8	-0.2
Government debt (% of GDP)	100	99	94	88	95	86	76
Total External Debt (% of GDP)	102	99	94	89	92	82	73

<sup>a</sup> Preliminary (see Table 1.1).

Source: Staff estimates.

22. **A high-case (“performance”) scenario would result from greater political stability, and more aggressive implementation of structural reforms.** This involves an acceleration of bank and corporate restructuring, careful management of the ongoing fiscal decentralization program, and appropriate monetary and exchange rate policies (as agreed in Government’s Extended Arrangement); as well as key actions on legal and judicial reforms, civil service reforms and toward improving financial management and procurement practices. These reforms will help improve investor confidence and raise investment to pre-crisis levels which, in turn, could drive higher GDP growth from 2002 onward. Higher investment demand would reduce the surplus on the current account more rapidly than in the base case. Higher growth, lower interest rates in light of better inflation performance, more asset recovery, and an appreciating exchange rate will accelerate the decline of Government debt to GDP to some 76 percent of GDP by 2003, while external debt to GDP also declines more rapidly to 73 percent of GDP by the same year.

23. **Unfortunately, there is also a not insignificant possibility of a “crisis” scenario.** A key risk is a breakdown of the Government’s Extended Arrangement with the IMF as a result of major policy slippage, including inadequate progress on bank and corporate restructuring. This could lead to a rapid erosion of market confidence and deterioration in economic conditions. A similar outcome could result from political instability or a widespread breakdown in law and order. In both cases, the turmoil would be reflected in a further deterioration in financial markets—especially interest rates and the exchange rate—which would cause a deterioration in the fiscal and balance of payment position. Yet another crisis scenario could result from external shocks such as a more rapid decline in oil prices, a more rapid slow-down of the global economy and global trade growth, or a rise in world interest rates, which could trigger renewed macroeconomic imbalances. Although the consequences are likely to be a far cry from the 1997-99 crisis, the impact of a macroeconomic shock could severely hit a more vulnerable Indonesia, facing a much higher debt burden

24. **The external financing position is likely to remain fragile in any scenario.** The current account surplus is likely to decline as demand recovers and imports grow while oil prices decline and non-oil export growth slows. New private equity inflows through direct or portfolio investment are likely to remain modest as long as governance reforms, corporate restructuring and privatization remain hesitant. Indonesian companies’ access to new external private

borrowing is likewise expected to be limited as long as their debts are not resolved and their balance sheets remain weak. Despite debt rescheduling by the Paris Club, debt-service on the Government's liabilities will continue to impose a heavy burden on government revenues—and more so after March 2002 when the current Paris Club agreement ends. Further debt rescheduling by official bilateral and private creditors is unlikely, and the Government is correctly reluctant to incur new debt from commercial sources. The Government's debt burden places a premium on concessional sources of external finance. It has, therefore, requested the Bank to blend its International Bank for Reconstruction and Development (IBRD) lending with additional International Development Association (IDA) resources. In the high case, disbursements from the additional IDA commitments, as proposed in the CAS (see para. 78), would begin to benefit the budget mainly in the year 2002 and beyond. This higher external financing would also support the emerging current account deficit caused by the higher investment level in the performance scenario. Additional IDA funds would be contingent on Government's strong performance on governance and poverty, which in turn will help boost investor confidence and prospects for an early recovery and enable Indonesia's rapid return to the international capital markets.

25. **Moving forward, the challenges are enormous.** In any future scenario for the short to medium term, there is likely to be considerable political turmoil, stop-go policies on reforms, and capacity constraints impeding the Government's ability to carry through on its commitments. The probability is high that Indonesia will "muddle through". The challenge for the Government, and for Indonesia's development partners, will be managing this uncertainty and helping reduce the associated risks. But there is also a real possibility—given Indonesia's past impressive development record—that from this process of muddling through will emerge enough momentum around a subset of reforms that it will be possible to lay the foundations for a more sustained development effort. Indeed the challenge for Indonesia's development partners will be to encourage and to help bring about this latter outcome.

## 2. BANK GROUP RESPONSE AND PRIORITIES

### PROGRESS SINCE LAST CAS

26. **In accordance with the CAS Progress Report the Bank focused on social safety nets, economic recovery, and governance reform.** The Bank continued its strong *social impact* monitoring, and prepared a comprehensive poverty report which now forms the basis for the poverty focus of the CAS. The Social Safety Net Adjustment Loan (SSNAL) helped protect and rationalize budgets for critical crisis response programs, improved designs and targeting, and helped open the way for civil society involvement in program monitoring. Investment lending focused on projects in health and education. In support of *economic stabilization and recovery*, the Bank continued its intensive participation in the Government's Extended Arrangement with the IMF (para. 13), with responsibility for the major structural and social reform components—besides social safety nets, the Bank focused on bank and corporate restructuring, along with sectoral reforms in agriculture and energy. A second policy reform support loan was approved in May 1999. The Bank stepped up its work on *governance and anti-corruption* in close collaboration with partners. It helped establish the Partnership for Governance Reform in Indonesia, which brings together Government, civil society, private sector, and donors to facilitate a national dialogue on governance. The Bank is leading similar donor groups in other areas (para. 62). It chaired three CGI meetings since the last Progress Report in which Government and donors discussed progress on the economic program and governance agenda. Representatives of civil society now attend as observers.

27. **Lending fell short of the CAS Progress Report base case scenario.** During FY98-00, the Bank committed a total of \$3.6 billion, or \$1.3 billion below the base case scenario in the Progress Report (see Table 2.1). The shortfall in adjustment lending was caused by delays in key policy reforms, as well as the Government's reduced borrowing needs for budget support. Lower investment lending reflected both new government priorities (leading to reformulation of the lending program) and reluctance of the new Government to borrow, particularly on IBRD terms, in view of the increase in public debt and Parliament's direction to reduce dependence on foreign borrowing. As a result of these trends, IBRD debt outstanding has been held to about \$11.8 billion (end-FY00).

**Table 2.1: Bank Lending: Changes since CAS Progress Report, FY98-00 (\$ million)**

	CAS Progress Report	Actual
Adjustment	3,200	2,400
Investment	1,695	1,177
<i>o/w IDA</i>	<i>(310)</i>	<i>(255)</i>
Total	4,895	3,577

28. **The Bank's project portfolio has started to recover from the crisis impact, and fiduciary controls have been strengthened although risks of "leakage" remain high.** Economic recovery and the Bank's portfolio restructuring efforts have substantially reduced portfolio risk and improved performance in line with our earlier plans (see Table 2.2). As part of restructuring, the Bank canceled over \$1.6 billion of undisbursed funds. Indonesia was removed from the Bank's "priority country list" for portfolio improvement plans. The Bank has begun to

**Table 2.2: Bank Portfolio:  
Changes since CAS Progress Report, FY98-00**

Indicators	FY98	FY99	FY00	
			CAS Plan	Actual*
% Projects at risk (no.)	54%	28%	20%	21%
% Actual problem projects (no.)	25%	26%	15%	18%
Realism index	47%	95%	75%	83%
Proactivity index	71%	78%	85%	83%
Disbursement ratio	14%	13%	20%	21%

\* includes Global Environment Facility (GEF) operations.

strengthen fiduciary controls and staffing to address allegations of misuse of project funds, through tightening of procurement reviews, follow-up on allegations of irregularities, enhanced monitoring of accounting and auditing compliance, additional procurement and financial management staff in the Bank's

Jakarta office, protection of supervision budgets, and beneficiary involvement in monitoring of implementation and use of funds in a number of new projects (see Box 2.1 on recent anti-corruption efforts in Bank-financed projects). The Bank's portfolio was subjected to a number of audits, which acknowledged the stronger management controls while recognizing the challenge of addressing corrupt practices in projects in Indonesia. This challenge is expected to grow as the Bank's portfolio shifts increasingly to "soft" sectors involving smaller procurement contracts and implementation takes place in a newly decentralized administrative and political environment.

### **Box 2.1: Recent Anti-corruption Efforts in Bank-Financed Projects**

While it is not possible to insulate Bank-financed projects from the country environment in which they are implemented, a number of steps have been taken to strengthen fiduciary controls including:

- Tightening of reviews of implementing agencies' procurement financed by the Bank and paying more attention to procurement issues at early stages of project preparation.
- Conducting assessments of the capacity of executing agencies to carry out procurement and financial management, and intensifying ex-post reviews of those contracts that are not subject to prior review by Bank staff under the Bank's procurement guidelines. This also led to a declaration of misprocurement totaling \$4.1 million in FY00.
- Maintaining a database of complaints on procurement.
- Enhancing monitoring of compliance with accounting and auditing requirements, and following up on significant audit findings with executing agencies.
- Protecting resources allocated to project supervision despite pressures on the overall administrative budget.
- Promoting beneficiary involvement in the design and implementation of Bank projects, particularly by building relations with civil society and local communities to help prevent misuse of development funds. Additionally, the Bank prepared a portfolio brief (in English and Bahasa Indonesia) to inform civil society about the Bank-financed projects.
- In collaboration with Government and the Asian Development Bank (ADB), the Bank carried out a country procurement assessment (CPAR, FY00) and country financial accountability assessment (CFAA, FY01) which made recommendations for reform. These were followed by a mission of senior Bank staff to review the fiduciary environment, which made recommendations to strengthen the public procurement and financial management systems and to further strengthen the fiduciary oversight of Bank-financed projects (see para. 68).

## LESSONS FROM THE CRISIS

29. **The lessons from the Operations Evaluation Department (OED) review of the Bank's role leading up to the crisis were absorbed in the Bank's program.**<sup>8</sup> The reorientation of the Bank's program toward poverty alleviation and governance reform addresses the major criticism that the Bank paid insufficient attention to these aspects. This includes efforts to absorb the political, institutional and social dimensions more fully in our country assessments and areas for future assistance. The Bank's relationship with Government has become more candid as we speak out publicly on areas of concern. It has opened up vis-à-vis civil society and strives for enhanced disclosure of its activities. The Bank also speaks out more in the media. The recent shift toward a more open and democratic Indonesia provides a more favorable environment for popular participation in government programs, and engagement with civil society. But it does not ensure that past concerns (e.g., on corruption) will be addressed. And the Bank is expected to remain the target of civil society criticism for its association with the past regime (see paras. 31-33 below).

30. **At the program level, the Bank is including important lessons from the crisis as it repositions its future operations.** The Bank's poverty work has generated important findings on the multidimensional nature of poverty in Indonesia, and developed a deeper understanding of the non-material aspects of poverty. It has learned from the work on the effectiveness of local institutions and communities, as well as from input from civil society during consultations. The lessons from the two recent village infrastructure projects and the ongoing Kecamatan development project underlined the strengths of local-level institutions and the importance of "bottom up" planning to better match needs and aspirations with resources. These in turn are the basis for our focus in the CAS on demand-responsive approaches in delivery of public services, which will be absorbed in our future lending for social sectors and basic infrastructure. At the same time, the Bank recognizes the limitations of its recent crisis adjustment lending in Indonesia. The SSNAL, while pioneering program safeguards for more transparency and accountability which improved the effectiveness of crisis programs for the poor, also brought out the difficulty of seeking fundamental institutional reforms in the operations of government programs through an adjustment lending instrument. The crisis social safety net programs also revealed the difficulty of reaching the poor with government programs. In fact, the poor mostly coped by relying on their ingenuity, sacrifices and hard work. Success of the Water Sector Adjustment Loan (WATSAL) underlined the importance of "ownership" of reform by the agencies involved. Through the crisis, the International Finance Corporation's (IFC's) portfolio benefited from its policy of not supporting projects promoted by sponsors with close affiliation to political leaders. In IFC's future operations, it will be particularly careful in selecting credible sponsors, who are transparent, professional and capable.

## FEEDBACK FROM CONSULTATIONS

31. **The CAS has been informed by a series of public consultations with civil society organizations (CSOs).** A total of about 400 organizations took part, over a three-month period, through interviews, seminars, and focus group discussions held in four different locations in

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<sup>8</sup> OED Country Assistance Note, February 1999.

Indonesia. The recommendations were compiled and discussed at a national roundtable held in Jakarta in August 2000. They focused on the following themes: economic recovery and poverty alleviation, decentralization of development and regional authority, education, labor issues and employment, improving governance and combating corruption, debt, and community and non-governmental organization (NGO) participation in Bank projects. Consultations also took place with a cross-section of private sector interests and the results of these consultations are outlined in the Bank Group Private Sector Strategy for Indonesia, prepared along with the CAS (para. 43). A summary of civil society feedback is shown below (see Box 2.2).

32. **The consultations took place in a very constructive atmosphere, although the Bank was reminded of concerns about its association with the past regime**, particularly where it concerns debt and corruption (see Box 2.2). While it was recognized that a number of recommendations from the consultations were directed more toward Government than the Bank, particularly where these involve changes in policy, many recommendations are reflected in the Bank's strategy. The types of projects in the CAS lending program are much closer to civil society preferences with their decentralized, community-based approaches. The Bank plans to involve civil society representatives more upstream in the design of future projects, and to make optimal use of disclosure to disseminate information on its activities and projects. It also strengthened anti-corruption controls in its projects, and intends to involve beneficiaries and civil society groups more closely in monitoring. As a follow-up to the national consultation meeting, the Bank plans to support joint Bank-CSO working groups on selected topics (e.g., civil society involvement in Bank projects, micro-finance), provided there is enough interest on the part of CSOs. A full list of recommendations from the consultations, together with the Bank's response, is covered in a separate report on the CAS civil society consultations.<sup>9</sup>

#### **Box 2.2: Summary Feedback from Civil Society Consultations**

- The recommendations from civil society representatives called for the Bank to focus on its core development mission of poverty alleviation. This would entail support to the productive sectors, assistance to micro and small business, and support for a people-centered approach to development. Projects that promote access by the poor should be promoted. Privatization should be slowed down to ensure fairness and transparency.
- Civil society organizations suggested that the Bank provide assistance in the decentralization process, working with both regional and central governments.
- Participants saw value in the Bank working on curriculum and teacher training improvements in the national education system, and in developing links with labor groups.
- The Bank was asked to emphasize grassroots activities, involving communities in all aspects of the project cycle and to facilitate the active participation of civil society organizations that are better placed to assist in bottom-up planning of community initiatives. Further dissemination of Bank information was called for.
- The debt issue remains controversial with many CSOs calling for debt reduction, a halt to new lending, or lending at highly concessional terms only. They asked that loans for technical assistance should be minimized, and adjustment loans phased out.
- Feedback indicated that the Bank had paid insufficient attention to the use of its funds, and should share responsibility for corruption in Indonesia. The Bank was asked to promote anti-corruption reform, investigate suspected cases of corruption, support establishment of CSO watchdog groups, and intensify attention to environmental and social safeguards.

<sup>9</sup> The report is made available on the Bank's Indonesia website ([www.worldbank.or.id](http://www.worldbank.or.id)).

33. **There remain areas where the Bank differs from the recommendations of the CSOs.** Debt is probably the most important one. The Bank has explained that Indonesia is not eligible for debt relief under the Heavily Indebted Poor Countries (HIPC) program, and that it cannot accept the arguments put forward that part of Bank debt should be canceled as it would have been subject to corruption and should be considered “criminal” or “odious.” At the same time, the Bank has worked in different ways to address Indonesia’s debt problem. It has (a) provided assistance on Indonesia’s debt management options, (b) responded positively to Government’s requests to cancel undisbursed loan balances (over \$1.6 billion) and reallocate funds to higher-priority activities (about \$1 billion), and (c) sought greater access to highly concessional IDA resources. The Bank has also strengthened its fiduciary controls to address any misuse of funds in Bank-financed projects. There are other areas where the Bank may differ from the civil society feedback. The Bank would be more positive than CSOs on proceeding more rapidly with privatization in the interest of efficiency improvement, although it strongly agrees with the need for transparency and fairness.

#### **BANK GROUP’S COMPARATIVE ADVANTAGE**

34. **The Bank Group remains a high profile player in Indonesia.** The Bank Group plays an important coordinating role among donors in its role as chair of the Consultative Group for Indonesia (CGI). And key bilateral donors look to it to take the lead on the development policy agenda. The Bank also co-leads donor efforts in governance reform (with special focus on legal, anti-corruption and civil service reforms), competition policy, water resource management, and forestry. Even where it is not in the lead, Government and donors rely on it for strong analytical and advisory support (decentralization, SMEs, corporate governance, privatization). The Bank plays a key role in Government’s Extended Arrangement with the IMF, working closely with the IMF and ADB. And its relationship with key policymakers continues to be good—although where it differs on policy it tends to do so more openly than in the past. The Bank’s comparative advantage is based on a strong presence in Jakarta which allows a fast response, a good analytical base on the economy, sectors, and key development issues (poverty, governance, public expenditure management), a good understanding of the implementation environment through the Bank’s large and varied project portfolio, a capacity to channel considerable financial resources through lending and trust funds, and its ability to draw on global knowledge through the Bank’s networks.

35. **Indonesia is also supported, with technical expertise and financial resources, by a wide range of development partners.** These includes more than 20 bilateral and over 10 multilateral governmental organizations and several UN agencies, with programs of various size and focus. Indonesia also counts many non-governmental organizations, such as the Ford Foundation and World Wildlife Fund, and private-sector partners among its supporters. In the context of the CGI meeting in October 2000, donors pledged up to \$4.8 billion of official aid for 2001—contingent on budget needs—and an additional \$530 million in technical assistance grants and financial support for non-governmental organizations. This level of support is in proportion to Indonesia’s scale, diversity and development challenges. There is room for donors to specialize in their areas of expertise, for example the UN takes the lead on humanitarian relief, while the World Bank Group and the ADB focus on longer-term development policy support and investments. At the same time, there are many common interests and a need for close collaboration as all partners work to best meet Indonesia’s requirements.

36. **This argues for a selective, flexible approach by the World Bank Group, building on past successes, learning from others and collaborating whenever possible.** The Bank will focus on areas where it can have the greatest impact on poverty and where there is strong local ownership and capacity to deliver. Its program will aim for resilience to shifting local conditions. Most of the Bank's new poverty-oriented, community-based programs have these features. Civil society has also asked the Bank to focus on these areas. At the same time, the Bank will need to look opportunistically for areas where possible breakthroughs in policy are possible and provide the necessary support to facilitate change. These opportunities are likely to shift during the CAS period, underscoring the need for flexibility. This also calls for greater reliance on analytical and advisory services, and for proactive management of the portfolio. Where the Bank is less effective in responding to development challenges, it relies on other donors to take the lead in partnership fashion (see para. 62).

#### DEVELOPMENT CHALLENGES AND PRIORITIES FOR THE BANK GROUP

37. **Support for Indonesia's political and economic transition in a highly uncertain environment.** The CAS Progress report provided a road map for responding to the crisis. This CAS attempts to spell out a Bank Group strategy during the forthcoming period of political and economic transition, and to help it manage the considerable risks associated with the large uncertainties in Indonesia today. This implies a two-pronged approach for the Bank Group. *First*, the Bank Group will need to provide continued support for efforts to sustain the stabilization and structural reform objectives under the economic recovery program and help the Government manage the considerable risks associated with the impending decentralization program. *Second*, the Bank Group will need to help Indonesia lay the foundations for a sound medium-term development strategy focused on reducing poverty and vulnerability for the bottom half of Indonesia's population.

38. **The overarching goal of the Bank Group's CAS will be to reduce poverty and vulnerability in a more open and decentralized environment.** This will require attention to government policies that promote broad-based economic growth as a key requirement for poverty reduction. At the same time, the quality of growth matters to make it sustainable and genuinely pro-poor. But it is not just *what* government does, not just *how much* the government spends, but *how well* its services are provided. Strong improvements in governance will be critical to winning back confidence from private investors and giving voice to the poor. With the far reaching decentralization of government functions just around the corner, actions will be required to build strong governance both at the national and local levels to ensure effective public service delivery to the poor. Accordingly, the Bank Group's strategy will focus on working closely with its donor partners on the following three broad priority areas which are closely related to Government's priorities in its economic recovery program and its medium-term development plan:

- **Sustaining economic recovery and promoting broad-based growth.** In the short run, this requires macroeconomic stability and accelerated bank and corporate restructuring. In the medium term, it will involve policies and public expenditures aimed at poverty reduction, efficient private sector growth, and human capital and infrastructure development to improve competitiveness;

- **Building national institutions for accountable government**, which includes legal and judicial reforms, civil service reforms, better public financial management and procurement, effective decentralization; and close attention to sustainable management of the rapidly depleting natural resource base of the country; and
- **Delivering better public services for the poor**, which involves assistance to help define government roles and responsibilities as functions are decentralized, support for improved public service delivery by sub-national governments which have demonstrated pro-poor, pro-growth reform, as well as promoting community development and selective assistance to post-conflict areas.

### **Sustaining Economic Recovery and Promoting Broad-based Growth**

39. **Accelerating bank and corporate restructuring.** In the short run, the core agenda in the financial sector focuses on restoring profitability to the banks, improving supervision, and moving firmly forward with the restructuring and divestiture of the state banks. In the medium term, Government must develop a strategy to reduce the state's involvement in the financial sector—and then implement it. Moving ahead on corporate restructuring involves implementation of the enhanced corporate restructuring framework,<sup>10</sup> adopting further means to force cooperation of recalcitrant debtors, remove tax and regulatory impediments to corporate restructuring, and accelerate IBRA's asset disposal.

40. Bank assistance in this area will remain a high priority, and it will continue to work closely with the IMF and ADB as part of Government's Extended Arrangement (para. 13). In bank restructuring, the Bank will retain its leadership role for work on state banks (excluding Bank Mandiri) and IBRA, while the Fund will work with Bank Indonesia (the central bank), Bank Mandiri, and private banks' restructuring. The Bank will lead a joint effort with the other international financial institutions to help Government develop a medium-term financial sector strategy. In corporate restructuring, the Bank's focus will continue to be on creating and supporting the enabling framework for effective resolution including the support for the corporate restructuring activities of IBRA's two asset management units, the Jakarta Initiative Task Force (JITF), and for improving the commercial court and bankruptcy process. The immediate priority is to establish a clear, transparent and consistent set of principles to govern all large debt restructurings by IBRA. IFC's priority is to focus on strengthening existing financial institutions through investments, attracting strategic investors where possible. In addition to individual restructuring transactions with its existing clients, IFC will explore opportunities to leverage its limited resources at wholesale level through specialized investment funds for urgent equity funding needs of corporates.

