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Statement by Neil Hyden
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Indonesia - Country Assistance Strategy

Despite recent setbacks, Indonesia has been one of the most successful countries in the world in reducing poverty over the last quarter century. Poverty levels in Indonesia fell from over 60% of the population in the 1970s to less than 12% in the mid-1990s. The Asian economic crisis, exacerbated by political turmoil and two years of severe drought, reversed this progress. Per capita GDP fell sharply and the number of people below the poverty line rose from around 20 million to over 50 million. While the direct impact has eased with the recovery, a high proportion of the population remains vulnerable to poverty, with 30-60 per cent of Indonesians facing a greater than 50-50 chance of periodically experiencing extreme poverty.

Indonesia is now at a crucial stage. The current situation presents considerable opportunities, but also immense risks and uncertainty. The transition to democracy is continuing. The economy is emerging from crisis, but remains fragile despite relatively sound macro-economic settings. The pace of reform in significant areas such as asset sales, bank and corporate restructuring and forestry needs to be accelerated. The ambitious program of decentralisation requires extensive coordination and support. And a continuing improvement in the security environment in West Timor and other areas remains critical to maintain international confidence. Overall, however, we should recognise that the Government is moving ahead with a wide-ranging reform program.

The Bank has played an important role working with the Indonesian Government in responding to the economic crisis and introducing reform. I welcome the reorientation of the lending program towards strengthening economic recovery, building accountable institutions, and providing better services to the poor. I also welcome the constructive role that Bank staff have played in discussing issues candidly with the Indonesian Government and in increasing dialogue with civil society.

But especially at this critical juncture for Indonesia, I am concerned that the CAS suggests that Bank lending is likely to be reduced by two thirds. While I hope that the level of reform in Indonesia will be sufficient to meet the high case in future, the CAS indicates that Indonesia is most likely to fit within the base case lending scenario. This would result in maximum annual lending to Indonesia of $400 million per year, or slightly less than $2 per capita. This would be a drastic reduction in the average annual lending program of $1.2 billion over the past decade and up until this year. Even under the high case, net World Bank lending to Indonesia will turn

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negative in FY02. But the cuts proposed under the base case would result in net repayments to the Bank of almost $1 billion over the period of the CAS.

It is appropriate to provide a substantial differential between the base case and the high case as an incentive to accelerate reform. But the 150% differential between the base and high cases proposed for Indonesia is very high. Some increase in the level of assistance attached to the base case could be made without reducing the incentive. Base case lending of $400 million per annum does not reflect the importance of continued support for the Indonesian Government's reform program and the vulnerability of Indonesia to further increases in poverty.

In particular, IDA funding to Indonesia could be increased under the base case scenario from the annual level of $150 million proposed in the CAS. Given the challenges facing Indonesia and the large numbers of people living in poverty, it is critical to provide carefully focused support for economic recovery and poverty reduction if progress toward the international development goals is to be made. Additional IDA lending could be provided to support local capacities to deliver basic education, community oriented health care, rural projects in East Indonesia, and micro-finance activities already in the pipeline. Although these activities provide an opportunity to assist some of the poorest people in Indonesia, the potential to do this will be limited severely under the base case scenario.

Indonesia's per capita income is now well below that of several other major IDA borrowers. Very high public debt levels (almost equal to GDP) limit additional borrowing on commercial terms. Increased IDA lending to Indonesia under the base case scenario would not be inconsistent with IDA lending to other major borrowers (see table below). And