41. **Maintaining macroeconomic stability and fiscal sustainability.** A key challenge will be to maintain fiscal sustainability as Government manages the high debt burden and complex decentralization program, while at the same time protecting essential development spending.

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<sup>10</sup> The enhanced framework involves improved coordination, allowing IBRA to apply discounts, strengthening JITF's leverage for referral of uncooperative debtors to the Attorney General, time-bound mediation procedures, and removal of regulatory impediments.

Important steps involve raising fiscal revenues, phasing out anti-poor fuel subsidies, improving fiscal management, and accelerating privatization and asset recovery. In support of the Government's Extended Arrangement with the IMF, the IMF leads the effort on macroeconomic policies, the Bank focuses on structural and social policies, the ADB leads on privatization and SMEs, while the IMF, the World Bank and ADB have joint responsibility for financial sector issues (para. 13).

42. **Promoting pro-poor policies and public expenditures.** For the most part, families and individuals will escape poverty and reduce their vulnerability through their own efforts. To help foster an environment in which individuals can make progress, the Bank will focus on the following areas:

- **Supporting broad-based poverty reducing economic growth by keeping rice prices affordable and internal trade open, and supporting rural development through provision of basic infrastructure, credit, research and extension services.** Affordable rice prices matter to the poor because they are net rice consumers. Import controls or higher tariffs on rice would hurt the poor by raising rice prices. The Bank will continue to provide policy advice in this critical area. Since over 70 percent of incomes in rice-growing regions is from non-rice sources, the emphasis of the Bank's rural development support—through analytical work and project support—lies in greater attention to the foundations of rural economic activity.
- **Helping to empower the poor through access to secure possession of land and natural resources and increasing the availability of financial services to them.** The Bank is working to encourage stakeholder dialogue on forestry and land policy. It is also undertaking analytical work and supporting preparation of a second land administration project to help reverse past practices of land allocation and distribution which disadvantaged the poor, including their community held lands. The Bank's support for micro-finance will focus on increasing access by the poor and institutional strengthening, rather than credit subsidies. A micro finance project is foreseen for FY03. Sound labor market policies are equally important for raising the economic prospects of the poor, as they are helped by a development strategy that favors a rapidly expanding demand for labor and fosters equitable

#### **Box 2.3: Labor Policies in Transition**

The broader political changes have opened up labor policies. In 1998, the Government ratified the ILO convention on freedom of association and issued a regulation opening up trade union registration. As a result, new labor unions have sprung up, challenging the only union allowed in the Suharto era. But there are questions about the capacity of business and labor to handle the changes and concerns that implicit alliances between Government, employers and even military and police may persist. Moreover, breakdown of law and order in parts of Indonesia have adversely affected labor relations. Law and order and fair economic relations will require cooperation among Government, employers and employees, and reform of the legal and judicial system, the police and the military. Issues for medium-term consideration involve: (i) further development of the labor relations framework covering the formation of trade unions, collective bargaining, and settlement of industrial disputes; and (ii) regulations governing employment standards, covering issues such as working hours, wage determination, and job security. Longer-term reform will also involve a sustainable system of social protection, including reform of the inefficient government-run Jamsostek social insurance scheme.

and just labor conditions (see Box 2.3). Among donors, the ILO has the lead in this area.

- **Helping to keep a poverty focus in public expenditures, including looking hard at what subsidies can be eliminated, and supporting poverty reduction by local governments.** The Bank will continue to support the Government's policy of reducing fuel subsidies which at Rp 36 trillion in 2001 cost more than the entire development budget, and redirecting funds to fund pro-poor programs. How best to encourage poverty agendas at the local level—through budget transfer—is a question the Indonesians are debating and its resolution will equally apply to large donors whose funds pass through the central government. This would involve piloting of different approaches to find what works best. It will also involve tracking of social and poverty indicators. The Bank will focus on the fiscal transfer framework, as well as the minimum standards of service delivery. These will be addressed through policy advice and technical assistance, and in the context of proposed projects in health, education and basic infrastructure.

43. **Enabling competitive private sector development.** The Bank Group's private sector development strategy is integrated across the Group's activities. It involves a combination of policy reform and institutional strengthening to address: (a) an inadequate business environment resulting from poor public governance and corruption, a weak legal and judicial system with poor enforcement, inadequate corporate governance, and continued red tape and burdensome regulations, particularly on SME activities; and (b) a concentrated corporate ownership structure and continued dominance of the state in key sectors combined with an underdeveloped SME sector which in other countries has been the driving force for growth and employment generation. The Bank Group's private sector development strategy, including an elaboration of the respective roles of the Bank, IFC and the Multilateral Investment Guarantee Agency (MIGA), is elaborated in a separate report prepared in connection with the CAS,<sup>11</sup> of which a summary is shown in Annex 1. The private sector agenda focuses on:

- helping Indonesia accelerate and complete the recovery from the crisis through banking and corporate restructuring (para. 39);
- addressing structural weaknesses in the economy through technical assistance, policy advice and partnerships, as well as ongoing Bank Group projects, to (a) improve public governance and reducing corruption, (b) improve corporate governance; (c) reform legal and judicial systems, (d) develop a modern competition policy framework, (e) promote foreign direct investment; and (f) reduce the role of the state through privatization of state-owned enterprises; and
- promoting long-term sustainable growth through (a) development of the SME sector, including provision of policy advice on the business environment, piloting innovative programs, helping establish SME support services, and building financial intermediaries, through IFC investment and capacity building initiatives; (b) promoting the role of the private sector in rural and urban development, through ongoing investment projects and planned adaptable program loans (APLs) in water and urban sectors; (c) promoting private

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<sup>11</sup> *Indonesia: World Bank Group Private Sector Development Strategy*, January 2001 (Report No. 21581-IND).

delivery of infrastructure and services in health and education, initially through analytical work on the potential for private provision of health services; (d) promoting sustainable private development of Indonesia's forest and mineral resources, and (e) preparing Indonesia for the knowledge economy by helping create the legal, institutional and regulatory framework for the new information and communications technologies, in part through assistance from an ongoing information technology project.

44. **Human capital development for competitive growth.** Development of human capital at all levels is critical to both the near and medium term efforts to sustain economic recovery and growth in Indonesia. Decentralization of the delivery of most government services makes capacity building at all levels a priority. Training programs, whether for district officials, local health service administrators or SME managers, have been chronically weak, but the needs will be far greater with decentralization. In the *near term*, the challenges of delivering basic education at the province and district levels and increasing access to quality basic education and health for Indonesia's children will take first priority in Bank assistance, and will be supported by ongoing and proposed projects in education and health, and analytical and advisory activities (AAA). In the *medium term*, attention must be given to skills development and modernizing safety nets, so that skill shortages and the continuing vulnerability to risks such as catastrophic income loss or prohibitive curative health costs will not impede Indonesia's competitive growth. The Bank's assistance in these medium-term areas will be directed in part at the restructuring of Indonesia's senior secondary and higher education and training sectors, both public and private—initially with analytical work and policy dialogue and then, if appropriate, with lending support. Support would be focused on sub-national and regional networks of education and training delivery systems, both public and private. In addition, the Bank, in collaboration with the University of Indonesia, is engaged in establishing a Global Development Learning Network (GDLN), which will provide opportunities for decisionmakers and others to access a global network of peers to share ideas and experience in the main development challenges. Furthermore, assistance will focus on assisting in the design and implementation of situation-relevant health insurance approaches, through ongoing AAA and project work.

45. **Addressing infrastructure bottlenecks.** As economic recovery takes hold, more infrastructure bottlenecks are expected to appear and become a drag on economic growth. Particularly as public spending on maintenance and preservation (especially in roads, water supply and sanitation) have declined over the past few years, and the implementation of infrastructure projects requires long lead times. Decentralization is expected to complicate management of infrastructure, as responsibilities need to be clarified, service standards and investments may further deteriorate, and interregional linkages may suffer. The Bank Group strategy is aimed at: (a) providing assistance for essential investments in maintenance and rehabilitation through ongoing projects and proposed investment projects in eastern Indonesia roads and irrigation systems; (b) improving the policy and legal framework of key sectors (e.g., water, energy) to facilitate competitive private sector investment, including better cost recovery, phasing out inefficient subsidies, development of regulatory capacity, and restructuring sector entities (e.g., state electricity company PLN); and (c) facilitating the implementation of agreed government reforms through joint action by the donors and contributing to financing of future infrastructure needs, by mobilizing co-financing from ADB, the Japan Bank for International Cooperation (JBIC) and United States Agency for International Development (USAID) and others, and, where appropriate, using the Bank Group's various instruments—including possible

guarantees. Focus will increasingly be at the regional level to work with receptive local governments in improving local capacity and supporting basic investments in preservation and upgrading of existing facilities and services, and addressing key bottlenecks. IFC will seek opportunities to encourage private investment in infrastructure in sectors where a suitable regulatory framework is emerging, by seeking to engage commercial and technical partners who will transfer international practice to management and operations of utilities and other infrastructure service companies.

### **Building National Institutions for Accountable Government**

46. **Strong improvements in governance will be critical to winning back investor confidence, giving voice to the poor, protecting the environment, and a key requirement for long term stability.** At the *national level*, action is required on legal and judicial reforms, civil service reforms, improving public financial management and public procurement, and helping the central government better manage its planned major decentralization program. Success depends on strong leadership and ownership from Government for a set of key actions which would bear results over the medium to long term, while looking for a few “quick wins” to build political support for the agenda. A key priority is reducing opportunities for corruption, by strengthening accountability and transparency in the public sector through better procurement, financial management, and audit. At the *regional level*, decentralization provides an opportunity for Government to becoming truly accountable to the people. A high priority will be ensuring the emergence of sound public economic and financial management at the local level with a particular focus on fiduciary controls. At both national and regional levels, the Bank will also approach national environmental policies from the prism of good governance, focusing on forestry and water management. The Bank’s involvement in this area is at two levels.

47. **First, through the Partnership for Governance Reforms in Indonesia—an Indonesian-led body that brings together Government, civil society, the private sector and Indonesia’s major development partners—the Bank together with its two co-sponsoring partners (UNDP and ADB) is supporting the promotion of a national policy dialogue on selected areas of governance.** This dialogue would be underpinned by strategic funding of key governance initiatives aimed at pushing important reform efforts and helping strengthen the demand for governance reforms. These initiatives are funded by a Governance Fund financed by donors. An active Indonesian governing board has identified three cross cutting issues as priorities for the Partnership: anti-corruption, decentralization, and an information outreach on good governance. The Bank’s role in the Partnership is to take the lead in coordinating donor support in two areas of governance reform: legal and judicial reforms and civil service reforms. In addition, the Bank is playing a key role in bringing its global knowledge to bear on the work on anti-corruption and decentralization, particularly through active support from the World Bank Institute (WBI) and the Public Sector Board. It helped the Partnership run a successful anti-corruption workshop and is working towards helping develop a national anti-corruption strategy.

48. **Second, the Bank is attempting to advance the agenda for governance reforms** through direct support to Government in the following areas:

- **legal and judicial reforms:** The Bank’s objective in this perhaps most critical area for strengthening the underpinnings for Indonesia’s nascent democracy and helping win back

investor confidence, is to assist Government to develop and implement a time-bound program of action drawing on the promising work of the Law Reform Commission. For such a program to succeed it will need to be reinforced with decisive action to reduce corruption in the judiciary as a signal of the Government's commitment to such reforms. This will be a major focus of the Bank's dialogue with Government in 2001, drawing heavily on the resources of a multi-donor team.

- **civil service reforms:** The Bank has pursued this issue for over a year through analytical and advisory work, with an initial focus on pay and employment policies and the decentralization of civil service functions. A new report on this issue will be shortly discussed with Government to test the waters of reform. Drawing on this report and on further planned work, the Bank will assist the Government in developing and implementing a civil service strategy.
- **decentralization:** The Bank is working with the IMF, the ADB and donors to help Government contain the risks from the impending decentralization focusing on fiscal decentralization, including measures to support poorer areas and encourage poverty reduction efforts by sub-national governments (para. 42), and the implications for the civil service.
- **the Government's fiduciary controls:** The Bank mounted a strong diagnostic effort in this area, including preparation of a country procurement assessment review (CPAR, FY00) and a country financial and accountability assessment (CFAA, FY01). A fiduciary mission from the Bank visited Indonesia in October 2000 to help develop an agenda of action. This was discussed at the CGI meeting in Tokyo and Government undertook to pursue this agenda (para. 69). Progress in this area will be critical to a successful transition to a high case in Indonesia.

49. **Sustainable natural resource management and environmental protection.** Indonesia's environment and natural resources are deteriorating at a considerable cost to society. Decentralization will make this worse as inexperienced sub-national agencies are inheriting management responsibilities. Actions are required to reach sustainable management of the most precious resources—forests, farmland, fisheries, marine ecosystems, water and urban air. The Bank's focus will be on the governance dimensions, since the principal constraint to sound policies in this area are weak institutional capacity and pervasive corruption. The Bank will concentrate on forestry and water resource management, where it is leading multi-donor efforts. In forestry, the main issues involve illegal logging, the large imbalance between sustainable log supply and industry requirements, poor management of production and protection areas, and ill-conceived forest conversion. Policy dialogue is in support of Government's formulation of a National Forest Program involving all stakeholders. In water, the Bank aims for more integrated management on river basin scale and for control of domestic waste water. In addition, we support selective environmental management capacity building of local governments, and development of a coral reef policy and strategy.

50. **The Bank's focus in the governance area has relied heavily on analytical and advisory activities, but lending support is being contemplated to help strengthen central government's capacity in the post-decentralization era.** Reforms will only succeed if there is strong government ownership and support. If this materializes, and the Bank's dialogue and

involvement in the Governance Partnership are all intended to bring about such an outcome, the Bank would consider the possibility of a public sector reform loan/credit in a high case scenario. Such an operation would support a program of public sector reforms and the proposed decentralization, over a three to five-year period, covering support for reform in many of the areas outlined above along with improvements in public expenditure management. A key priority will be to strengthen the central government's capacity to deliver on its residual responsibilities in a post-decentralization era, particularly in setting standards, establishing development priorities, monitoring performance and enhancing accountabilities. Thus such an operation would attempt to provide an umbrella for the provincial level reform operations envisaged in the CAS (see below). Such an operation could also provide matching grant support for sub-national governments by establishing criteria that would create incentives for local governments to pursue good governance strategies.

### **Delivering Better Public Services to the Poor**

51. **In the words of the Government, “The overriding objective of decentralization is to bring the government closer to the people. This enhances local government transparency and accountability as well as community participation.”**<sup>12</sup> Indonesia is just beginning to decentralize and de-concentrate public service delivery, and there is still much to get right—from finalizing regulations and achieving broad agreement with the regions on the implementation timing and strategy, to ensuring civil servants get transferred and paid. As local governments take up their new responsibilities, Government and donors can best support poverty reduction by rewarding those that demonstrate pro-poor reform through matching grants or other resource transfer vehicles. The Bank has started to rebuild its lending pipeline to selectively support creation of capable, demand-responsive sub-national government institutions, and to eventually target a limited number of provinces (2-4) and/or districts, including cities, which have demonstrated reform. Support will focus on services from which the poor benefit most, including basic education, health and basic infrastructure in rural and urban areas. Where district/provincial governments are reluctant to undertake reform, central government and donors could directly support community driven development. The Bank will thus continue to foster “bottom-up” reform by building on its extensive experience with community development in Indonesia. As all donors are affected by the newly decentralized environment, the Bank is also reviewing with Government and other donors how best to coordinate the approach to sub-national assistance.

52. **In the short run (at least through 2002), the Bank will support the Government in specific sectors and regions to maintain service delivery through the transition, while at the same time helping to lay the groundwork for the Government and other donors to direct assistance where it can be most effective in reducing poverty.** Because responsibility for decentralization of administrative functions lies with line-ministries and guidelines have been very general or wanting, sectors are at different stages of preparation and taking different approaches. There is a real risk of service disruption, declining governance standards, and local decisions contrary to national interests. Some district governments appear to be taking steps to protect services and are looking for opportunities for administrative and budget efficiencies. To support the transition, the Bank's assistance will target three priority areas: (1) helping to define

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<sup>12</sup> *Poverty Reduction Strategy In Indonesia*, prepared for the Consultative Group for Indonesia, October 2000.

sectoral roles and responsibilities across levels of government; (2) supporting a selected number of local governments, which have put reform into practice, to improve the design and implementation of service delivery; and (3) continuing to help directly empower communities in poor regions (rural and urban). In addition, the Bank will provide selective assistance to areas in conflict.

53. **First, the Bank will help Government define roles and responsibilities for each level—center, province, district and below, and for private sector involvement.** Getting these roles and responsibilities right during the transition period and re-orienting the civil service to become responsive to those it is meant to serve will have long-term implications for the quality of service delivery. For each sector, specific technical issues must be taken into account (see Box 2.4 for examples in irrigation, roads and environment). Thus, the Bank will give priority to supporting Government to identify, give authority to, and build capacity at the appropriate administration level, and help create openings for the private sector where appropriate. Primary sectors of focus include: basic education, health, basic infrastructure (roads, irrigation, urban services, and energy), and environmental management. This will be done in connection with supervision of on-going projects, and as a particular focus in the preparation of new ones, including eastern Indonesia roads, second provincial health, strengthening local education

**Box 2.4: Getting The Right Level of Government Is Critical For Effective Service Delivery:  
Examples from Irrigation, Roads and Environmental Management**

**Irrigation:** Part of the sector is best served through “highly” decentralized arrangements (at the district level), such as operations and maintenance (O&M) and water allocation in irrigation systems at the tertiary and secondary canal levels. However, where externalities and economies of scale demand a more aggregated approach, such as in river basin management (pollution control, O&M, erosion abatement, etc.), decision-making at an intermediate level is required with a larger involvement of provinces. Other functions are best performed at the central level, such as development of policy and regulatory systems and standards, databases, and support for large infrastructure such as dams. However, the picture is complicated as institutional arrangements follow *hydrological* and not administrative boundaries. Thus, water user associations and river basin corporations require close cooperation—between local governments and non-governmental entities as well as among provincial and district governments.

**Roads:** If responsibility for all aspects of national/provincial roads are decentralized to the district level, Indonesia risks degradation of service on its road network. Overall network planning—planning, programming, and budgeting of a program of works (where national/provincial responsibility is needed) should be distinguished from design and implementation of individual packets of works (where local responsibility is appropriate). “Local” interests could put “local” projects before national/provincial ones, and roads in poorer provinces could deteriorate rapidly. Moreover, if design and construction is decentralized before adequate technical staff, competitive procurement (nationwide), and independent quality assurance or oversight are in place, there is a risk of poor quality work, and deterioration of roads and bridges.

**Environmental Management:** Decentralizing the majority of environmental management authority to the municipal (district) level is not appropriate; it is not a successful model in other countries, and most that have tried it have recentralized partially or completely. As conceived, decentralization will shift resource development decisions (industrial plant siting, major land development, and exploitation of natural resources) to district control. Environmental assessments (EAs) will be reviewed by provincial commissions. But, where provincial capacity is weak, or where there is no EA required, districts will give the approvals, and there are many incentives for the district to exploit their resources in the short run and ignore longer-term consequences.

capacity (1&2), and improving quality and responsiveness of community-oriented healthcare, as well as sectoral AAA work.

54. **Second, the Bank will support selected local governments who have put reform into practice with the basics of effective service delivery and work toward identifying promising provinces and districts for future support.** Government commitment is the prerequisite to effective aid. The Bank aims to help a limited set of provinces and districts (including cities) which have demonstrated reform to develop the basics of transparent, accountable, and demand-responsive public service delivery (see Box 2.5), and to position the Bank to increase sub-national programmatic and investment lending—both within and across sectors—once conditions permit. The Bank will seek to support reform-minded, pro-poor leaders and performing governments, through on-going supervision, project preparation, and sub-national dialogue. Selection criteria and a short-list of areas would be reviewed with the central government, to seek agreement on 2-4 provinces in which the Bank could initiate deeper engagement through consultations with local governments and civil society, and through provincial public expenditure reviews. Adjustable Program Loans (APLs) are being prepared for water management—following reforms supported by the Bank-financed Water Sector Adjustment Loan—and for urban services, which will support sub-national governments which have taken concrete reform measures.<sup>13</sup> The Bank is also assessing the feasibility of establishing 3-4 regional public information centers to expand its sub-national presence.

**Box 2.5: Encouraging “Demand-Responsive” Service Delivery in  
Basic Education and Health**

Prior to the crisis, the Government mobilized a sizable corps of public employees to deliver education and health services. These services were expected to reach the poor by virtue of broad coverage. While impressive gains were made, large gaps between the education and health attainments of the rich and poor remained. For example, the poor have much higher incidence of certain diseases, higher infant and child mortality, poor nutrition and their children lag in school. These discrepancies can be traced back to inadequate performance of teachers, doctors, nurses and other health care providers who lack skills, environment and incentives to address the needs of the poor.

During the crisis, emergency programs, including those supported by the SSNAL, helped to prevent sharp reductions in education and health status common to crisis-hit countries and brought important institutional changes which improved transparency and accountability - complaints were independently monitored and communities had more information and involvement. These “demand-responsive” service delivery mechanisms should be retained in future programs. Bank policy dialogue and projects will also work to help:

- Improve capacity—raise the quality of civil servants (teachers and health workers) in terms of training and capabilities;
- Provide workers more flexibility to structure services based on local needs;
- Provide adequate compensation for those that perform (which will almost certainly require substantial reduction in the numbers);
- Promote private provision of education and health services where appropriate;
- Develop feedback mechanisms and accountability for adequate services to the poor; and
- Create a “broker” or “facilitator” function that works to help the poor articulate their voice.

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<sup>13</sup> The final approach to APLs will depend on the fiscal transfer framework ultimately agreed.

55. **Third, the Bank will continue to help empower communities so that poor everywhere have an opportunity.** Building on the successes of recent community-driven development projects, the Bank will continue to focus on approaches in which project selection and implementation are in the hands of communities, and which support civil society monitoring of project implementation budgets and expenditures.<sup>14</sup> This approach has shown to better match community investments with local needs, and to build local social capital. In future projects, the Bank will support the Government to retain and enhance the direct fund channeling mechanisms and monitoring systems in these projects, which have yielded 20-40 percent savings over standard public sector delivery of basic infrastructure. These projects would target poorer urban and rural areas, on and off-Java, and will seek to further improve fiduciary controls, quality of outputs, and links with district governments. Proposed new projects include Kecamatan development project (supplemental), second Kecamatan development project, NTB poverty (pilot), and community-based urban development.

56. **Assistance to areas in conflict.** At least five provinces are involved in serious violent conflict, while others are affected by large numbers of people displaced by violence. About 15 ongoing Bank projects have components in four of these areas (Maluku, Central Sulawesi, Aceh, West Timor). The Bank may have comparative strengths in dealing with post-conflict situations, as it already deals with many of the underlying economic causes (economic disparities, governance issues, weak government and civil society), and has developed innovative approaches to community development and demand-responsive program design. The Bank's Kecamatan Development Project (KDP) approach provides a possible avenue for assistance to post-conflict areas. But the Bank is not well placed to provide emergency assistance. And risks are high as donor involvement may exacerbate divisions while there are possible reputational risks to the Bank. The Bank therefore does not foresee taking a leadership role among donors in this area, but will seek to get better integrated into the United Nations system for monitoring conditions in violence prone areas and sharing Bank experience in successful poverty approaches that may apply to such areas. Besides, the Bank will (a) develop a more systematic response to the impact of conflict on ongoing projects to ensure continued development impact and protection of project resources, and to create flexibility for possible refocusing of assistance on reconstruction and development in post-conflict areas; and (b) selectively pilot innovative approaches in violent prone areas that address critical needs of the poor (e.g., recent support for widows in Aceh) as the basis for learning and possible wider application in other areas.

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<sup>14</sup> The community development model of the two completed village infrastructure projects and the Kecamatan development project is now also applied in various other new projects—Urban Poverty Project, Water and Sanitation Supply for Low Income Communities II, rural area development projects, and the school building components in basic education projects.

### 3. IMPLICATIONS FOR THE BANK GROUP PROGRAM

57. **The Bank Group’s assistance program will require flexibility and adjustments as circumstances change.** The base case—considered to be the most likely scenario—presumes that the current “muddle through” situation will continue, with some slippage in structural reforms, but continued macroeconomic stability (para. 21) that would help sustain poverty reduction. On the downside, there is the possibility of increasing political turmoil, further major policy slippage or external shocks that may further delay implementation of the economic program. At the same time, the change in government offers significant opportunities for fundamental reform that have eluded Indonesia in the last three decades. The Bank Group’s program should be ready to respond and move to a high-case scenario in case reforms accelerate.

58. **The Bank Group’s conservative base case program is expected to be reasonably robust in the face of most downside risks, while at the same time positioning the Bank Group for possible upside opportunities.** The “muddle through” base case scenario provides a tenuous base for Bank Group support to Indonesia. This is not a desirable scenario to undertake much new lending and even harbors risks to our portfolio as fiduciary standards may slip in the newly decentralizing environment. At the same time, the Bank is one of Indonesia’s major long-term development partners and cannot disassociate itself as the country moves through its historic democratic transition. The base case program takes account of these factors and provides for a conservative Bank lending program of up to US\$400 million per year with an average 65:35 IBRD/IDA blend over the CAS period. This is less than one third of pre-crisis lending levels, and would result in a gradual reduction of the Bank’s high exposure in Indonesia (para. 89). The focus will be on poverty and community development projects which are expected to be reasonably robust in such an uncertain environment. The minimum conditions for the base case scenario would be the maintenance of macroeconomic stability, minimum fiduciary safeguards for delivery of public services with decentralization, and establishment of organizational arrangements, scope, process, and schedule for developing a broad-based poverty reduction strategy. A continued strong AAA program in the base case would assist Government in enhancing policy performance, which in turn may lead to a possible high case assistance scenario—including enhanced IBRD and IDA lending. On the other hand, a possible deterioration from the “muddle through” base case scenario could lead the Bank to cease all new lending.

59. **The country’s decentralization move will reshape the Bank Group’s operating environment.** The Bank has begun to prepare for working in a decentralized environment. But during the transition to such an environment, the Bank can expect significant difficulties to its program. It has devoted significant resources to advising the Government on how to minimize the associated risks. Decentralization also presents important medium-term opportunities for the Bank. As explained in the previous section, the Bank has started a consultative process to develop new ways of doing business in this new environment. Much of the Bank’s future new lending will be to assist sub-national governments.

60. **Indonesia's weak fiduciary environment poses continued risks for the Bank's portfolio and lending activities.** As noted, Indonesia suffers from weak traditions of accountability in the public sector which has led to widespread corruption and misuse of public funds. This affects donor funds in equal measure. The forthcoming decentralization of a large share of public expenditures to regional governments will compound existing weaknesses. While the Bank has made considerable progress in strengthening fiduciary controls (para. 28), the challenge will be to further enhance protection of its portfolio and lending resources in a context of greater risk. Protecting Bank-financed projects in a sustainable manner can be effective only if there are systemic reforms to Indonesia's accountability, procurement and financial management framework. Government has indicated its commitment to take steps in this area (para. 69). Besides strengthening its own fiduciary controls, the Bank will condition its lending levels and access to additional IDA on progress in strengthening of public procurement and financial management systems.

61. **The Bank Group program involves close cooperation with the Bank's development partners based on comparative strength, proactive portfolio management with enhanced fiduciary controls, a high-quality program of analytical and advisory activities focused on key areas of reform and risk management, and a flexible lending program with strong poverty focus.** The CAS program, instruments and assistance scenarios are elaborated in the following sections. Table 3.1 provides an overview of the CAS program components and related Bank instruments and lead partners. A CAS program matrix is shown in Annex B9.

**Table 3.1: Bank Group Instruments and Major Partners by Bank Group Program Area**

Bank Program Area	Bank Instruments		Major Partner(s)
	National level	Sub-national level	
<b><i>Economic recovery &amp; quality growth:</i></b>			
• bank & corporate restructuring	AAA, SPN, IFC	-	IMF, ADB
• macroeconomic stability	AAA	AAA	IMF
• pro-poor policies	LEN, AAA	AAA, LEN	DFID
• private sector development	AAA, IFC, MIGA	AAA	ADB
• human capital development	AAA	AAA, LEN	ADB, WHO
• addressing infrastructure bottlenecks	AAA, IFC, MIGA	AAA, LEN	ADB, Japan
<b><i>Building national institutions:</i></b>			
• legal & judicial reform	AAA	-	Netherlands, ADB, USAID
• civil service reform	AAA	-	-
• public procurement & financial mgt.	AAA, SPN	AAA, SPN	ADB, Japan
• managing decentralization	LEN, AAA	-	IMF, ADB, GTZ
• natural resource management	AAA	AAA	EU, DFID
<b><i>Delivering better public services to the poor:</i></b>			
• defining roles and responsibilities for each government level	AAA	AAA	ADB
• demand responsive service delivery	AAA	LEN, SPN	ADB, Netherlands
• community development	-	LEN, SPN	ADB, Japan
• assistance to (post) conflict areas	-	AAA, SPN	UNDP, UNHCR

*Note:* AAA = analytical and advisory services (policy advice, economic and sector work—ESW); LEN = lending; SPN = supervision of ongoing projects

## PARTNERSHIPS AND SELECTIVITY

62. **The Bank Group is increasingly pursuing partnership arrangements based on strategic fit and comparative advantage.** This allows the Bank Group much greater selectivity in terms of areas of concentration, while drawing on its partners' skills and expertise to provide the broad overview of the development process that is supported by the Bank's central aid coordination function. In Indonesia, as elsewhere, the Bank Group continues to pursue a multi-layered partnership strategy. Managing these partnerships is resource-intensive, but the payoff for the Bank Group is a leveraging of its resources, and the sharing of knowledge and expertise, and access to civil society that the Bank Group on its own would find difficult to achieve.

63. As **chair of the CGI**, the Bank works closely with most of Indonesia's major development partners who rely on the Bank's analytical work and its close relation with Government to provide them the framework for assistance. In the rapidly changing development context of Indonesia, this implies not just the annual CGI meeting but also regular meetings in Jakarta, including a mid-year informal review of progress on CGI commitments. The CGI itself has evolved into a focused discussion on a range of key issues (e.g., structural reform, poverty reduction, governance, decentralization, forestry), typically led by donor partners with the Bank facilitating, but not leading, the process.

64. In support of the **Government's economic recovery program**, the Bank works closely with the IMF and the Asian Development Bank (ADB) in the context of Government's Extended Arrangement with the IMF. The IMF takes the lead on macroeconomic policy, while the Bank takes the lead on structural and social policies (including corporate restructuring and sectoral policy). ADB is the lead agency on privatization and state-owned enterprise (SOE) reform, and SME development. All three institutions share joint responsibility for support of bank restructuring and financial sector reforms. The Bank works closely with the IMF and ADB in preparing the LOI for the Extended Arrangement.

65. In support of the **Government's medium-term development program**, the Bank Group partnerships are again multi-layered:

- **Sectoral partnerships:** A range of partnerships have emerged in a number of areas, such as governance, decentralization, SME development, competition policy, water resource sector reform and forestry. Each has lead donors and a concerted effort to coordinate donor program and policies in support of a common set of objectives agreed with and sometimes led by Indonesian stakeholders. Perhaps the most ambitious and innovative of these is the Indonesian-led Partnership for Governance Reform in Indonesia, an initiative of the UNDP, the World Bank Group and the ADB, which is intended to support Indonesia's transition to a democratic decentralized society by facilitating a national dialogue on governance issues

aimed at bolstering the demands for reform, with funding to support innovative governance reform.<sup>15</sup>

- **Major lenders:** Official lending in support of Indonesia's development priorities is dominated by three agencies: Japan's JBIC, ADB and the World Bank Group. These three agencies work closely together to ensure consistency in approach and policy stance. The Bank has pulled back from areas where it no longer has a comparative advantage and strategic fit, such as parastatal-led infrastructure investment projects in power and telecommunications, which were a big part of the Bank Group's pre-crisis lending. Japan is still a player, while the Bank Group complements this role through advice to Government on its policy and regulatory framework for infrastructure. The Bank and ADB work together on joint sectoral approaches and in some cases joint documentation (e.g., basic education). The Bank, ADB and JBIC work closely on the period Country Portfolio Performance Reviews (CPPRs) with Government, and the three lenders are coordinating closely to manage the fiduciary risk reviews posed by decentralization.
- **Policy dialogue:** The more important, established bilateral donors look to the Bank Group to take the lead on the overall policy dialogue and seek to complement the Bank Group's role through strategically directed technical assistance on grant terms, thus filling a gap in the Bank Group's arsenal. They support the Bank Group's policy work through consultant trust funds and occasional secondment of staff to the Bank Group office in Jakarta.
- **Cofinancing:** Some donors (most notably the United Kingdom and the Netherlands) do not wish to maintain a large aid presence in Jakarta but are conscientiously choosing to cofinance, on grant terms, the Bank Group's operations, thus softening the overall terms the Bank Group offers. These donors work particularly closely with the Bank Group and have been most supportive in stretching the Bank Group's AAA resources.
- **Partnerships with smaller agencies:** The smaller agencies, such as UNICEF, see the Bank Group as a partner who allows them to marry their local knowledge and expertise with an ability to scale up their activity. These agencies and foundations are keen to work with the Bank Group because they see us amplifying their voices on policy issues and providing them a framework within which they are able to operate.

66. **The CAS program will more systematically exploit synergies within the Bank Group, particularly in private sector development.** Bank and IFC activities in Indonesia are now managed by a joint Director who coordinates private sector development activities. This provides for greater scope in exploiting synergies between policy and transactions, such as applying the lessons from IFC's corporate experience in the Bank's work on developing the policy and regulatory frameworks across the sectors in which the Bank is active, for example in

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<sup>15</sup> Under the partnership, a *Facility* houses a small number of national and international experts who facilitate an Indonesian-led national dialogue on issues of governance that is informed by surveys, strategic thinking and research, and sharing of international best practices; A *Governance Fund*, which has attracted bilateral donor support (\$25 million) for innovative governance reform proposals from civil society and government agencies. These two vehicles function under the direction of an Indonesian-led Board of Governors shared by two prominent advocates of governance reform.

banking, legal reform, corporate restructuring and governance, infrastructure and the social sectors. While the Bank will focus on policy and institutional reforms, IFC will invest in priority areas—taking steps to avoid any conflict of interest that may arise. Financial sector, SMEs and mining are good examples. IFC may invest in existing and new financial institutions and strengthen management, credit analysis, risk management. In SMEs, IFC is looking for opportunities to help set up a decentralized SME facility for SME services, and to invest in financial intermediaries serving SMEs. In mining, based on its experience with the Business Partnership for Development, the Bank is looking at strengthening capacity at local and regional levels to develop and enforce environmental regulations, and facilitating partnerships and procedures to set up mechanisms for dispute resolution. IFC in turn could invest in environmentally and socially sustainable mining operations. Within the Group, the Foreign Investment Advisory Group (FIAS) and MIGA focus on strengthening foreign investment services at the regional level in the context of decentralization.

### PORTFOLIO MANAGEMENT

67. **Portfolio management will focus on continued quality improvement and further strengthening of fiduciary controls.** The Bank's portfolio will continue to decline in size as more projects are closed than are added. By FY03, we expect our portfolio to stabilize at around 50 to 55—down from 66 projects at end-FY00 (including GEF operations). In view of decentralization, the Bank will be adjusting implementation arrangements with related capacity strengthening in ongoing projects that will operate in the newly decentralized government structure (e.g., basic education and health projects). The Bank will continue to seek quality improvements and emphasize fiduciary oversight in its portfolio through: (a) proactive management of problem projects; (b) restructuring of projects to maintain relevance and improve performance; (c) increased thematic supervision to review systemic issues and enhance cost-effectiveness of supervision work across projects in a sector or region; (d) improved readiness for implementation to avoid start-up delays;<sup>16</sup> and (e) attention to fiduciary controls related to procurement and financial management. The Bank will intensify its work with ADB and JBIC on common approaches to portfolio management as an extension of the joint CPPR work started in FY00. Improvements in portfolio performance during the CAS period are expected to be modest because of the fluidity of the overall environment and uncertainty and challenges caused by the forthcoming decentralization. The portfolio quality targets are shown in Table 3.2.

**Table 3.2: Bank Portfolio Quality Targets, FY01-03**

<b>Indicators</b>	<b>FY00 (actual)</b>	<b>FY01</b>	<b>FY02</b>	<b>FY03</b>
% Projects at risk (no.)	21%	18%	17%	16%
% Actual problem projects (no.)	18%	16%	15%	14%
Realism index	83%	85%	90%	90%
Pro-activity index	83%	85%	85%	90%
Disbursement ratio	21%	20%	20%	20%

<sup>16</sup> Implementation readiness is judged by a combination of factors, including (1) performance indicators being in place; (2) firm arrangements in place for implementation funding; (3) completion of plans and financing arrangements for any land acquisition and resettlement; (4) establishment and staffing of project implementation units; (5) procurement and financial management/audit arrangements in place; (6) completion of procurement documents for first-year implementation.

68. **Actions to strengthen fiduciary controls in procurement and financial management include steps at the national level and at the level of the Bank's portfolio.** Portfolio management in Indonesia will remain challenging because of continued downside risks associated with macroeconomic performance, inadequate project management and governance, limited monitoring and evaluation capabilities, ineffective fiduciary functions (procurement, financial management, internal controls and reporting), and the huge decentralization agenda. The Bank also realizes that the deep-seated nature of corruption in Indonesia will make strengthening of fiduciary controls a long-term challenge and managing large fiduciary risks to Bank-financed projects will require constant attention. Also, decentralization if not well managed on fiduciary standards at the local level can pose fiduciary fragmentation and divergence, which will pose severe control risks and result in unnecessary costs. Building on the results of the CPAR and CFAA work in FY00-01 and of a recent high-level Bank mission to review Indonesia's fiduciary control environment, the Bank will support Government efforts toward the preparation and implementation of action plans to strengthen the weak financial management and procurement systems.

69. **At the CGI meeting in Tokyo, the Government made specific commitments to reform the public procurement and financial management systems along the lines of the CPAR and CFAA.** These steps are outlined in Box 3.1, along with an overview of the fiduciary environment and the strategy to protect Bank-financed projects. Satisfactory progress in reform of these systems has been built in as triggers for future Bank lending (see para. 80). This includes immediate steps to ensure for the base case lending program that same fiduciary standards for public procurement and financial management are applied at provincial and district levels, as at the national level. Maintaining uniform standards for procurement and financial management will require a revision of current government regulations related to implementation of the decentralization program. In order to develop a sound fiduciary environment, these actions will need to be complemented by reforms in the overall governance system, including reforms in legal and judicial systems, civil service reform and the overall accountability structure. These efforts are supported by the Bank's work on governance reform (para. 46).

70. **IFC has been able to turn around its portfolio hit by the crisis, by way of intensive restructuring and recapitalizing of its existing client companies.** As in other crisis-affected countries, IFC has worked on restructuring of its existing client companies. IFC's portfolio included 14 problem projects with total exposure of \$364 million (\$138 million A loans, \$43 million equity, and \$183 million B loans), representing about 43 percent of IFC's total exposure in Indonesia. IFC completed four major restructuring projects for a total \$135 million, or about 42 percent of the problem loan portfolio. Only one portfolio company has been put into liquidation proceedings as a result of other creditors taking legal action. IFC will continue to follow up on these efforts in protecting its portfolio.

71. **MIGA's portfolio in Indonesia was affected by a claim from one of its projects.** As a result, MIGA has suspended its guarantee activities in Indonesia. As soon as it has settled handling of the claim with Government, MIGA will resume cover in Indonesia.

### Box 3.1: Fiduciary Environment and Bank-Financed Projects

The overall fiduciary environment in Indonesia is weak. The findings of the recent CPAR and CFAA confirmed that the public procurement system does not function well and the internal control environment remains inadequate. Practices vary widely from the formal rules and procedures, enforcement is weak and sanctions are rare. There are concerns about the value of money and accountability for public funds. The main problems are:

- Weak compliance with existing procurement rules and procedures; lack of internal controls, oversight and enforcement; uneconomic packaging, inadequate advertising; use of restrictive bidding practices; prevalence of collusive practices; and lack of capacity.
- Lack of clarity in important policy and procedural requirements for public procurement, with an effect on the level of transparency and enforcement
- Absence of a single agency with a mandate for formulation of procurement policy, and monitoring compliance, and for ensuring clear and enforceable sanctions and enforcement mechanisms.
- Absence of strong enforcement when procurement irregularities are discovered and mishandling of funds is reported.
- Unclear roles, responsibility, and authority of various external and internal audit functions.
- Inadequate parliamentary oversight and delays in timely public reporting of financial information.

Decentralization and the increasing shift to new lending to social sector projects, which involve thousands of small-value contracts at the sub-national government level that are generally not subject to prior review by Bank staff and where capacity for implementation and monitoring is generally weak and the accountability issues are significant, would increase fiduciary risks in Bank-financed projects.

Despite the Bank's best efforts, it is simply not possible to fully insulate Bank-financed projects from the systemic problems in the country's environment in which they are implemented. A recent mission of senior staff from Operational Core Services (OCS) recommended further strengthening of accountability and fiduciary oversight in the use of public funds, including those under Bank-financed projects. Building on the outcome of the OCS mission and the CPAR and CFAA, the Bank's strategy to help reduce opportunities for corruption and thereby help ensure that proceeds of Bank loans are used for the intended purposes with due attention to economy and efficiency, has the following four components (besides our broader work on governance reform and anti-corruption):

- **Prevention—Reducing opportunities for corruption in new projects through strengthened project design:** the Bank will pay close attention to the fiduciary environment and capacity of the implementing agencies and incorporate adequate safeguards in the design of new projects. It will give priority in new projects to the provinces and districts that demonstrate concerns for economy, efficiency and transparency in the use of public funds. The Bank will insist on the installation of planning, budgeting, and project management reporting systems, and on additional legal provisions to make the national competitive bidding procedures acceptable to the Bank. It will promote greater beneficiary and civil society involvement in the design, implementation and monitoring of projects to enhance transparency and prevent misuse of funds, and third party verification as a feature of new projects.
- **Strengthening existing mechanisms of fiduciary monitoring and supervision of ongoing projects:** the Bank will intensify efforts for requiring updated and satisfactory annual procurement and financial plans and insisting that they are used for guiding implementation and supervision, conducting regular ex-post procurement and SOE reviews, strengthening capacity of the implementing agencies, and ensuring that procurement complaints and audit findings are followed up. Projects with increased fiduciary risks will receive special attention. The Bank will increase the number of selective site visits to review procurement by sub-national governments and physical progress to match with fiduciary risks.
- **Enforcement—Investigating cases of alleged fraud and corruption:** the Bank will rely on its Corruption and Fraud Investigation Unit (CFIU) to investigate cases of alleged fraud and corruption, and apply sanctions where called for. The first visit of CFIU to Indonesia was in November 2000, and a follow-up mission will take place in early 2001.
- **Supporting Government efforts to reform the public procurement and financial management systems:** This support will follow up on the recommendations of the CPAR and CFAA and the recent OCS fiduciary mission. Full implementation of reforms of the overall systems at all levels of government will take time. At the October 2000 CGI meeting in Tokyo, Government made specific commitments along the lines of the CPAR and CFAA. The Bank's immediate priority will be to support Government efforts to (1) ensure that the same fiduciary standards are applied at national, provincial and district levels; (2) establish a National Public Procurement Office (NPPO) to formulate procurement policy, and enhance and monitor compliance; (3) revise draft laws on State Finance, Treasury and Audit, which been submitted to Parliament already; and (4) support NPPO in the formulation of a public procurement law.

## ANALYTICAL AND ADVISORY ACTIVITIES

72. **The Bank is rebuilding its AAA program with heavy emphasis on advisory activities, a small but growing body of analytical work, and increased attention to regional issues.** The main components of the program are shown in Annex B4. In the “muddle-through” base-case scenario, the Bank will retain a high level of advisory activities on immediate policy issues in:

- **Bank and corporate restructuring:** The Bank’s intensive involvement in this key area must be maintained. Not to do so would invite a large reputational risk for the Bank Group.
- **Development of a poverty strategy:** The Bank’s draft paper contributing to a Government poverty strategy will feed into the development of a poverty strategy backed by a multi-stakeholder consultation process. This would also involve assistance for Government’s preparation of a PRSP in FY02 (para. 17).
- **High-priority public procurement and financial management reforms:** Based on ongoing work in public procurement and assessment of the government financial system, the Bank will advise on key initial steps in setting up a public procurement agency, on revisions of the draft Laws on State Finance, Treasury and Audit, currently in Parliament, and on safeguarding public finances in a decentralized environment (para. 69).

73. **The Bank’s AAA program will also include components of a medium-term nature,** such as:

- **Governance:** The Bank’s recent work on fiscal decentralization, civil service reform, financial management, and corporate governance should be considered only the first step in a long-term engagement with these issues—involving advisory activities supported by analytical work.
- **Implementation of the poverty strategy:** Preparation of the poverty strategy in the short term will need to be followed up with support for its implementation, especially at the regional level. The Bank will also continue its agricultural policy dialogue, which it considers a key component of a broad-based poverty strategy.
- **Analytical work at the regional level:** Work will be undertaken to develop a better understanding of local institutions, local capacity, public expenditure programs, fiduciary environment and the quality of public service delivery to the poor. This work will be undertaken by cross-sectoral teams that engage with sub-national governments, civil society groups, the private sector, and local communities. It will be aimed at developing a new generation of lending operations at sub-national level that embody demand-responsive policies and public service delivery as outlined in the previous section (para. 51).
- **Design and implementation of a long-term financial sector strategy:** The current focus on bank restructuring will now need to make way for a broader and more medium-term reform of the entire financial sector, including non-bank financial institutions, the capital market, rural financial intermediation, and micro-finance.

- **Long-term development prospects:** The Bank intends to initiate a joint work program with Indonesian policy and research institutions and its international development partners to help Indonesia prepare a long-term view of its development prospects focusing, among others, on agriculture, environment, health, education, urban and spatial issues. The Bank's role will primarily be one of facilitator and intellectual interlocutor, while the leadership will come from Indonesian institutions supported by trust funds.

74. **The Bank is building a strategic partnership with the World Bank Institute (WBI) focused on governance and capacity building but also including poverty and forestry.** WBI will support the Bank's substantive agenda in a few key areas (governance/anticorruption, decentralization, forestry reform), help access the new technology-based global learning networks that the Bank is developing, and access learning programs for external audiences (such as parliamentarians, think tanks, civil society).

#### LENDING PROGRAM, TRIGGERS AND INSTRUMENTS

75. **The base case lending program could return investment lending to less than one third of pre-crisis levels.** In the "muddle-through" base-case scenario, lending would be up to \$400 million a year, as compared with average lending of about \$1.3 billion a year during FY90-97. This would include Indonesia's current IDA-12 allocation of SDR300 million (about \$400 million), and assumes continued IDA access beyond FY02. If Indonesia's IDA allocation were to be maintained at the level of IDA-12, this would result in an average 65:35 IBRD/IDA blend during the CAS period. Any proposals for an IDA allocation beyond the IDA-12 period (FY00-02) would be considered within the context of the IDA-13 replenishment. Minimum conditions for the base case would be maintenance of macroeconomic stability, including prudent debt management and progress on asset sales and privatization, minimum fiduciary safeguards for delivery of public services with decentralization, and establishment of organizational arrangements, scope, process, and schedule for developing a broad-based poverty reduction strategy. Specifics of these minimum conditions are shown in Table 3.4 below. Lending would be for projects in health, education, basic infrastructure, and community development. The types of poverty-oriented projects in the base case are expected to be reasonably resilient as long as macroeconomic conditions remain stable. No adjustment lending is foreseen in the base case.

76. **The CAS also anticipates possible "crisis" scenarios.** As indicated above, the base case scenario is expected to involve considerable volatility in policy and institutional performance. A breakdown in Government's Extended Arrangement with the IMF as a result of major policy slippage, including inadequate progress on bank and corporate restructuring, could lead to a rapid erosion of market confidence and deterioration in economic conditions. A similar outcome could result from political instability or a widespread breakdown in law and order. In these adverse situations, the Bank would cease all new lending until base case conditions have been restored. In the event of another macroeconomic shock, e.g., from lower world oil prices, slower global growth, or volatility in international capital markets, the Bank may be asked to contribute to an international rescue effort with additional adjustment lending or support to crisis-response programs. However, the Bank's response this time around would be limited by Indonesia's high debt burden, as well as IBRD's high exposure in Indonesia (para. 89).

77. **The Bank is prepared to move to a higher lending case, if policy performance improves (“performance” scenario).** The change in government has offered significant opportunities for fundamental reform. The Bank is working with Government in the various areas of structural and governance reform, and in developing a poverty strategy. In case reforms accelerate, and in line with Government’s request, the Bank is prepared to raise lending to about \$1 billion per year from FY02. In such a scenario, increased investment financing needs for basic infrastructure services (urban and rural) are envisaged as economic activity accelerates, besides an accelerated expansion of community development and social sector programs given the higher prospects for sustainability with a broad-based poverty strategy. A high performance environment would allow for an earlier move toward programmatic lending—as early as FY02 for sectoral interventions (APLs for water and urban services). Indonesia would be eligible for adjustment lending in the high case, although it is unlikely to be needed given current budget and balance of payments projections. The high-case program includes a small indicative amount of adjustment lending in FY01-02 (about \$200 million a year) before it is phased out in later years.

78. **As part of the high case, the Bank would temporarily increase Indonesia’s IDA allocation.** At the recent IDA Deputies meeting in Lisbon, Deputies broadly agreed that the processes of reform and improving governance in Indonesia should be strongly supported, including through enhanced IDA allocations as elaborated in the background note from staff.<sup>17</sup> In the meantime, Government has taken initial steps in the areas of poverty reduction and governance reform. Based on adoption *and* sustained implementation of coherent action programs in these areas, the Bank would increase Indonesia’s current IDA share by about US\$200 million a year over the period FY01-03. In the high case, the average IBRD/IDA blend would be about 60:40 over the CAS period. The lending scenarios in the base case and the high case are shown in Table 3.3.

**Table 3.3: Lending Scenarios, FY01-03**

	<b>FY00 (Actual)</b>	<b>FY01</b>	<b>FY02</b>	<b>FY03</b>	<b>CAS Period (FY01-03)</b>	<b>IDA-12 Period (FY00-02)</b>
<i>Base-Case (“Muddle-Though” Scenario)</i>						
IBRD:						
-- investment	13	238	280	265	783	531
-- adjustment	-	-	-	-	-	-
Subtotal	13	238	280	265	783	531
IDA	120	160	120	135	415	400
Total	133	398	400	400	1,198	931
<i>High-Case (“Performance” Scenario)</i>						
IBRD:						
-- investment	13	158	400	600	1,158	571
-- adjustment	-	200	200	-	400	400
Subtotal	13	358	600	600	1,558	971
IDA	120	240	400	400	1,040	760
Total	133	598	1,000	1,000	2,598	1,731

79. **Indonesia’s IDA eligibility would be on a temporary basis.** The reforms supported by the higher IDA allocation would boost prospects for an accelerated economic recovery and

<sup>17</sup> Staff paper entitled “Indonesia—Recent Developments and Issues That Will Underpin the FY01-03 Country Assistance Strategy,” circulated to the deputies on May 24, 2000.

enable Indonesia's return to full market access. Indonesia is expected to phase out from IDA as economic growth gains momentum and its per capita GNP surpasses again the IDA threshold (\$885 for IDA-12). Based on current projections this is not likely to happen for another four to six years. Using current market sentiments as a guide and the increased uncertainties, Indonesia is more likely to surpass the IDA threshold before it regains the status of a high-creditworthy borrower with full market access.

**80. The high-case lending scenario is conditioned on a set of upfront reform actions plus continued progress in key reform areas monitored by regular policy performance assessments.** For the high case, upfront actions involve a set of key Government actions in two broad areas—macroeconomic stability and structural reforms, and governance and poverty strategy. In the first area, Government will need to take actions aimed at improving macroeconomic performance, accelerating bank and corporate restructuring, implementing its privatization plan, and setting a medium-term direction of rice policy. The Bank will continue to use the LOI as the primary instrument to assess progress on macroeconomic stability, bank and corporate restructuring, and privatization (also see para. 81). Upfront actions in these areas will comprise agreement on the appropriate policies and targets in the LOI. In the second area, key conditions for the high case involve Government actions to strengthen public procurement and financial management systems, and to initiate preparation of a broad-based poverty reduction strategy based on multi-stakeholder consultations. These upfront actions for the high-case lending scenario are elaborated in Table 3.4 below.

**81. The Bank will undertake regular semiannual policy assessments with Government to determine continued eligibility for the high case and to set performance targets for the next six months.** Given the difficulty of setting upfront annual lending triggers for the CAS period in Indonesia's uncertain environment, these semiannual policy assessments will provide the basis to judge whether Indonesia qualifies for the high case scenario. The findings of the review would be made available to the semi-annual CGI meetings for review by the Government with the donor community. A satisfactory outcome of the review would mean that Indonesia would be eligible for enhanced financial support from IBRD and IDA. Alternatively, if policy actions fall short of agreed targets, Indonesia's eligibility will be revisited after six months. These semiannual reviews provide the Bank and the Government a benchmark against which to judge progress and a regular vehicle to discuss structural and social reforms. As part of these reviews, the Bank will continue to use the LOI as the primary instrument to assess progress in the areas of macroeconomic performance, bank and corporate restructuring and privatization. Over time, as the scope of the LOI narrows, the Bank will review with Government the feasibility to move toward a letter of development policy which would outline Government's agreed commitments for social and structural reform not covered in the LOI.

**82. The Bank lending program foresees a mix of investment projects that respond to its poverty focus and that would provide flexibility to respond to changing circumstances.** The program's core investment projects would support delivering better public services to the poor through local governments that have demonstrated reform and community empowerment to reach the poor. Project focus would include: (1) community-based development programs (the recent Kecamatan development and urban poverty projects provide good examples); (2) human development (sub-national programs in health and education); and (3) basic infrastructure (urban and rural). In addition, investment projects would support pro-poor policies for quality growth,

**Table 3.4: Minimum Conditions and Up-front Actions for Poverty Reduction in a Base Case and High Case Lending Scenario**

<b>Base Case ("Muddle-Through" Scenario)</b>	<b>High Case ("Performance" Scenario)</b>
<b>A. Macroeconomic stability &amp; structural reforms</b>	
<p>Maintain macroeconomic stability:</p> <ol style="list-style-type: none"> <li>1. Prudent debt management, and progress on asset sales and privatization, to keep government debt below 100% of GDP*</li> <li>2. Base money program consistent with inflation below 15%</li> <li>3. Primary (non-interest) budget surplus at least 1% of GDP</li> </ol>	<p>Improve macroeconomic stability:**</p> <ol style="list-style-type: none"> <li>1. Government debt below 100% of GDP (2001); 90% (2002) and 80% (2003)*</li> <li>2. Base money growth program consistent with inflation below 10%</li> <li>3. Primary (non-interest) surplus of at least 1.5% of GDP</li> </ol> <p>Accelerate bank- and corporate restructuring:**</p> <ol style="list-style-type: none"> <li>1. Agreement on corporate restructuring principles</li> <li>2. IBRA cash recovery Rp 27 trillion during 2001</li> <li>3. Complete privatization of BCA, Bank Niaga</li> </ol> <p>Implement privatization plan:**</p> <ol style="list-style-type: none"> <li>1. Receipts &gt; Rp 6.5 trillion in FY2001</li> </ol> <p>Set medium-term direction of rice policy:</p> <ol style="list-style-type: none"> <li>1. Establish and operationalize interdepartmental working group on rice policy</li> <li>2. Adopt agreed strategy for future rice policy, including price and trade policy, the role of BULOG, and productivity enhancing measures for farmers</li> </ol>
<b>B. Governance and participation</b>	
<p>Provide fiduciary safeguards for delivery of public services with decentralization:</p> <ol style="list-style-type: none"> <li>1. Restrict local government borrowing in FY01</li> <li>2. Apply national standards to local government procurement and financial management</li> </ol>	<p>Strengthen public procurement and financial management:</p> <ol style="list-style-type: none"> <li>1. Establish and operationalize two high-level committees to guide reform of procurement and financial management systems;</li> <li>2. Adopt and publish satisfactory action plan to reform the organizational structure and legal framework for procurement;</li> <li>3. Submit acceptable laws on state finance, treasury and audit to Parliament.</li> </ol>
<p>Establish organizational arrangements, scope, process, and schedule for developing a broad-based poverty reduction strategy based on multi-stakeholder consultation.</p>	<p>Prepare broad-based poverty reduction strategy:</p> <ol style="list-style-type: none"> <li>1. Draft agenda on poverty reduction strategy to facilitate consultations;</li> <li>2. Initiate multi-stakeholder consultations.</li> </ol>

\* At projected prices and average exchange rate; debt includes debt to IMF.

\*\* Upfront actions will comprise agreement on appropriate policies and targets in the LOI.

where appropriate (land administration and access to micro-finance). Particularly in a high case scenario, the Bank intends to use Adaptable Program Loans (APLs) increasingly at the sub-national level, rewarding those regions which undertake pro-poor reforms—both sectoral and broad-based public sector reform toward transparent, accountable government. Such programmatic lending is expected to have the largest poverty reduction impact by targeting provinces and districts whose leaders have already taken pro-poor, pro-growth reform measures (para. 54). This would require sub-national administrative institutions to be functioning in a satisfactory manner—including maintenance of minimum fiduciary standards. A possible public

sector reform loan/credit is contemplated at the national level to help strengthen central government capacity in a post-decentralization era.

83. **As decentralization proceeds, Bank funds will be increasingly onlent to sub-national governments.** Although the Bank is still discussing the regulatory framework with Government, it is likely that its lending will continue to be to the central government. Onlending will probably take place on terms that reflect the borrowing costs to the central government as well as the financial capacity of the local government. The average *cost-sharing ratio* in future projects (three-year rolling average) would be kept at the 75/25 ratio for IDA blend countries. The Bank will consider front-loading of disbursement percentages in individual projects if necessary in view of possible counterpart funds constraints at local levels in the early stages of decentralization.

84. **Beyond the restructuring of its existing clients, IFC will focus on interventions with strong demonstration effects and positive impact on market perceptions.** IFC has commissioned a study to identify candidates for restructuring assistance. These projects typically combine financial, operational and managerial restructuring, using a variety of instruments loan/equity, quasi-equity and technical assistance. In addition to individual transactions, IFC is exploring ways to leverage its limited resources at wholesale level through specialized investment funds to respond to the urgent needs for equity capital in the corporate sector. As part of IFC's crisis response, the Corporation will explore opportunities to help the restructuring process with the recapitalization of private banks, establishment of restructuring funds or other specialized institutions, investments in individual financial institutions, attracting strategic partners where possible, and complementing its investments with capacity building through technical assistance and twinning arrangements. A longer-term objective is to assist the deepening of the Indonesian financial sector through institution building in housing finance and mortgage-based securities products, securitization, corporate bond markets, and e-banking. In addition, IFC is preparing a second trade enhancement facility to respond to urgent needs.

85. In support of SME development, IFC intends to mobilize donor funds to finance a decentralized SME facility to provide a range of services, and build financial infrastructure for SMEs such as credit bureaus. It is looking for opportunities to invest in financial intermediaries focusing on SMEs and micro-enterprises. It is also exploring investment opportunities in resource-based industries, particularly oil and gas, and mining. Finally, IFC is interested to promote private participation in infrastructure in areas where regulatory structures are developing and where development needs are acute, such as water and transport. In a base case scenario, IFC's new business in Indonesia is expected to be in the order of \$140 to 180 million a year for IFC's own account. In a high case, the level could be in the order of \$220 million a year for IFC's own account.

86. **IFC's investment scenarios would be affected by progress in key reform areas.** IFC activity level would depend on: (a) progress on developing the bankruptcy and legal regime for protecting creditor rights; (b) progress on corporate governance (transparency and minority investor rights); (c) further openings in the FDI regime; and (d) the depth of corporate restructurings in terms of meaningful financial and operational restructuring taking place. A satisfactory resolution to the issue of IFC's tax immunities will be critical to its ability to continue operations in Indonesia.

## CIVIL SOCIETY OUTREACH

87. **The Bank will continue to extend efforts to engage civil society.** Since the crisis, the Bank has engaged a much more active and vocal civil society. It had to answer to persistent questions that its association with the previous regime contributed to high levels of debt and corruption. Considerable time was spent with members of the NGO community to review aspects of the Bank's program and discuss their concerns. The recent CAS consultations provided a good forum to discuss the Bank's role in Indonesia and explain its position on these issues (para. 31). Following the Kecamatan Development Project and social safety net adjustment loan models, the Bank is also building in civil society monitoring of project implementation. The new generation of demand-responsive projects would create much greater scope for involvement of all stakeholders in project design and implementation. The Bank has invited interested representatives to look at a sample of projects for ways to reduce possible corruption. Following up on the civil society consultations, the Bank is open to an arrangement for a consortium of "anticorruption" NGOs to act as watchdog over the use of funds in Bank projects, and to work with regional councils comprised of civil society and local government and civil society, to monitor projects during both planning and implementation. In view of the diversity of the NGO community in Indonesia, it may take some time for such a consortium to emerge. The Bank has also increased its disclosure of information and has recently launched a new external website. The Jakarta-based Public Information Center is becoming more proactive in dissemination and outreach, and the Bank is considering establishment of small regional information centers in selected provinces. The media are used more actively in explaining the Bank's position, and the Bank speaks out more openly when it differs from government positions. The Bank has also developed closer ties with an active Parliament and its relevant committees. If anything, these efforts will need to be intensified to maintain the Bank Group's relevance in the new Indonesia.

## PROGRESS MONITORING

88. **The Bank intends to monitor country progress against poverty reduction indicators once they are agreed in the Government's broad-based poverty reduction strategy.** Indonesia's historic approach to poverty overemphasized numerical targets, leaving many important dimensions of poverty and well-being unaddressed (para. 9). But giving up on goals would not be appropriate: without goals consensus in measuring progress would not be possible. To help ensure that progress is being made on the broader concept of poverty, the Bank's draft poverty report suggests a new set of objectives, but emphasizes that goals should be set as part of the process of creating a poverty strategy which should be open to dialogue and debate among the stakeholders. Table 3.5 gives details of these possible poverty reduction goals to be attained by 2004. On the headcount of expenditure poverty, the proposed goal would reduce the headcount to a slightly lower level than that achieved pre-crisis—halving the headcount from the peak reached during the crisis. Based on CAS review feedback, the goals for "human investment" and "infrastructure access" poverty measures have been scaled back somewhat from the poverty report given likely setbacks in these areas during the transition to decentralization. These possible goals aim to advance by 2004 the bottom fifth of Indonesian's population (below the 20<sup>th</sup> percentile by wealth or expenditure) to levels of human investment and access to basic infrastructure, which have been achieved by the those in the lower-middle income strata (20<sup>th</sup> to 40<sup>th</sup> percentiles). The Bank is also working with the Government to find ways to measure and

track “social poverty,” including the number of poor and women who participate fully in community life and in local political decisions that affect their lives.

**Table 3.5: Possible Poverty Reduction Goals**

Dimension of poverty	Empirical Measure	Current/Recent (% of population or quintile)	Possible Goals (2004)
Material standard of living	Headcount of expenditure poverty (1999)	27	Half
Human Investment	Completion of basic education of bottom quintile (1999)	37	45*
	Infant mortality rate of bottom quintile (1997)	109	77*
	Children in the bottom quintile with acute respiratory infection treated medically (1997)	52	68*
Infrastructure Access	Access of bottom quintile to “improved” water sources (1999)	22	33*
	Access of bottom quintile with “adequate” sanitation (1999)	13	23*
Vulnerability to material poverty	Vulnerability to expenditure poverty (1999)	50	Half

Notes: Current Poverty Rate is from Pradhan, et al. (2000), Vulnerability is from Suryahadi et al. (2000), two of the Human Investment measures are from Gwatkin et al. (2000) based on the 1997 DHS. Infrastructure Access and Basic Education Completion are from SUSENAS data.

\*Goals are set to the level currently achieved by those in the 20<sup>th</sup>-40<sup>th</sup> percentiles by wealth (DHS) or consumption expenditures.

### BANK EXPOSURE AND RISK MANAGEMENT

89. **Bank exposure.** By end-FY00, Indonesia’s outstanding debt to IBRD was about \$11.8 billion—one of IBRD’s three largest. This is lower than had been foreseen in the CAS Progress Report, but remains close to the Bank’s concentration limit of \$13.5 billion for single large borrowers. Net IBRD disbursements, which are likely to be positive this year, will turn negative in the years to come, offset at least partly by net IDA flows (see Table 3.6 below). Even in the high case this will be so from FY03. This is appropriate in view of the authorities’ desire to limit Indonesia’s indebtedness, the Bank’s greater focus on IDA lending and the sharp deterioration in Indonesia’s creditworthiness for IBRD borrowing compared to before the 1997/98 crisis. In the base case, IBRD’s exposure will fall to around \$10.7 billion by the end of FY03 and in the high case would reduce only marginally to \$11.2 billion. Indonesia’s continued high level of exposure would pose very serious costs to IBRD’s net income and balance sheet in the event that Indonesia’s precarious creditworthiness led to non-accrual during the CAS period.

90. **Financial risks.** The financial risks to IBRD in Indonesia remain substantial during the CAS period. By end-2000, total external debt service was estimated to be 40 percent of exports of goods and services, and is projected to exceed 30 percent throughout the CAS period—even after the reschedulings so far agreed, particularly by the Paris Club. Also at the end of 2000, Indonesia’s total external debt to both GDP and exports—at an estimated 102 percent and 278 percent, respectively—was considerably higher than the average for other IBRD/IDA blend borrowers—74 percent of GDP and 199 percent of exports respectively, leaving the country vulnerable to new shocks. Further details of key exposure indicators are shown in Annex B7. Debt service to IBRD is projected to breach the exposure guideline of 20 percent of total debt

service to preferred creditors in 2003. The share of preferred creditors as a whole in public debt service is also projected to remain high and to breach the guideline of 35 percent in 2001-03, reflecting large payments coming due to the IMF.<sup>18</sup> It should be noted that these ratios in Indonesia's case are sensitive to oil prices. The generally high level of prices in the past year will have been helpful, but Indonesia remains vulnerable to any renewed slippage in oil prices, especially if this results from a more general slowdown in world trade growth, which would hurt Indonesia's non-oil exports at the same time and shrink the current surplus more quickly.<sup>19</sup>

**Table 3.6: Bank Exposure Indicators**  
(\$ million)

	FY00 (Actual)	FY01	FY02	FY03
<i>Base Case Scenario</i>				
Debt outstanding and disbursed:	12,457	12,589	12,237	11,517
• IBRD	11,755	11,857	11,460	10,673
• IDA	702	732	777	844
Net disbursements:	221	124	(352)	(721)
• IBRD	201	100	(397)	(787)
• IDA	20	24	45	67
IBRD debt service as % of public debt service <sup>a</sup>	15.5	14.0	15.6	21.7
IBRD debt service as % exports <sup>a</sup>	2.2	2.3	2.5	2.6
<i>High Case Scenario</i>				
Debt outstanding and disbursed:	12,457	12,705	12,615	12,155
• IBRD	11,755	11,967	11,794	11,183
• IDA	702	738	821	972
Net disbursements:	221	240	(89)	(460)
• IBRD	201	210	(173)	(611)
• IDA	20	30	83	150
IBRD debt service as % of public debt service <sup>a</sup>	15.5	14.0	15.8	22.0
IBRD debt service as % exports <sup>a</sup>	2.2	2.4	2.5	2.6

<sup>a</sup> Based on government fiscal year.

91. **Country risks.** As elaborated in the CAS, the Bank Group's assistance strategy in Indonesia is subject to high uncertainty and risk. Broadly, the following major country risks may be foreseen: (1) increasing political turmoil that may lead to a disintegration of the current government and possible further moves to impeach the President; (2) increasing political interference in the reform process, particularly in bank restructuring and sale of state assets; (3) increasing limitations in administrative capacity and government leadership—in part brought on by the complex decentralization program—which would result in further delays in the economic program and reform, and would adversely affect the implementation environment of Bank Group projects; (4) an escalation of regional demands for independence, which may lead to further social turmoil and would affect the ability for coherent macroeconomic (especially fiscal) and

<sup>18</sup> These ratios are upwardly biased since they take fully into account the proposed Bank lending program and debt service thereon, but project debt service of other creditors based on *existing* loans and credits.

<sup>19</sup> The CAS economic scenarios assume a reduction in oil prices from \$28/bbl in 2000 to \$20/bbl in 2003 (para. 19).

structural policies; (5) growing nationalistic sentiments, which may affect policies and lead to political pressure for limiting Bank Group involvement; and (6) a less favorable external environment caused by more rapid decline in oil prices, or slowdown in world trade. These risks, individually or in combination, may threaten more broadly the prospects for restoring macroeconomic stability and growth by jeopardizing companies' ability to increase output and investment, by leaving banks weak and unable to provide financial intermediation, and by undermining fiscal and monetary control which could leave debt levels high, discourage inflows of private foreign capital and lead to fresh strains on the rupiah, reserves and debt-servicing capacity.

92. **The CAS takes account of these risks.** The CAS is built around uncertainty and risk. The base case is based on conservative lending levels compared to earlier years, and the Bank would be ready to cease all lending in case macroeconomic or political stability is threatened or fiduciary standards deteriorate. The Bank would focus lending on poverty-oriented projects, which are expected to be more resilient to changes in macroeconomic and political conditions. Adjustment lending is only foreseen in a high-case scenario and would be phased out by FY02. AAA is focused on areas where risks are the highest and the potential to lower them the greatest—such as fiscal decentralization, civil service reforms, judicial reforms, government debt management, and public expenditure management. The Bank would also strengthen other risk mitigating measures, such as: (a) continued intelligence gathering on social and political risks; (b) more emphasis on regular contingency planning; and (c) improved risk analysis in new loans.

**James D. Wolfensohn**  
**President**

**By:**  
**Sven Sandstrom**

**Peter Woicke**

Washington, DC  
January 4, 2001

## INDONESIA

### SUMMARY OF WORLD BANK GROUP

#### PRIVATE SECTOR DEVELOPMENT STRATEGY<sup>1</sup>

##### Overview

The level of poverty in Indonesia and the vulnerability of the poor will not be permanently reduced without sustained, broad based economic recovery and growth. This growth can only be generated and sustained by private activity. But past patterns of development contributed to the onset, the severity and the length of the financial and economic crisis. Indonesia's potential will not be realized without a pattern of private sector activity that is very different from the past. Indonesia cannot afford to miss the opportunity offered by the crisis to make fundamental changes in the business environment and in the way business is done.

Indonesia's large corporations account for 60 percent of GDP. But 99.5 percent of employment is in enterprises with less than 100 employees. The small and medium enterprise sector is highly underdeveloped. The result of this is a lost productive potential from a "missing middle" group of enterprises that in more economically developed countries is the driving force for development. With the top ten families owning more than 60 percent of the corporate assets, ownership concentration in Indonesia is higher than in other countries in the region. Close relationships between corporations, banks and government, poor oversight by the regulators, insider control and pervasive state ownership of economic assets have all acted against the openness to competition and transparency that are necessary for sustainable growth and resilience to shock.

The first priority should be for the banking and corporate sectors to speed up the resolution of the corporate debt overhang so that financial flows for investment and working capital can resume. Secondly, the many structural inefficiencies that led to the crisis and made it deeper and longer lasting in Indonesia than elsewhere in Asia need to be overcome. Reforms are needed to enable Indonesia to become a modern market economy and avoid future crises. This means fighting corruption in the public administration and ensuring the rule of law through the court system, reinforcing property rights and dispute resolution mechanisms, ensuring open and transparent transactions through more competition and better corporate governance, and creating a business environment where following the rules rather than crony capitalism is the norm. The state needs to withdraw transparently from its over-extended ownership of productive assets and allow the private sector to realize its potential as the driving force for growth. But at the same time the state has to step up and take on its legitimate oversight role by strengthening the rules, and the institutions that enforce them. This means improving supervision of the banks and financial markets, creating independent regulators for public monopolies, developing and enforcing competition law, and enforcing financial disclosure and audit of financial institutions and public corporations. Thirdly, measures to ensure that the necessary growth is broad based and sustainable will be necessary. This means firstly removing the current obstacles to small and medium enterprise activity and promoting SME development. It also means building the necessary physical and social infrastructure and ensuring that growth is environmentally sustainable, particularly for Indonesia's forests, mineral and marine resources. Finally, Indonesia will need to create the infrastructure and regulatory environment necessary to take full advantage of the new information and communications technologies.

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<sup>1</sup> The strategy is elaborated in a separate report prepared in connection with the CAS entitled *Indonesia: World Bank Group Private Sector Development Strategy*, January 2001 (Report No. 21581-IND).

### **The private sector was hit hard by the crisis**

The crisis had a devastating impact on the corporate sector, particularly in construction, financial services and manufacturing. The corporates had depended excessively on foreign borrowing and very little on equity finance. In late 1997 a large part of the corporate and banking sector became insolvent. Small enterprises, the majority of which are in agriculture, suffered less than the corporate sector as they were not as exposed to the devaluation of the rupiah. They did, however suffer from the decline in aggregate demand resulting from the crisis.

GDP recovered and grew by 4-5 percent over the year to the third quarter of 2000. The incipient recovery was relatively well spread across the sectors, with investment gaining importance over consumption, and non-oil exports contributing substantially. But the financial markets have not yet recovered, due mainly to continued concerns about political instability and regional violence and delays in corporate restructuring. The stock market in December 2000 had lost one third of its value since December 1999. Since the start of the crisis 68 out of 237 banks have been closed, and another 12 banks nationalized in an effort to stabilize the banking system. As the banking sector begins to emerge, the Government is directly in control of 70 percent of the deposits in the banking system, compared to 40 percent in Korea, and 23 percent in Thailand. The bank recapitalization program has been extremely costly. A total of about Rp 650 trillion of sovereign bonds have been issued and this to recapitalize the banks only to a capital adequacy ratio (CAR) of 4 percent. Bank lending is resuming, up just under 6 percent in the first half of 2000 compared with the previous year, but lending is mostly for short term working capital rather than for investment. Large non-performing loan portfolios are still holding back bank profitability.

Indonesian corporate debt in late 2000 is around \$117 billion - 70 percent of this is for large private corporations and 30 percent for state-owned enterprises and SMEs. Of the total, 48 percent is owed to foreign creditors and more than 70 percent is denominated in foreign currencies. Around 49 percent of corporate debt is distressed. Of the large corporate debt, three-quarters is distressed and in need of restructuring. After a very late start, corporate debt restructuring began to pick up towards the end of 1999. Around \$15 billion in distressed corporate debt has been restructured since the crisis began, and most of that during the year 2000. A number of large debt restructuring deals are imminent and both creditors and debtors are cautiously optimistic that, barring unforeseen problems, the momentum will continue.

### **There are many impediments to robust recovery and sustainable growth**

*Banking and corporate restructuring.* Sustainable economic growth cannot begin until banking and corporate debt restructuring have made substantial progress, and there is a long way to go. The Indonesian Bank Restructuring Agency's (IBRA) internal governance needs improvement and IBRA's last two annual audits included disclaimers of opinion. Following some recent high profile transactions involving well connected conglomerates, the quality of IBRA's restructuring deals is currently being questioned and there is an urgent need for IBRA to adopt transparent debt restructuring principles, especially for its largest obligors. The slow speed of divestiture of IBRA's assets is also causing concern not only because of the consequent delay to the restructuring of the economy and but also because of the acute need for revenues from asset sales to cover the cost of bank recapitalization. There are doubts about IBRA's and Government's willingness to accept that realization from the assets to be sold will likely be much less than their book value. The restructuring and privatization of Indonesia's state banks is an urgent priority for the creation of a healthy banking system, but progress to date has been very slow.

In addition to the high profile cases, there are also concerns about the quality of many of the other corporate restructuring deals concluded to date. They have relied excessively on term extensions and debt equity conversions. Little real operational restructuring has taken place and the risk is that many corporates could remain vulnerable to future crisis even after restructuring. The bankruptcy process in Indonesia does not pose a credible threat to recalcitrant debtors and much effort has gone into devising ways of getting around this, including granting IBRA extraordinary powers to seize assets and giving the voluntary debt restructuring agency, JITF, additional leverage to refer non-cooperative debtors to the Ministerial Committee, FSPC, for referral on to the Attorney General. These measures have yet to be seriously tested, however and it remains to be seen whether they will be effective. Meanwhile some progress has been made in offering tax and regulatory incentives to parties concluding debt restructuring deals. Further implementing rules are needed to make these measures fully effective.

*Structural weaknesses.* Restructuring the banks and resolving the debt overhang are only the first steps. Action needs to be taken to remove a formidable range of structural impediments and constraints to sustainable and equitable economic growth. These cannot be resolved overnight but action to deal with them needs to begin and be sustained over time. These impediments fall into several broad categories:

- Poor governance and corruption in the public sector;
- The uncertainties surrounding the forthcoming decentralization process;
- The absence of an effective court system and the longstanding need for legal and judicial reform;
- Poor corporate governance, particularly lack of information disclosure or enforcement against offenders;
- The need for effective rules and institutions to implement competition policy;
- A less than welcoming climate for foreign direct investment; and
- The extended role of the state and its crowding out of private sector activity.

*Impediments to long term sustainable development.* Broad based growth cannot happen without development of the SME sector. At present SMEs face a number of impediments including market distortions acting against them, excessive regulation, corruption and red tape, ineffective support systems, low skills development and a banking system that lacks the capacity or skills to lend to SMEs. Rural areas in particular remain underdeveloped as public sector delivery systems have not provided farmers with effective services or access to micro-finance.

The effectiveness of attempts to privatize physical infrastructure in the 1990s were limited by lack of independent regulation, by lack of competitive market structures and by lack of transparency in many of the deals that were concluded. One consequence is the frequency of high profile contractual disputes between the public utilities and their private partners. Government policies do not yet favor transparent privatization of infrastructure and frequently act to crowd out new private investors. Similar considerations apply in the health and education sectors where private providers frequently are able to reach poorer sections of the population that the public providers do not reach, and in other cases are able to provide better quality services at lower cost. But government policies have discriminated against private providers.

In forestry, the distorted incentive framework, irresponsible behavior by timber companies and lack of enforcement of regulations against offenders has led to a crisis of illegal logging which is threatening the very existence of Indonesia's forests.

Finally, Indonesia is lagging behind neighboring countries in embracing the new information and communications technologies. The legal and regulatory framework for e-

commerce does not yet exist. Government itself has not used the new technologies to advantage. Important opportunities are being missed, in terms of the possibilities of making existing business more effective, of opportunities for creating completely new businesses, and of the benefits from increased transparency that would accrue to the population from putting government on line and using new electronic and communications applications in education and other public services.

### **World Bank Group Private Sector Development Strategy**

The World Bank Group's (WBG's) vision and strategy for development of the private sector responds closely to that recently elaborated in Government's ten point economic recovery program. It is based on solid analysis of the conditions on the ground in Indonesia and continuous dialogue with and feedback from beneficiaries, our partners in the private sector, in government, and among the donors. To sharpen up the relevance and focus of this private sector development strategy, the WBG held discussions during its preparation with focus groups of private entrepreneurs, and also commissioned a business environment survey of private businesses in Indonesia.

*The medium term vision* is one in which, firstly, the immediate aftermath of the crisis will have been resolved, with a healthy restructured banking sector lending again for corporate investment and working capital. Secondly, progress will have been made in resolving the structural impediments to private sector led growth mentioned above. Private activity would be based mainly on competition and effectiveness rather than on protective relationships between government, the banks and the corporate sector. Thirdly, the private sector will be playing the leading role in generating growth and fiscal resources and providing the public infrastructure and services needed for sustained poverty reduction. The ownership pattern would be less concentrated than in the past, but more broadly based on accelerated development of SMEs and broader share ownership in the large corporations.

*The role of the WBG.* The WBG is taking advantage of the synergies resulting from the recently implemented co-management of Bank PSD and IFC activities in the East Asia Region and the joint WB/IFC Global Product Groups. We are being selective in our interventions, operating in catalytic mode, supporting activities for which there is a strong government or partner commitment, a demonstrated country need and where we have a comparative advantage. The WBG is maximizing opportunities to leverage its scarce resources with those of other donors and investors and taking care to avoid duplication of activities. Private sector development is a cross-sectoral objective and, where possible, PSD activities are being mainstreamed through the Bank's sector projects and other interventions. In a few cases, such as banking and corporate restructuring, corporate governance, competition policy, SME development and information and communications technology, the WBG is implementing free standing projects, trust fund grants or advisory activities.

*Crisis response activities.* The Bank has worked closely with the IMF and the ADB since the onset of the crisis, in supporting government's banking and corporate restructuring program and will continue to do so until the crisis is over, with technical assistance, lending, trust funds and analytical and advisory activities (AAA). IFC is supporting corporate restructuring by actively restructuring problem projects in its own portfolio and seeking out candidates for demonstration restructuring transactions.

*Addressing structural weaknesses.* In the areas of public sector governance and decentralization, the Bank is leveraging donor resources through the multi-donor Governance Partnership and through trust funds to provide advice to government and we propose to continue this assistance as a priority. In legal and judicial reform the Bank is playing the role of

coordinator of donor activities in response to a request from the Government. Trust funds and a component of a Bank project will also support training activities for Commercial Court personnel. In corporate governance, the Bank through its AAA is sponsoring seminars and other best practice dissemination events. The Bank also proposes to complete a benchmarking exercise of Indonesian corporate governance practices during the coming year. IFC is applying corporate governance best practices through its role as a shareholder in a number of Indonesian corporations. The Bank is taking the lead and coordinating among the donors in providing help to the new competition agency. In promotion of foreign direct investment, FIAS has provided a number of missions and is ready to respond to further requests. MIGA's operations in Indonesia were affected by a claim from one of its projects. As a result, it has suspended its guarantee activity in Indonesia, but it is accepting applications of interest and is keen to support the resumption of FDI in Indonesia. In privatization, the Bank has played a key advisory role in the past but there is little receptiveness from Government at present. The ADB now has the lead in this area.

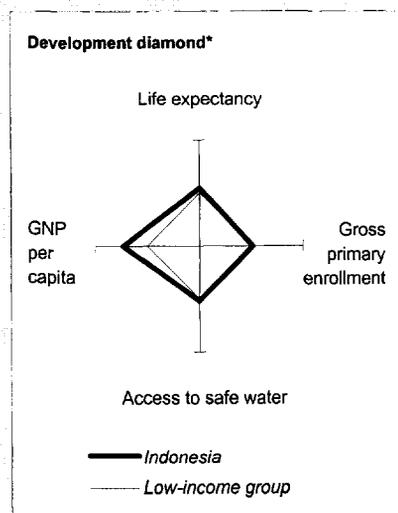
*Promoting long term sustainable development.* SME development in Indonesia is a priority area of assistance for the new Joint Bank/IFC SME Unit. The WBG has supported a variety of SME programs and projects over the years in Indonesia. The focus at present is on policy advice, improved delivery of business development services through a decentralized SME facility, and the building of capacity within banks to lend to SMEs. In rural and urban development, the Bank will continue to promote private sector development through its sector projects and IFC will work through investments in agribusiness. In infrastructure, the Bank will continue to promote privatization and private participation through its ongoing sector projects in telecommunications, power and transport. IFC is looking for opportunities to invest in the transport and water sectors. The Bank will seek means of promoting the private provision of social services in health and education through its sector projects and AAA advisory activities. In forestry, the Bank has supported reforms through its policy based lending and is leading the forest policy dialogue with government and other partners. The WBG is ready to invest in the oil, gas and mining sectors, based on sound policy and regulatory frameworks. In mining, the emphasis will be on small scale mining activities in a decentralized environment. In information and communications technology, the Bank is supporting preparation of a national networking strategy including upgrading of the regulatory framework for e-commerce and supporting government on line initiatives.



## Indonesia at a glance

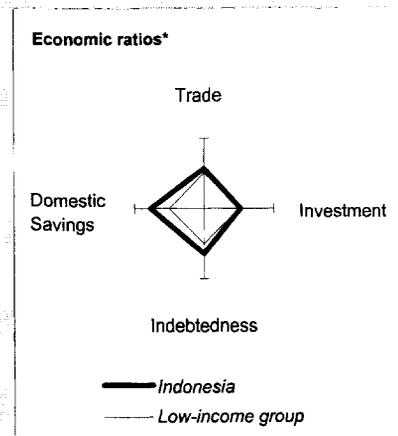
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POVERTY and SOCIAL	East Asia & Pacific		
	Indonesia	East Asia & Pacific	Low-income
<b>1999</b>			
Population, mid-year (millions)	206.5	1,837	2,417
GNP per capita (Atlas method, US\$)	600	1,000	410
GNP (Atlas method, US\$ billions)	124.9	1,833	988
<b>Average annual growth, 1993-99</b>			
Population (%)	1.5	1.2	1.9
Labor force (%)	2.5	1.3	2.3
<b>Most recent estimate (latest year available, 1993-99)</b>			
Poverty (% of population below national poverty line)	24	..	..
Urban population (% of total population)	39	34	31
Life expectancy at birth (years)	66	69	80
Infant mortality (per 1,000 live births)	46	35	77
Child malnutrition (% of children under 5)	30	22	43
Access to improved water source (% of population)	67	84	64
Illiteracy (% of population age 15+)	12	15	39
Gross primary enrollment (% of school-age population)	98	119	96
Male	97	121	102
Female	98	121	86



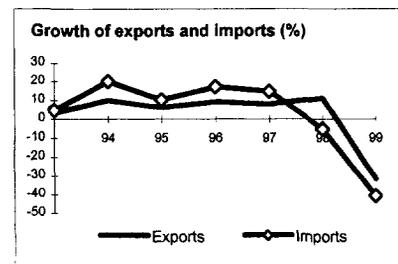
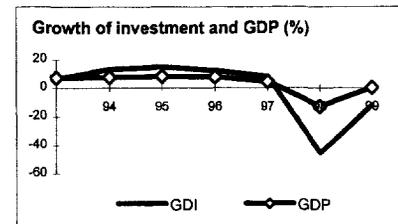
## KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1979	1989	1998	1999	
GDP (US\$ billions)	55.1	101.5	98.8	142.5	
Gross domestic investment/GDP	24.8	29.1	15.5	20.8	
Exports of goods and services/GDP	30.6	25.1	51.2	34.9	
Gross domestic savings/GDP	32.8	32.8	24.9	28.8	
Gross national savings/GDP	..	28.6	20.8	23.1	
Current account balance/GDP	..	-1.1	4.1	4.1	
Interest payments/GDP	1.9	3.3	5.7	5.0	
Total debt/GDP	33.8	58.5	152.7	105.3	
Total debt service/exports	..	38.4	34.6	36.9	
Present value of debt/GDP	..	..	146.4	105.1	
Present value of debt/exports	..	..	263.8	268.3	
<b>(average annual growth)</b>					
GDP	6.0	5.3	-13.0	0.3	
GNP per capita	3.9	3.3	-17.9	0.9	
Exports of goods and services **	1.4	6.9	11.2	-31.6	
	<b>1979-89</b>	<b>1989-99</b>	<b>1998</b>	<b>1999</b>	<b>1999-03</b>
GDP	6.0	5.3	-13.0	0.3	4.3
GNP per capita	3.9	3.3	-17.9	0.9	9.1
Exports of goods and services **	1.4	6.9	11.2	-31.6	3.3



## STRUCTURE of the ECONOMY

	1979	1989	1998	1999
<b>(% of GDP)</b>				
Agriculture	27.3	21.7	17.6	19.5
Industry	37.7	38.3	44.9	43.3
Manufacturing	11.7	19.7	24.1	25.4
Services	35.0	40.0	37.5	37.3
Private consumption	57.6	58.5	69.6	65.1
General government consumption	9.5	8.7	5.5	6.2
Imports of goods and services	22.6	21.4	41.7	26.9
<b>(average annual growth)</b>				
Agriculture	3.4	2.5	-0.7	2.1
Industry	6.5	7.2	-14.0	1.2
Manufacturing	13.0	8.2	-11.4	2.6
Services	7.0	4.7	-16.4	-1.4
Private consumption	6.5	7.2	-1.6	-0.1
General government consumption	5.3	0.8	-15.4	0.7
Gross domestic investment	6.7	3.4	-45.2	-12.1
Imports of goods and services	1.8	8.5	-5.3	-40.7
Gross national product	5.9	5.1	-16.7	1.9



Note: 1999 data are preliminary estimates.

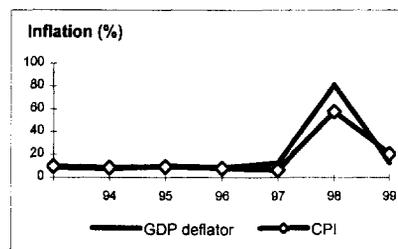
\* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

\*\*Central Bureau of Statistics figure. There is a discrepancy with the Balance of Payments figure as recorded by Bank Indonesia.

## Indonesia

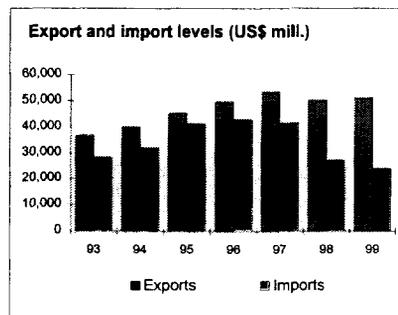
## PRICES and GOVERNMENT FINANCE

	1979	1989	1998	1999
<b>Domestic prices</b>				
<i>(% change)</i>				
Consumer prices	..	6.4	57.7	20.5
Implicit GDP deflator	33.6	10.0	81.2	12.8
<b>Government finance</b>				
<i>(% of GDP, includes current grants)</i>				
Current revenue	..	17.1	13.9	16.3
Current budget balance	..	-3.9	3.1	2.8
Overall surplus/deficit	..	..	-2.0	-1.5



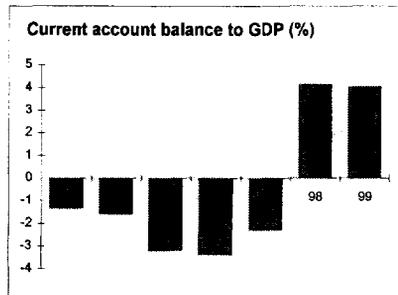
## TRADE

	1979	1989	1998	1999
<i>(US\$ millions)</i>				
Total exports (fob)	..	23,833	50,371	51,242
Fuel	..	8,678	7,868	9,765
Rubber	..	952	1,010	855
Manufactures	..	11,028	34,593	33,332
Total imports (cif)	..	19,624	27,337	24,003
Food	..	521	1,167	1,625
Fuel and energy	..	1,205	2,671	3,705
Capital goods	..	5,904	9,048	4,959
Export price index (1995=100)	..	83	..	..
Import price index (1995=100)	..	87	..	..
Terms of trade (1995=100)	..	95	..	..



## BALANCE of PAYMENTS

	1979	1989	1998	1999
<i>(US\$ millions)</i>				
Exports of goods and services	..	24,849	54,850	55,811
Imports of goods and services	..	21,749	43,903	42,151
Resource balance	..	3,100	10,947	13,670
Net income	..	-4,547	-8,189	-7,283
Net current transfers	..	339	..	..
Current account balance	..	-1,108	4,096	5,785
Financing items (net)	..	1,603	-7,789	-3,813
Changes in net reserves	..	-495	3,693	-1,972

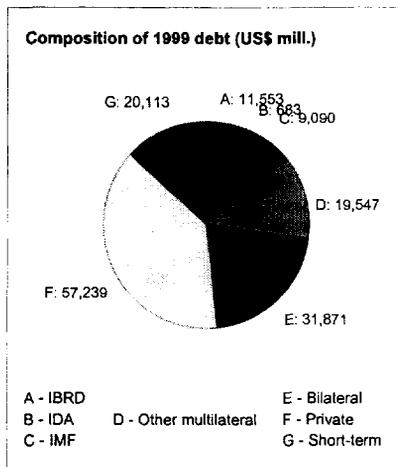


## Memo:

Reserves including gold (US\$ millions)	..	..	..	..
Conversion rate (DEC, local/US\$)	623.1	1,770.1	10,013.6	7,855.2

## EXTERNAL DEBT and RESOURCE FLOWS

	1979	1989	1998	1999
<i>(US\$ millions)</i>				
Total debt outstanding and disbursed	18,624	59,402	150,884	150,096
IBRD	739	8,542	11,692	11,553
IDA	525	854	683	683
Total debt service	3,065	9,833	19,967	21,397
IBRD	95	1,134	1,445	1,583
IDA	4	15	26	29
Composition of net resource flows				
Official grants	137	214	..	..
Official creditors	555	2,935	2,694	2,428
Private creditors	99	80	-1,651	-10,527
Foreign direct investment	226	682	-400	-2,817
Portfolio equity	0	199	..	..
World Bank program				
Commitments	815	2,007	1,672	1,692
Disbursements	229	1,258	1,207	1,506
Principal repayments	24	481	754	789
Net flows	205	777	458	720
Interest payments	76	667	718	826
Net transfers	130	109	-260	-106



**CAS Annex B2 - Indonesia**  
**Selected Indicators\* of Bank Portfolio Performance and Management**  
**As of Date 11/30/2000**

Indicator*	1998	1999	2000	2001**
<b>Portfolio Assessment</b>				
Number of Projects Under Implementation <sup>a</sup>	71	69	63	61
Average Implementation Period (years) <sup>b</sup>	3.3	3.4	3.8	4.2
Percent of Problem Projects by Number <sup>a, c</sup>	25.4	26.1	18	13
Percent of Problem Projects by Amount <sup>a, c</sup>	28.8	26.6	14.4	10.8
Percent of Projects at Risk by Number <sup>a, d</sup>	53.5	27.5	21	16.4
Percent of Projects at Risk by Amount <sup>a, d</sup>	54.6	26.9	16.6	12.6
Disbursement Ratio (%) <sup>e</sup>	14.1	12.8	21	14
<b>Portfolio Management</b>				
CPPR during the year (yes/no)	yes	no	yes	no***
Supervision Resources (total US\$)	5141.00	4924.00	6772.00	est. 5466
Average Supervision (US\$/project)	58.00	60.00	81.00	est. 89.00

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	198	36
Proj Eval by OED by Amt (US\$ millions)	17565.6	4372.7
% of OED Projects Rated U or HU by Number	20.7	27.8
% of OED Projects Rated U or HU by Amt	16.5	24.2

- a. As shown in the Annual Report on Portfolio Performance (except for current FY).
- b. Average age of projects in the Bank's country portfolio.
- c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.
- \* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.
- \*\* FY98/99 supervision costs do not include indirect costs, FY00/01 supervision costs include indirect costs.
- \*\*\* Interim Portfolio Review December 2000



## INDONESIA - BANK GROUP PROGRAM SUMMARY, FY 2001-2003

## Proposed IBRD/IDA Lending Program, FY 2001-2003

Fiscal Year	Project	US\$(M)		Strategic Rewards (H/M/L)	Implementation risks (H/M/L)
		IBRD	IDA*		
2001	<b>Base Case</b>				
	West Java/Jakarta Environmental Management (APL, plus GEF component)	18		M	H
	Kecamatan Development Project (supplemental)		55	H	M
	Provincial Health 2		60	M	M
	Basic Education 4 (stand-by)	20	40	H	M
	Eastern Indonesia Roads (stand-by)	200		H	M
	Library Development (LIL)		5	M	M
	<b>Subtotal</b>	<b>238</b>	<b>160</b>		
	<b>High Case</b>				
	West Java/Jakarta Environmental Management (APL, plus GEF component)	18		M	H
	Kecamatan Development Project (supplemental)		55	H	M
	Provincial Health 2		60	M	M
	Basic Education 4 (stand-by)		60	H	M
	Eastern Indonesia Roads (stand-by)	140	60	H	M
	Library Development (LIL)		5	M	M
	Policy Reform Support Loan III**	200			
	<b>Subtotal</b>	<b>358</b>	<b>240</b>		
2002	<b>Base Case</b>				
	Land Administration Project II	50		H	H
	Strengthening Local Education Capacity II	65		M	M
	Kecamatan Development Project II	80	120	M	M
	NTB Poverty (pilot)	20		M	M
	Improving Quality and Responsiveness of Community Oriented Health Care	65		M	M
	<b>Subtotal</b>	<b>280</b>	<b>120</b>		
	<b>High Case</b>				
	Land Administration Project II	50		H	H
	Strengthening Local Education Capacity II		65	M	M
	Kecamatan Development Project II	200	100	M	M
	NTB Poverty (pilot)		20	M	M
	Improving Quality and Responsiveness of Community Oriented Health Care		65	M	M
	Water Resource Management (APL)	150		H	M
	Energy (APL/SECAL)**	200		H	H
	Community Based Urban Development		150	M	M
	<b>Subtotal</b>	<b>600</b>	<b>400</b>		

**Proposed IBRD/IDA Lending Program, FY 2001-2003 cont.**

Fiscal Year	Project	US\$(M)		Strategic Rewards (H/M/L)	Implementation risks (H/M/L)
		IBRD	IDA*		
2003	<b>Base Case</b>				
	Water Resource Management (APL)	120		H	M
	Energy (APL)	100		M	M
	Community Based Urban Development		105	M	M
	Coral Reef Management (APL 2nd tranche, plus GEF component)	35		M	M
	Micro Finance	10	30		
	<b>Subtotal</b>	<b>265</b>	<b>135</b>		
	<b>High Case</b>				
	Water Resource Management (APL)	100	50	H	M
	Energy (APL)	200		M	M
	Community Based Urban Development		125	M	M
	Coral Reef Management (APL 2nd tranche, plus GEF component)	35		M	M
	Micro Finance	60	50		
	Rural Area Development (APL)	60	75	H	M
	Urban Local Governance Reform (APL)	85	100	H	M
	Public Sector Reform Loan	60			
	<b>Subtotal</b>	<b>600</b>	<b>400</b>		

\* IBRD/IDA breakdowns are indicative and subject to discussion with the Government of Indonesia.

\*\* Possible adjustment loans.

### Indonesia - IFC and MIGA Program, FY 1998-2001

	1998	1999	2000	2001
IFC approvals (US\$m)	14.00	83.50	31.37	
<b>Sector (%)</b>				
Financial Services		60	16	
Industrial & Consumer Services			4	
Infrastructure	26			
Manufacturing	100			
Mining & Metals			80	
Textiles		40	0	
<b>Total</b>	126	100	100	
<b>Investment instrument(%)</b>				
Loans	82	36	48	
Equity	18	4	26	
Quasi-Equity			26	
Other	0	60		
<b>Total</b>	100	100	100	
MIGA guarantees (US\$m)	80.40	74.69	74.69	

**CAS Annex B4 - Summary of Non-lending Services - Indonesia  
(FY00-03)**

Product	Completion FY	Cost (US\$000) <sup>a</sup>	Audience <sup>b</sup>	Objective <sup>c</sup>
<b>Summary of Recent Completions</b>				
CGI Note	2000	\$112	Government, donors, public	KG
Public Expenditure II	2000	\$143	Government, donors, Bank	PD
Debt Management	2000	\$102	Government	PD
Environment Report	2001	\$425	Government	PD
CGI Note	2001	\$75	Government, donors, Bank	KG
Country Financial Accountability Assessment	2001	\$177	Government, Bank, donors	
Country Procurement Assessment Report	2001	\$121	Government, Bank, donors	
<b>Key Activities Underway</b>				
Corporate Restructuring/FSPC Corp. Restructuring	2001	\$378	Government	PS
Poverty Report and follow up	2001	\$350	Government	PD
Governance Strategy	2001	\$303	Government, donors, Bank	PD
Delivering Public Goods & Services at the Sub-National Level	2001	\$245	Government	KG
Policy Notes on Health and Education	2001	\$140	Government, donors	KG
Fiscal Decentralization Strategy	2001	\$100	Government	PS
Power Demand and Investment Planning	2001	\$75	Government	KG
Land and Forest Policy Dialogue	2001	\$130	Government, donors	PS
Civil Service Reform	2001	\$50	Government	PS
Competition Policy	2001	\$40	Government	KG
Social Capital & Local Governance	2001	\$30	Government	KG
<b>Key Activities Planned</b>				
Long Term Development Prospects	2002/3	\$350	Government, donors, Bank	KG, PD
Provincial Public Expenditure Reviews	2002/3	\$300	Government, donors,	KG
Civil Service Reform (cont.)	2002/3	\$100	Government	PS
Fiscal Decentralization	2002/3	\$250	Government, donors, Bank	KG, PS
Public Financial Management (cont.)	2002/3	\$150	Government	KG
Debt Management (cont.)	2002/3	\$120	Government	PS
Financial Sector Strategy	2002/3	\$100	Government, donors, Bank	KG, PD
Land and Forest Policy Dialogue (cont.)	2002/3	\$130		
Sectoral Studies in Decentralized Environment	2002/3	\$600	Government, donors, Bank	KG, PS
Policy Performance Assessments (2)	2002/3	\$350	Government, Bank	KG, PS
Support for Poverty Reduction Strategy Paper (PRSP)	2002	\$250	Government, donors, Bank, Public	PD, PS

a. Estimates for planned activities

b. Government, donors, Bank, public dissemination.

c. (KG) Knowledge Generation, (PD) Public Debate, (PS) Problem-Solving.

## Indonesia Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1999	East Asia & Pacific	Low-income
<b>POPULATION</b>					
Total population, mid-year (millions)	132.6	163.0	206.5	1,817.1	3,536.4
Growth rate (% annual average)	2.4	1.9	1.6	1.0	1.4
Urban population (% of population)	19.4	26.1	39.4	33.9	30.5
Total fertility rate (births per woman)	5.4	4.1	2.6	2.1	3.1
<b>POVERTY*</b>					
<i>(% of population)</i>					
National headcount index	..	..	27.1	..	..
Urban headcount index	..	..	16.3	..	..
Rural headcount index	..	..	34.1	..	..
<b>INCOME</b>					
GNP per capita (US\$)	230	530	600	990	520
Consumer price index (1995=100)	15	46	219	130	136
Food price index (1995=100)	..	40	260	..	..
<b>INCOME/CONSUMPTION DISTRIBUTION</b>					
Gini index	..	33.0	32.0	..	..
Lowest quintile (% of income or consumption)	6.8	8.0	7.5	..	..
Highest quintile (% of income or consumption)	52.0	42.1	43.4	..	..
<b>SOCIAL INDICATORS</b>					
<b>Public expenditure</b>					
Health (% of GDP)	..	..	0.7	1.7	1.3
Education (% of GNP)	2.8	2.0	1.2	2.9	3.2
Social security and welfare (% of GDP)	..	..	2.2	..	..
<b>Net primary school enrollment rate</b>					
<i>(% of age group)</i>					
Total	71	89	94	99	86
Male	75	90	95	99	89
Female	66	87	93	99	82
<b>Access to safe water</b>					
<i>(% of population)</i>					
Total	..	39	67	84	..
Urban	..	60	84	89	..
Rural	..	32	53	82	..
<b>Immunization rate</b>					
<i>(% under 12 months)</i>					
Measles	..	15	65	93	80
DPT	..	15	83	93	82
Child malnutrition (% under 5 years)	..	..	30	20	..
<b>Life expectancy at birth</b>					
<i>(years)</i>					
Total	49	56	66	69	63
Male	48	55	..	67	62
Female	51	58	..	71	64
<b>Mortality</b>					
Infant (per thousand live births)	114	80	46	35	68
Under 5 (per thousand live births)	172	125	60	43	92
<b>Adult (15-59)</b>					
Male (per 1,000 population)	478	368	..	188	235
Female (per 1,000 population)	405	308	..	145	208
Maternal (per 100,000 live births)	..	450	373	..	..

\* These are derived by the SMERU iterative method. The BPS method yields different values: national at 23.55%, urban at 19.98% and rural at 25.85%.

## Indonesia - Key Economic Indicators

Indicator	----- Actual -----			Estimate	----- Projected -----		
	FY97/98	FY98/99	FY99/00	9 m 2000	CY2001	CY2002	CY2003
<b>National accounts (as % of GDP)</b>							
Gross domestic product <sup>a</sup>	100	100	100	100	100	100	100
Agriculture	17	20	20	18	18	18	18
Industry	42	44	45	45	46	46	46
Services	42	36	35	37	36	36	36
Total Consumption	69	78	75	72	74	76	75
Gross domestic fixed investment	27	21	16	17	16	16	17
Government investment	4	4	3	3	3	3	3
Private investment (includes increase in stocks)	23	17	12	14	13	13	14
Exports (GNFS) <sup>b</sup>	42	49	40	47	48	48	44
Imports (GNFS)	38	38	29	35	39	41	42
Gross national savings <sup>c</sup>	27	15	18	20	21	20	19
<i>Memorandum items</i>							
Gross domestic product (US\$ million at current prices)	149,896	106,913	151,669	110,956	156,648	162,914	173,563
GNP per capita (US\$, Atlas method)	960	620	680	650	740	760	840
Real annual growth rates (% calculated from 1993 prices)							
Gross domestic product at market prices	2.1	-14.1	3.5	4.0	4.0	4.0	4.0
Real annual per capita growth rates (% calculated from 1993 prices)							
Gross domestic product at market prices	0.6	-15.3	2.0	2.5	2.6	2.6	2.6
Total consumption	3.9	-7.9	2.4	0.7	2.5	5.6	5.7
<b>Balance of Payments (US\$ millions)</b>							
Exports (GNFS) <sup>b</sup>	62,302	52,722	60,011	52,499	72,343	74,647	78,330
Merchandise FOB	56,162	48,354	55,200	48,437	66,653	68,664	72,022
Imports (GNFS) <sup>b</sup>	57,643	41,060	43,285	38,313	57,337	61,274	66,579
Merchandise FOB	42,704	30,707	32,551	29,142	43,539	46,272	50,164
Resource balance	4,659	11,662	16,726	14,186	15,005	13,373	11,751
Net current transfers	463	1,013	753	-105	-753	-148	923
Current account balance	-1,700	4,609	6,648	5,290	4,371	3,422	2,730
External debt/GDP (%)	92	139	97	102	95	90	84
<i>Memorandum item</i>							
Resource balance (% of GDP)	3.1	10.9	11.0	12.8	9.6	8.2	6.8
<b>Public finance (as % of GDP at market prices)<sup>c</sup></b>							
Current revenues	15.4	13.8	16.8	19.8	17.0	17.0	17.4
Current expenditures	10.8	10.9	13.8	18.7	16.3	14.6	14.3
Budget surplus (+) or deficit (-)	-0.5	-2.0	-1.5	-3.4	-3.6	-2.4	-2.1
Capital expenditure and transfers	5.2	5.0	4.5	4.5	4.4	4.8	4.8
Foreign financing	0.2	2.0	1.5	2.0	2.6	0.7	-0.3
Government debt/GDP	38	81	92	100	99	94	88
<b>Monetary indicators</b>							
M2/GDP	65	60	61	60	61	61	61
Growth of M2 (%)	53	34	9	9	8	8	8
<b>Price indices( YR93 =100)</b>							
Real exchange rate (US\$/LCU) <sup>d</sup>		100	137	126	120	118	115
Consumer price index (% change)	6.7	57.7	20.5	5.1	8.0	8.0	8.0
GDP deflator (% change)	25	75	3.1	6.8	8.0	8.0	8.0

a. GDP at market prices

b. "GNFS" denotes "goods and nonfactor services."

c. Consolidated central government.

d. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.

## Indonesia - Key Exposure Indicators

Indicator	Actual		Estimate		Projected		
	FY97/98	FY98/99	FY99/00	9 m 2000	CY2001	CY2002	CY2003
Total external debt outstanding and disbursed (TDO) (US\$m) <sup>a</sup>	137,363	148,906	147,626	150,984	149,123	147,131	144,969
Net disbursements (US\$m) <sup>a</sup>	20,291	15,758	13,828	17,894	17,957	15,120	13,464
Total external debt service (TDS) (US\$m)	19,588	19,672	24,148	21,826	29,280	26,668	24,869
External debt and debt service indicators (%)							
TDO/XGS <sup>b</sup>	214.1	272.6	237.9	278.3	198.6	189.7	178.2
TDO/GDP	91.6	139.3	97.3	102.1	95.2	90.3	83.5
TDS/XGS	30.5	36.0	38.9	40.2	38.9	34.2	30.4
Concessional/TDO	18.2	18.8	19.4	19.5	19.8	19.2	18.4
IBRD exposure indicators (%)							
IBRD DS/public DS	14.2	16.2	15.2	15.5	14.0	15.6	21.7
Preferred creditor DS/public DS (%)	22.5	25.1	27.0	28.6	40.2	48.6	49.7
IBRD DS/XGS	2.2	2.9	2.6	2.2	2.3	2.5	2.6
IBRD TDO (US\$m) <sup>c</sup>	9,891	10,993	11,608	11,755	11,857	11,460	10,673
IDA TDO (US\$m) <sup>c</sup>	711	689	682	702	732	777	844
IFC (US\$m)							
Loans (A + B loan) <sup>d</sup>	316	333	313	299	..	..	..
Equity and quasi-equity <sup>e</sup>	170	176	167	168	..	..	..
MIGA							
MIGA guarantees (US\$m)	80	80	75	75	..	..	..

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Includes present value of guarantees.

d. Disbursed and outstanding.

e. Includes equity and quasi-equity types of both loan and equity instruments.



Indonesia: Status of Bank Group Operations (Operations Portfolio)  
As of 11/30/2000

Closed Projects: 234

Active Projects		Last PSR		Fiscal Year	Original Amount in US\$ Millions				Undisb.	Difference Between Expected and Actual Disbursements <sup>a/</sup>	
Project ID	Project Name	Development Objectives	Implementation Progress		IBRD	IDA	GRANT	Cancel.		Orig.	Frm Rev'd
P004019	ACCOUNTANCY DEV II	S	S	1995	25.0	0.0	0.0	4.3	2.0	6.3	1.2
P003972	AG. RESEARCH II	S	S	1995	63.0	0.0	0.0	22.1	15.2	33.4	0.3
P055755	BANKING REFORM ASST.	S	S	1998	20.0	0.0	0.0	0.9	6.4	7.3	0.0
P040061	BENGKULU REG DEV	U	U	1998	20.5	0.0	0.0	0.0	19.1	6.0	0.0
P049051	BEPEKA AUDIT MODER P	S	U	1997	16.4	0.0	0.0	0.9	10.6	7.3	5.2
P034080	BIODIVERSITY COLLECT	HS	S	1994	0.0	0.0	7.2	0.0	0.3	0.6	0.0
P036048	CORAL REEF MGM REHAB	U	U	1998	6.9	0.0	0.0	0.0	5.4	4.1	3.4
P040062	CORAL REEF MGMT REHA	U	U	1998	0.0	0.0	11.6	0.0	2.6	1.8	1.3
P063732	CORPORATE RESTRUCTRG	S	S	1999	31.5	0.0	0.0	6.1	20.0	23.5	0.0
P004010	DAM SAFETY	S	S	1994	55.0	0.0	0.0	19.8	5.8	25.2	13.6
P059930	DECENT AGR/FOR EXT	S	S	2000	13.0	5.0	0.0	0.0	16.9	1.6	0.0
P003945	HIGHWAY SECTOR II	S	S	1994	350.0	0.0	0.0	46.0	69.9	116.6	10.2
P003968	ID-BOOK & READING DEV	S	S	1995	132.5	0.0	0.0	36.5	43.1	64.8	28.4
P003987	ID-CENTRAL INDONESIA SEC. EDU.	S	S	1997	104.0	0.0	0.0	0.0	64.4	36.3	0.0
P037097	ID-E.JAVA SEC.EDUC.	S	S	1996	99.0	0.0	0.0	3.6	51.4	20.3	0.0
P036049	ID-EARLY CHILD DEVELOPMENT	S	S	1999	21.5	0.0	0.0	0.0	20.0	11.8	11.8
P003967	ID-FIFTH HEALTH PROJECT	S	U	1999	44.7	0.0	0.0	5.0	33.4	9.8	0.0
P003965	ID-HEALTH IV:IMPR HEALT	S	S	1995	88.0	0.0	0.0	39.0	4.5	34.6	8.8
P004004	ID-HIGHER EDUC SUP.(DUE)	S	S	1996	65.0	0.0	0.0	6.9	13.9	-2.9	-5.8
P041896	ID-HR CAPACITY BUILDING	U	U	1996	20.0	0.0	0.0	12.1	5.9	18.0	14.4
P042540	ID-IODINE DEF. CONTROL	S	S	1997	28.5	0.0	0.0	9.0	12.1	10.8	10.0
P045337	ID-KECAMATAN DEV FUND	HS	S	1998	225.0	0.0	0.0	0.0	129.6	41.3	0.0
P003988	ID-PHRD II	S	S	1995	69.0	0.0	0.0	12.0	9.8	18.4	10.6
P049545	ID-PROVINCIAL HEALTH I	S	S	2000	0.0	38.0	0.0	0.0	35.7	0.9	0.0
P040195	ID-QUALITY OF UNDERGRADUATE EDUC (QUE)	S	S	1997	71.2	0.0	0.0	9.9	35.4	11.8	3.4
P036956	ID-SAFE MOTHERHOOD	S	S	1998	42.5	0.0	0.0	8.0	23.8	11.7	8.7
P004003	ID-SECONDARY SCHOOL TEACHER DEVT	S	S	1996	60.4	0.0	0.0	30.0	3.1	31.6	-3.1
P063939	ID-SOCIAL SAFETY NET AL	S	S	1999	600.0	0.0	0.0	0.0	300.0	300.0	0.0
P041895	ID-SULAWESI BASIC EDUC.	S	S	1999	47.9	15.9	0.0	0.0	55.7	14.3	0.0
P040196	ID-SUMATRA BASIC EDUC	S	S	1999	54.5	20.1	0.0	0.0	60.0	8.7	0.0
P041894	ID-SUMATRA SEC EDUC	S	S	1997	98.0	0.0	0.0	0.0	39.9	-4.7	0.0
P003914	ID-THIRD COMM HEALTH &	S	S	1993	93.5	0.0	0.0	19.7	1.3	21.1	5.1
P039644	ID-W. JAVA BASIC EDUC.	S	S	1998	103.5	0.0	0.0	3.0	62.9	-23.3	0.0
P059477	ID-WSSLIC II	HS	S	2000	0.0	77.4	0.0	0.0	77.4	0.0	0.0
P048715	IIDP	S	S	1998	34.5	0.0	0.0	8.5	20.9	20.2	17.0
P003978	IND'L TECHNOLOGY DEV	S	S	1996	47.0	0.0	0.0	8.5	10.6	18.4	11.5
P036047	IND-BALI URBAN INFRASTRUCTURE PROJECT	S	S	1997	110.0	0.0	0.0	30.1	63.7	30.8	10.6
P039312	IND-EAST JAVA UDP II	S	S	1996	142.7	0.0	0.0	53.0	18.3	72.0	-8.6
P003951	IND-KALIMANTAN UDP	S	S	1995	136.0	0.0	0.0	15.0	20.8	36.2	8.2
P056074	IND-MUNICIPAL INNOVATIONS PROJECT	S	S	1999	5.0	0.0	0.0	0.0	3.4	1.9	0.0
P003890	IND-SEMARANG SURAKARTA UDP	S	S	1994	174.0	0.0	0.0	38.7	34.9	73.6	9.9
P036053	IND-SULAWESI UDP II	S	S	1997	155.0	0.0	0.0	67.0	36.5	88.9	-16.8
P039754	IND-TAP4I-2	S	S	1995	28.0	0.0	0.0	3.0	11.7	15.2	4.9
P055821	IND-URBAN POVERTY PROJECT	S	S	1999	0.0	100	0.0	0.0	48.0	-2.4	0.0
P003954	JAVA IRR IMP & W R M	S	HS	1994	165.7	0.0	0.0	34.0	30.8	65.6	43.6

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

<b>Active Projects</b>		<b>Last PSR Supervision Rating</b>			<b>Original Amount in US\$ Millions</b>				<b>Difference Between Expected and Actual Disbursements<sup>a</sup></b>		
<b>Project ID</b>	<b>Project Name</b>	<b>Development Objectives</b>	<b>Implementation Progress</b>	<b>Fiscal Year</b>	<b>IBRD</b>	<b>IDA</b>	<b>GRANT</b>	<b>Cancel.</b>	<b>Undisb.</b>	<b>Orig.</b>	<b>Frm Rev'd</b>
P004014	KERINCI SEBLAT ICDP	S	S	1996	19.1	0.0	0.0	3.0	12.1	9.8	0.0
P003699	KERINCI SEBLAT ICDP	S	S	1996	0.0	0.0	15.0	0.0	10.0	4.6	0.0
P037095	MALUKU REG. DEV	U	U	1998	16.3	0.0	0.0	4.5	1.0	4.4	0.0
P004008	NUSA TENGGARA DEV.	S	S	1996	27.0	0.0	0.0	4.9	8.3	6.4	-0.9
P003701	ODS I- UMBRELLA	HS	S	1995	0.0	0.0	27.0	0.0	14.9	4.9	0.0
P004021	POW. TRANS & DIST II	U	S	1996	373.0	0.0	0.0	110.0	78.4	184.3	15.5
P004026	RLWY EFFICIENCY	S	S	1997	105.0	0.0	0.0	20.0	79.9	69.6	0.0
P035544	SOLAR HOME SYSTEMS	S	S	1997	20.0	0.0	0.0	19.5	0.5	16.0	0.0
P003700	SOLAR HOMES SYSTEMS	S	S	1997	0.0	0.0	24.3	0.0	19.2	11.7	0.0
P004016	STRATEGIC URB. RDS I	S	S	1996	86.9	0.0	0.0	10.0	32.8	33.5	6.4
P004011	SULAWESI AGRI AREA	S	S	1996	26.8	0.0	0.0	3.7	7.3	1.7	-3.7
P003910	SUMATERA & KALIMAN P	U	S	1994	260.5	0.0	0.0	46.0	80.4	133.9	121.9
P003993	SUMATRA REG. ROADS	S	S	1998	234.0	0.0	0.0	50.0	161.1	17.5	-5.5
P003997	TELECOM IV	S	S	1992	375.0	0.0	0.0	81.0	7.8	88.8	47.2
P004001	TELECOM SECTOR MODER	S	S	1995	325.0	0.0	0.0	69.7	98.8	169.7	119.7
P064118	WATSAL	S	S	1999	300.0	0.0	0.0	0.0	250.0	150.0	0.0
P004017	UNIV.RES.GRADUATE EDUC	S	S	1994	58.9	0.0	0.0	20.6	0.0		
P003984	LAND ADMINISTRATION	S	S	1995	80.0	0.0	0.0	33.9	0.0		
I02020451	BIODIVERSITY STRATEGY	S	S	2000	0.0	0.0	0.4	0.0	0.4		
<b>Grand Total:</b>					<b>5,836.5</b>	<b>256.4</b>	<b>85.1</b>	<b>974.9</b>	<b>2,420.0</b>	<b>2,196.4</b>	<b>508.5</b>

Summary as of November 30, 2000

	<u>Active Projects</u>	<u>Closed Projects</u>	<u>Total</u>
Original amount	5,958.26	22,297.95	28,256.21
Total disbursed (IBRD and IDA)	2,231.84	20,022.12	22,253.96
of which has been repaid	0.62	9,566.31	9,566.93
Total now held by IBRD and IDA	4,694.28	10,367.75	15,062.03
Amount sold	0.00	88.08	88.08
of which repaid	0.00	88.08	88.08
Total Undisbursed:	2,465.88	0.00	2,465.88

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

Indonesia - Statement of IFC's Held and Disbursed Portfolio as of 10/31/00  
(In US Dollars Millions)

FY Approval	Company	Held				Disbursed			
		Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
2000	Ciluluk Village	0.04	-	-	-	0.02	-	-	-
1994	KDLC Bali	2.08	1.14	-	-	2.08	1.14	-	-
1991	LYON-MLF-Ibis	2.01	-	-	2.01	2.01	-	-	2.01
1985	Manulife	-	0.32	-	-	-	0.32	-	-
1995/96	POF	5.14	1.93	-	6.00	5.14	1.93	-	6.00
1994	Prudential Asia	-	4.80	-	-	-	2.24	-	-
1995	PT ABS Finance	-	1.31	-	-	-	1.31	-	-
1997	PT AdeS Alfindo	10.29	3.53	-	17.64	10.29	3.53	-	17.64
1989	PT Agro Muko	0.00	2.20	-	0.00	0.00	2.20	-	0.00
1997	PT Alumindo	18.88	-	-	16.00	18.88	-	-	16.00
1991	PT Argo Pantas	9.38	13.00	-	11.36	9.38	13.00	-	11.36
1989/91/94	PT Astra	-	12.16	-	-	-	12.16	-	-
1997	PT Astra Graphia	-	2.00	-	-	-	2.00	-	-
1997/98	PT Astra Otopart	-	1.07	-	-	-	1.07	-	-
1995	PT Bakrie Pipe	17.14	-	9.50	-	17.14	-	9.50	-
1997/00	PT Bank NISP	5.71	-	-	-	5.71	-	-	-
1993/96	PT BBL Dharmala	11.43	-	-	21.54	11.43	-	-	21.54
1997/98	PT Berlian	9.29	20.00	-	27.38	6.72	16.65	-	19.44
1995	PT Bunas Finance	5.54	-	-	1.45	5.54	-	-	1.45
1996	PT Dharmala	20.00	-	-	10.00	20.00	-	-	10.00
1997	PT Grahawita	-	-	5.00	-	-	-	5.00	-
1995	PT Hotel Santika	3.78	-	-	-	3.78	-	-	-
1991	PT Indaci	-	-	1.83	-	-	-	1.44	-
1990/91/93/95/99	PT Indo-Rama	39.82	12.22	-	24.10	39.82	11.80	-	24.10
1997	PT Kalimantan	20.00	15.00	-	6.00	15.56	15.00	-	4.67
1992/94/96	PT KIA Keramik	17.19	9.12	-	57.13	17.19	8.99	-	57.13
1995	PT KIA Serpih	15.00	6.35	-	49.50	15.00	6.24	-	49.50
1997/98/00	PT Makro	-	3.90	-	-	-	3.40	-	-
1998	PT Megaplast	8.75	2.50	-	-	8.75	2.50	-	-
1993/98	PT Nusantara	3.18	-	-	10.38	3.18	-	-	10.38
1994	PT PAMA	-	0.71	-	-	-	0.71	-	-
1996	PT Pramindo Ikat	25.00	8.18	25.00	59.50	25.00	3.91	25.00	59.50
1991	PT RIMBA	2.56	0.60	-	0.74	2.56	0.60	-	0.74
1993	PT Samudera	-	5.00	-	-	-	5.00	-	-
1997	PT Sayap	10.00	-	-	14.00	10.00	-	-	14.00
1992/95	PT Viscose	28.76	-	-	34.05	28.76	-	-	34.05
1997	PT Wings	8.68	-	-	14.92	8.68	-	-	14.92
1991	SEAVI Indonesia	-	1.43	-	-	-	1.43	-	-
1980/85/87/94/95	Semen Andalas	6.44	10.02	-	5.83	6.44	10.02	-	5.83
Total Portfolio		306.11	138.49	41.33	389.52	299.08	127.16	40.94	380.25

**Approvals Pending Commitment**

FY Approval	Company	Loan	Equity	Quasi	Partic
2000	NISP Equity	-	5.00	-	-
2000	PT Petrosea	15.00	1.80	8.20	-
Total Pending Commitment:		15.00	6.80	8.20	-



### CAS Program Matrix

**CAS Objectives, Sub-Themes:**

- Sustaining economic recovery and quality growth
- Building national institutions for accountable government
- Delivering better public services for the poor

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/ benchmarks
<b>Sustaining Economic Recovery and Quality Growth</b>				
<b>Bank and Corporate Restructuring</b> <ul style="list-style-type: none"> <li>• Excessively high govt. ownership of banking sector</li> <li>• Weak oversight by the state as owner of state owned banks</li> <li>• Inefficient Bank supervision by BI</li> <li>• Slow disposition of assets by IBRA, poor implementation of IBRA's governance, risk of less than optimum quality corporate debt restructuring deals by IBRA</li> <li>• Ineffectiveness of 'sticks' to enforce corporate debt restructuring</li> <li>• Tax and regulatory impediments to voluntary corporate debt restructuring still remain</li> </ul>	<ul style="list-style-type: none"> <li>• Orderly, expedited privatization of state owned banks</li> <li>• Strengthen and empower MOF Monitoring Unit</li> <li>• Strengthen supervision in BI or in the new FSA</li> <li>• Expedited asset disposition with agreed upon targets</li> <li>• Empower IBRA's OC and management for independent decision-making</li> <li>• IBRA to adopt transparent corporate restructuring principles.</li> <li>• IBRA and JITF to make full use of their powers or leverage to accelerate and facilitate debt restructuring deals</li> <li>• Fully implement the incentives that are already planned or drafted</li> </ul>	<ul style="list-style-type: none"> <li>• AAA (BFR Technical Assistance)</li> <li>• Corporate Restructuring Technical Assistance Project (CRTAP)</li> <li>• Banking Restructuring Assistance Project</li> <li>• PHRD TA Grants</li> <li>• IFC liquidity facilities</li> <li>• IFC investments to recapitalize select banks</li> <li>• IFC investments in restructuring funds or other specialized institutions targeting development of an active distressed debt market.</li> <li>• IFC corporate restructurings</li> </ul>	<ul style="list-style-type: none"> <li>• IMF LOI</li> <li>• USAID corporate and financial sector restructuring</li> <li>• IMF LOI and TA</li> <li>• ADB lending and TA</li> </ul>	<ul style="list-style-type: none"> <li>• By end of CAS period less than 40% of banking assets in state ownership</li> <li>• Routine governance actions exercised by MOF, M&amp;G Unit</li> <li>• Inst. Strengthening program in place for supervision in BI/FSA. Transition plan in place.</li> <li>• Disposition schedule for all IBRA assets set and followed</li> <li>• Improved disclosure and transparency in IBRA's operations and audit</li> <li>• Corporate restructuring consistently in accordance with agreed upon CR principles.</li> <li>• Build up in momentum in the number of CR deals completed</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/ benchmarks
<ul style="list-style-type: none"> <li>• Lack of comprehensive medium to longer term financial sector strategy</li> <li>• Underdeveloped NBFIs sector and capital markets</li> </ul>	<ul style="list-style-type: none"> <li>• Draft and implement a medium to longer term financial sector strategy</li> <li>• Market development and enabling actions for NBFIs sector</li> </ul>	<ul style="list-style-type: none"> <li>• AAA on financial sector strategy</li> <li>• IFC institution building to help deepen and diversify financial markets; micro finance, NBFIs and life insurance, e-banking, brokerage firms and pension fund management companies, provision of greater liquidity to bond and swap markets via partial guarantees, and support to housing finance via long-term local currency funding, credit information bureau.</li> </ul>		<ul style="list-style-type: none"> <li>• Medium to long term Financial Sector Strategy and Implementation Plan agreed and followed</li> <li>• Market and NBFIs development in accordance with FSF</li> </ul>
<p><b>Macroeconomic stability</b> Fragile as reflected in:</p> <ul style="list-style-type: none"> <li>• High government debt reserve, weak Rupiah, uptick in inflation, high interest rates</li> </ul>	<ul style="list-style-type: none"> <li>• Adhere to LOI</li> <li>• Implement agreed budget</li> <li>• Ensure fiscal decentralization is budget neutral</li> <li>• Manage fiscal risks actively</li> <li>• Observe agreed monetary policy targets</li> </ul>	<ul style="list-style-type: none"> <li>• AAA - TA, policy advice</li> <li>• ESW - Debt Management, Public Financial Management</li> </ul>	<ul style="list-style-type: none"> <li>• IMF LOI</li> </ul>	<ul style="list-style-type: none"> <li>• Ongoing LOI performance benchmarks/targets.</li> <li>• Budget outcome close to plan</li> <li>• Formulate a “road-map” (with key outcome-based milestones) for capacity building and information systems upgrading in the Debt Management Unit and proceed with its implementation.</li> <li>• Monitor existing public contingent liabilities and limit new ones (including borrowing by sub-national governments).</li> <li>• Monetary indicators close to plan</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/ benchmarks
<p><b>Pro-poor policies</b></p> <ul style="list-style-type: none"> <li>• Open internal trade threatened</li> <li>• Rice price policy changes may hurt poor</li> <li>• Land policy - insecure access to and constrained management authority over natural resources</li> <li>• Access to micro finance</li> </ul>	<ul style="list-style-type: none"> <li>• Encourage local revenue options that limit deterioration to the business environment.</li> <li>• Raise awareness of rice price impact on poor and alternatives for helping farmers</li> <li>• Discourage import controls and higher tariffs</li> <li>• Land: (i) establish a national forum on land policy reform; (ii) strengthen decentralized capacity to provide land administration services; (iii) strengthen and accelerate application of the framework for providing community titles to agrarian land.</li> <li>• Establish a strategy that focuses on developing a sustainable market-based financial system, and decreases reliance on subsidized program credits</li> <li>• Complete BRI's reorientation to focus on micro- and small-scale finance</li> </ul>	<ul style="list-style-type: none"> <li>• Monitoring (ASEM grant), policy advice</li> <li>• Policy advice/condition (trigger for high case)</li> <li>• AAA – focus on facilitating the national-level, multi-stakeholder definition of land policy reform</li> <li>• LEN – Second Land Administration Project</li> <li>• ESW/TA - review of micro-credit</li> <li>• SPN - focused review of existing portfolio of community driven projects (e.g. UPP, KDP, NAATP, SAADP, BRDP) that involve revolving microcredit activities</li> <li>• LEN - possible loan to support expanded access in rural areas, ongoing support for revolving micro-credit in community driven</li> </ul>	<ul style="list-style-type: none"> <li>• AusAID is preparing a second phase of technical assistance in support of land administration. USAID is providing ongoing support through its National Resource Management project for strengthening community mapping and rights identification for forestry land</li> <li>• ADB – leadership on SME finance via TA and lending; supervision of ongoing microfinance and P4K projects</li> <li>• GTZ ongoing PROFI project supporting BI in strengthening the</li> </ul>	<ul style="list-style-type: none"> <li>• Internal trade barriers limited</li> <li>• Farm gate prices of commodities</li> <li>• Price of rice to consumers</li> <li>• Land-titling proceeds</li> <li>• Establishment of national forum</li> <li>• Improved local capacity</li> <li>• Public promulgation of a strategy</li> <li>• Reduction of budget support for subsidized program credits</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/benchmarks
<ul style="list-style-type: none"> <li>Insufficient poverty focus to public expenditure budgeting</li> </ul>	<ul style="list-style-type: none"> <li>Strengthen regulatory and supervisory framework</li> <li>Use of 'benefit incidence' to guide public spending to programs which benefit poor and women and away from inefficient programs and subsidies, including fuel prices.</li> <li>Develop approach to encourage poverty reduction by local governments through the fiscal transfer framework</li> </ul>	<ul style="list-style-type: none"> <li>projects</li> <li>IFC support to micro-finance institutions; SME facilities, and SME-focused banks.</li> <li>AAA/ ESW - Poverty Report and follow up, Hydrocarbon Sector report, Energy policy discussions, budget discussions</li> <li>LEN -possible Energy APL/SECAL</li> <li>AAA - TA to GOI on decentralization framework, ESW - Provincial PERs</li> <li>LEN - possible Public Sector Reform Loan to support</li> </ul>	<ul style="list-style-type: none"> <li>regulatory framework for Bank Percreditan Rakyat (BPR)</li> <li>IMF LOI – phasing out inefficient subsidies</li> </ul>	<ul style="list-style-type: none"> <li>Benefit incidence for bottom quintiles of programs/subsidies in central budget</li> <li>Benefit incidence for bottom quintiles of programs/subsidies in local budgets</li> </ul>
<p><b>Competitive PSD</b></p> <ul style="list-style-type: none"> <li>Corporate governance widely perceived to be worse than in any other country in the Region</li> <li>Inadequate implementation of competition law</li> <li>Poor climate for foreign direct investment</li> <li>Privatization has stopped</li> </ul>	<ul style="list-style-type: none"> <li>Strengthen regulatory and enforcement capacity in BAPEPAM and other regulatory agencies</li> <li>Develop public awareness of need for good corporate governance and promote self regulation by the private sector</li> <li>Create and fully staff and fund the new competition agency</li> <li>Rationalize FDI policy, laws and regulations</li> <li>Adopt a rational privatization policy, fund, create and staff an effective privatization institution</li> </ul>	<ul style="list-style-type: none"> <li>AAA, PHRD Grant</li> <li>Technical assistance through PHRD and AAA</li> <li>ESW - Competition Policy</li> <li>Advice from MIGA and FIAS</li> <li>AAA</li> <li>AAA for policy advice</li> </ul>	<ul style="list-style-type: none"> <li>ADB corporate governance reforms</li> <li>CIDA - policy for private sector development</li> <li>Netherlands corporate governance capacity building</li> <li>Many donors</li> <li>UN agencies labor market monitoring</li> </ul>	<ul style="list-style-type: none"> <li>Improved investor confidence as measured by improved investment flows</li> <li>Increase in the number of effective enforcement actions against offenders</li> <li>Agency fully staffed</li> <li>Policies and regulations in place</li> <li>Successful actions brought against offenders who abuse market power</li> <li>Increased investment flows</li> <li>Privatization begins again and makes steady progress</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/ benchmarks
<ul style="list-style-type: none"> <li>Many constraints to SME development</li> <li>Indonesia not ready to take advantage of the new information and communications technologies</li> </ul>	<ul style="list-style-type: none"> <li>Rationalize government policies and interventions to support SMES</li> <li>Develop effective, market based support systems and skills development</li> <li>Develop capacity in banks to lend to SMEs</li> <li>Privatize telecoms fixed line service providers TELKOM and INDOSAT</li> <li>Prepare a National Networking Development Plan</li> <li>Develop a regulatory framework for networking and e-commerce</li> <li>Put government on line</li> </ul>	<ul style="list-style-type: none"> <li>IFC to pilot innovative support programs through a decentralized SME facility</li> <li>IFC investments in private education and health, internet-related investments, e-commerce.</li> <li>SPN - Information Infrastructure Development Project (IIDP)</li> <li>AAA</li> </ul>	<ul style="list-style-type: none"> <li>ADB non-bank financial institutions and many others</li> <li>UNIDO small business development</li> <li>JBIC</li> </ul>	<ul style="list-style-type: none"> <li>Growth in number and output of SMEs</li> <li>Increase in bank lending to SMEs</li> <li>Increase in the use of the internet, in particular an increase in the volume of e-commerce</li> <li>Effective delivery of government services such as distance learning and procurement using the new technologies</li> </ul>
<p><b>Human capital development for competitive growth</b></p> <ul style="list-style-type: none"> <li>Human capital development necessary for sustainable economic recovery.</li> <li>Risk of decentralization having negative effect on human capital development.</li> </ul>	<ul style="list-style-type: none"> <li>Improve basic education at district level</li> <li>Increased access to quality basic education</li> <li>Improve skills development, professional management, training</li> </ul>	<ul style="list-style-type: none"> <li>LEN - sub-national projects including Basic Education IV, Strengthening Local Education Capacity II, Improving Quality And Responsiveness Of Community Oriented Health Care, Provincial Health II</li> <li>SPN - supporting restructuring of secondary and higher education sectors</li> <li>AAA - policy notes on health and education</li> <li>Global Development Learning Network initiative with University of Indonesia</li> </ul>	<ul style="list-style-type: none"> <li>ADB decentralized education support in quality improvement and to strengthen poverty targeting</li> <li>UNICEF basic education performance monitoring and pilot projects</li> <li>Japan - vocational and technical education</li> <li>Australia - education and employment, technical and vocational training</li> <li>Canada - human resource development</li> </ul>	<ul style="list-style-type: none"> <li>School enrollments</li> <li>Quality indicators</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/benchmarks
<p><b>Addressing infrastructure bottlenecks</b></p> <ul style="list-style-type: none"> <li>Declining public spending on maintenance/preservation (roads, water supply, sanitation, irrigation and urban services)</li> <li>Slow private sector participation, inefficient public sector entities, and distorted pricing</li> <li>Minimal domestic financing capabilities</li> <li>Infrastructure bottlenecks in power, roads and water</li> </ul>	<ul style="list-style-type: none"> <li>Provide assistance for essential investments for maintenance/rehabilitation, improve capacity of local government</li> <li>Improve policy/legal/regulatory framework, restructure sector entities, phase out price subsidies</li> <li>Strengthen domestic capital markets</li> <li>Mobilize cofinancing for infrastructure needs, emphasizing equity investments</li> </ul>	<ul style="list-style-type: none"> <li>LEN: Eastern Indonesia Roads, Water Resource Management (APL), Community Based Urban Development, Kecamatan Development II and III, Energy APL/SECAL</li> <li>AAA - Road Maintenance Strategy, Power Demand and Investment Planning</li> <li>Possible policy-based guarantees</li> <li>IFC - Possible investments in water and transport.</li> </ul>	<ul style="list-style-type: none"> <li>ADB focus on local road and small ports development, rural and outer islands needs</li> <li>Japan - urban infrastructure development and housing development</li> <li>ADB Power Sector Program Loan</li> <li>ADB and JBIC lending for gas sector</li> </ul>	<ul style="list-style-type: none"> <li>No disruptions to the supplies of essential services</li> <li>Maintenance improved</li> <li>Oil and gas sector deregulated</li> <li>New oil/gas/electricity laws and regulatory bodies established</li> <li>PLN financial health restored and restructured</li> <li>Fuel and power subsidies phased out</li> <li>Energy APL/SECAL implemented</li> </ul>
<b>Building National Institutions for Accountable Government</b>				
<p><b>Governance Strategy</b></p> <ul style="list-style-type: none"> <li>Lack of overall strategy on governance and no champion within government to lead governance reform efforts.</li> </ul>	<ul style="list-style-type: none"> <li>Develop and implement governance and anti-corruption strategy led by high powered inter-ministerial team.</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing advisory activities. Close interaction with Governance Partnership.</li> </ul>	<ul style="list-style-type: none"> <li>Indonesia led Governance Partnership sponsored by UNDP and World Bank.</li> </ul>	<ul style="list-style-type: none"> <li>Governance strategy in place by June 2001.</li> <li>Interministerial team in place by January 2001.</li> <li>Governance Partnership launches anti-corruption survey and position papers in January 2001.</li> </ul>
<p><b>Legal and judicial reforms</b></p> <ul style="list-style-type: none"> <li>Total public mistrust of legal and judicial system due to corruption in judiciary and in law enforcement agencies, poor quality of legal profession and weak infrastructure.</li> </ul>	<ul style="list-style-type: none"> <li>Adoption of a comprehensive and time bound law and judicial reform action program drawing on work of Law Reform Commission, and fill the institutional vacuum in managing legal reform process</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing AAA activities - Civil Service Reform, Legislative Transparency</li> <li>Coordination of donor activities</li> </ul>	<ul style="list-style-type: none"> <li>USAID legal and judicial reform support</li> <li>ABD support to Attorney General's office</li> <li>Netherlands, Australia, USA, ADB, Canada</li> <li>Governance</li> </ul>	<ul style="list-style-type: none"> <li>National program on legal reform adopted early in 2001; Lead person for legal reforms designated.</li> <li>Selection of reformist judge for head of Supreme Court.</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/ benchmarks
			Partnership to take the lead on increasing demand for law reforms.	<ul style="list-style-type: none"> <li>Allocation of adequate budget resources for National Law Reform Commission, Ombudsman, Anti-Corruption Commission.</li> </ul>
<p><b>Civil service reforms</b></p> <ul style="list-style-type: none"> <li>Decentralization poses risks to service delivery and without redundancy policy, could result in large numbers of civil servants unwanted in regions</li> <li>Civil service compensation may have been raised too much; no long term strategy for civil service reform.</li> </ul>	<ul style="list-style-type: none"> <li>GOI to prepare civil service reform strategy under IMF LOI</li> <li>GOI should prepare redundancy plan, and develop clear implementation plan including making sure civil servants get paid, civil servants transferred to regions carry their budgets with them.</li> <li>Avoid further increases in civil service pay and develop exit program for redundant employees; GOI should build capacity and institutional infrastructure for ongoing pay policy formulation</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing analytical and advisory activities including report on civil service reform</li> <li>Ongoing analytical work on civil service reforms</li> <li>If government is keen, public sector reform loan</li> </ul>	<ul style="list-style-type: none"> <li>IMF LOI</li> </ul>	<ul style="list-style-type: none"> <li>Seamless transfer of civil servants to region, and redundancy plan in place</li> <li>No pay increases.</li> <li>Establish Pay Commission with TOR. aimed at broad reforms of system and development of methodology for pay determination.</li> <li>Civil service strategy in place</li> </ul>
<p><b>Public procurement and financial management</b></p> <ul style="list-style-type: none"> <li>Procurement and financial management systems weak and corruption ridden.</li> <li>Government established a Steering Committee to guide reforms of public procurement system.</li> </ul>	<ul style="list-style-type: none"> <li>Implement recommendations of the Country Procurement Assessment and Country Financial Accountability Assessment, particularly in relation to the establishment of the National Procurement Office, and revisions of the draft State Finance, Treasury and Audit bills.</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing AAA and fiduciary control work by Bank.</li> <li>CPAR, CFAA</li> </ul>	<ul style="list-style-type: none"> <li>Asian Development Bank participated in CPAR and CFAA work and will work with Bank on these issues.</li> </ul>	<ul style="list-style-type: none"> <li>National Public Procurement office (NPPO) is up and running with a clear mandate to formulate national public procurement policy and monitor compliance.</li> <li>New laws and regulations enacted consistent with international practice on State Finance, Treasury and Audit.</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/benchmarks
<b>Management of decentralization process</b>		<ul style="list-style-type: none"> <li>• AAA, TA, fiscal decentralization, provincial public expenditure reviews.</li> <li>• LEN - possible Public Sector Reform Loan/Credit</li> </ul>	<ul style="list-style-type: none"> <li>• GTZ decentralization and local capacity building</li> <li>• Japan - addressing regional development disparities,</li> </ul>	
<b>Sustainable Natural Resource Management and environmental protection</b> <ul style="list-style-type: none"> <li>• Deterioration in environment and lack of adequate NRM including impacts on global environment</li> <li>• Potential for further degradation following decentralization</li> <li>• Forests - illegal logging, inefficient industry, poor forest management, ill conceived conversion.</li> <li>• Poor Urban Air Quality</li> <li>• Degradation in marine resources</li> </ul>	<ul style="list-style-type: none"> <li>• Implement CGI forestry commitments</li> <li>• Follow through on global environmental treaty obligations drawing on international funds for support</li> <li>• Public participation in effective forest and protected area management</li> <li>• Urban air quality improvement</li> <li>• Strengthen and improve implementation of pollution regulation and licensing</li> <li>• Strengthen marine resource management</li> </ul>	<ul style="list-style-type: none"> <li>• AAA/Donor Coordination</li> <li>• DFID Secondment</li> <li>• GEF - update biodiversity strategy - long-term support if political commitment demonstrated</li> <li>• Montreal Protocol - grants for phase out of ozone depleting substances</li> <li>• AAA - Decentralized environmental management, Forestry, Land Policy</li> <li>• TA - possible component for sub-national lending project</li> <li>• SPN - Kerinci Seblat ICDP</li> <li>• LEN - Decentralized, demand-driven projects,</li> <li>• SPN and LEN - COREMAP (APL)</li> <li>• IDF Grant to DKP</li> </ul>	<ul style="list-style-type: none"> <li>• TA loans and grants and institutional strengthening programs (EU, JICA, DFID, USAID, GTZ, others)</li> <li>• Australia - environmental impact assessment</li> <li>• GTZ forest resource management</li> <li>• TA (SwissContact, USAEP)</li> <li>• Air quality monitoring equipment (Austria)</li> <li>• CIDA "CEPI" program</li> <li>• USAID Urban Env. Management</li> <li>• ADB COFISH Project, Marine Resources</li> </ul>	<ul style="list-style-type: none"> <li>• IDCF operational</li> <li>• National Forest Program formulated</li> <li>• Urgent actions taken</li> <li>• Improved access to resources</li> <li>• Secure tenure for resources</li> <li>• Removal of non-forest land from "forest estate" for use in agroforestry, social forestry</li> <li>• Intensive replanting programs</li> <li>• Implementing regulations for Environment Law</li> <li>• Adequate budgeting and staffing for BAPEDALDA</li> <li>• Clean fuel specifications</li> <li>• Effective vehicle emissions testing and enforcement</li> <li>• Energy APL/SECAL implemented</li> <li>• DKP fully operational</li> <li>• COREMAP Phase I</li> </ul>

Diagnosis	Strategy/Actions	Bank Group Instruments	Other Donor Instruments	Progress Indicators/ benchmarks
<ul style="list-style-type: none"> <li>Inadequate water resource management and potential negative effects of decentralization.</li> </ul>	<ul style="list-style-type: none"> <li>Water – establish and implement policy framework for river basin management and for irrigation management</li> <li>Follow through with investment to support reforms at subnational level</li> </ul>	<ul style="list-style-type: none"> <li>SPN - Piloting of new approaches through the JIIWRMP</li> <li>LEN - National Water Resources Management Program consistent with the WATSAL framework</li> </ul>	<p>Loan</p> <ul style="list-style-type: none"> <li>COREMAP (ADB, AusAID)</li> <li>Proyek Pesisir (USAID)</li> <li>JICA coral reef project</li> </ul> <p>A post-WATSAL investment phase is being closely coordinated through a local donors group that includes: ADB, EU, JICA, JBIC, FAO, GTZ, Netherlands.</p>	<p>satisfactory</p> <ul style="list-style-type: none"> <li>COREMAP Phase II goes ahead</li> </ul> <p>Completion of WATSAL agenda</p>
<b>Delivering Better Public Services for the Poor</b>				
<p><b>Effective public service delivery to the poor</b></p> <ul style="list-style-type: none"> <li>Centrally controlled public service delivery: provisions don't match needs and resources are wasted</li> <li>Government needs to define roles and responsibilities for each level - center, province, district and below, and possible private sector involvement</li> <li>Forging new social contracts between local governments and citizens should precede donor support.</li> <li>Despite abilities,</li> </ul>	<ul style="list-style-type: none"> <li>Improve incentives for demand orientation of public good providers through civil service reform and introduction of competition through use of non-government providers.</li> <li>Sector-by-sector analysis and stakeholder consultation to work out right level of government for planning and administration of services, particularly health, education and basic infrastructure.</li> <li>Reward reformers. Create local government networks, share best practice and lessons.</li> <li>Involve communities, including poor and vulnerable, in development planning and implementation.</li> </ul>	<ul style="list-style-type: none"> <li>AAA/ESW – Delivering Public Goods and Services at Sub-National level, Provincial Public Expenditure Reviews, Sectoral Studies in Decentralized Environment, Policy Notes on Health and Education</li> <li>SPN - Modification of existing projects to cope with new risks and seize new opportunities raised with decentralization</li> <li>LEN - sectoral and cross sector programmatic investment and TA supporting basic education, health and infrastructure through sub-national governments, communities, or both: Basic Education IV, SLEC II, Provincial Health II, W.Java/Jkt Environmental Management Kecamatan Development Project II and III, Improving Quality And Responsiveness Of Community</li> </ul>	<ul style="list-style-type: none"> <li>Local Government Capacity Building: ADB is addressing via a community development project; GTZ/USAID/CIDA study is supporting analytical work and strategy formulation for local capacity building.</li> <li>Germany - health sector infrastructure financing</li> <li>Participatory planning: many donors are using, including IFAD, ADB.</li> <li>ADB provincial projects.</li> <li>UNICEF, WHO health</li> </ul>	<ul style="list-style-type: none"> <li>Quality of local government services.</li> <li>Health and education status indicators.</li> <li>Accountability mechanisms</li> <li>Fiduciary controls at local level improved</li> </ul>

<b>Diagnosis</b>	<b>Strategy/Actions</b>	<b>Bank Group Instruments</b>	<b>Other Donor Instruments</b>	<b>Progress Indicators/ benchmarks</b>
<p>communities ignored as development partners</p> <ul style="list-style-type: none"> <li>• Vulnerability of communities in conflict areas</li> </ul>	<ul style="list-style-type: none"> <li>• Develop systematic response to impact of violent conflict on ongoing projects</li> <li>• Selectively pilot approaches in violence prone areas addressing critical needs of the poor</li> </ul>	<p>Oriented Health Care, Eastern Indonesia Roads, Community Based Urban Development, Urban Governance Reform (APL), Water Sector (APL) and possible Rural Area Development (APL)</p> <ul style="list-style-type: none"> <li>• AAA - Post-conflict/widows study, Post-conflict strategy</li> </ul>	<p>care pilot projects and communicable disease controls.</p> <ul style="list-style-type: none"> <li>• UN agencies providing emergency response</li> </ul>	<ul style="list-style-type: none"> <li>• Community development approaches adopted in post-conflict areas.</li> </ul>

## INDONESIA - CAS Summary of Development Priorities

<i>Network area</i>	<i>Country performance<sup>a</sup></i>	<i>Major issue<sup>b</sup></i>	<i>Country priority<sup>c</sup></i>	<i>Bank priority<sup>c</sup></i>	<i>Reconciliation of country and Bank priorities<sup>d</sup></i>
<b>Poverty Reduction &amp; Economic Management</b>					
Poverty reduction	Good	Develop and adopt broad based poverty strategy	High	High	
Economic policy	Fair	Structural reform; macrostability	High	High	
Public sector	Fair	Governance/anti-corruption	High	High	
Gender	Fair	Voice and visibility	Moderate	High	Community development, social projects
<b>Human Development Department</b>					
Education	Good	Quality of basic education	High	High	
Health, nutrition & population	Fair	Quality of health services	Moderate	High	Policy dialogue, projects
Social protection	Good	Effectiveness of social safety nets	Moderate	Moderate	
<b>Environmentally &amp; Socially Sustainable Development</b>					
Rural development	Fair	Rural incomes and infrastructure	High	High	
Environment	Poor	Forests, water	Moderate	High	Forestry sector dialogue
Social development	Fair	Community development	Moderate	High	Community development projects
<b>Finance, Private Sector &amp; Infrastructure</b>					
Financial sector	Poor	Bank restructuring	High	High	
Private sector	Fair	Corporate restructuring, SMEs	Moderate	High	Policy dialogue
Energy & mining	Fair	Sector policies and restructuring	Moderate	Moderate	
Infrastructure	Fair	Preservation, bottlenecks	Moderate	High	Policy dialogue, projects

a. Use "excellent," "good," "fair," or "poor."

b. Indicate principal country-specific problems (e.g., for poverty reduction, "rural poverty;" for education, "female secondary completion;" for environment, "urban air pollution").

c. To indicate priority, use "low," "moderate," or "high."

d. Give explanation, if priorities do not agree; for example, another MDB may have the lead on the issue, or there may be ongoing dialogue.



# INDONESIA

- MAIN ROADS
- SELECTED CITIES AND TOWNS
- ⊙ PROVINCE HEADQUARTERS
- ⊕ NATIONAL CAPITAL
- - - PROVINCE BOUNDARIES
- - - INTERNATIONAL BOUNDARIES

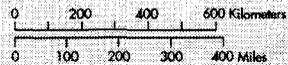
## PROVINCES:

- |                    |                        |                      |
|--------------------|------------------------|----------------------|
| 1 D.I. ACEH        | 11 JAWA BARAT          | 21 SULAWESI UTARA    |
| 2 SUMATERA UTARA   | 12 JAWA TENGAH         | 22 SULAWESI TENGAH   |
| 3 RIAU             | 13 D.I. YOGYAKARTA     | 23 SULAWESI TENGGARA |
| 4 SUMATERA BARAT   | 14 JAWA TIMUR          | 24 SULAWESI SELATAN  |
| 5 JAMBI            | 15 BALI                | 25 KAUMANTAN TIMUR   |
| 6 BENGKULU         | 16 NUSA TENGGARA BARAT | 26 KAUMANTAN SELATAN |
| 7 SUMATERA SELATAN | 17 NUSA TENGGARA TIMUR | 27 KAUMANTAN TENGAH  |
| 8 LAMPUNG          | 18 TIMOR               | 28 KAUMANTAN BARAT   |
| 9 D.K.I. JAKARTA   | 19 PAPUA               | 29 RIAU ARCHIPELAGO* |
| 10 BANTEN          | 20 MALUKU              | 30 BANGKA-BELITUNG   |

\*Proposed province



## INDIAN OCEAN



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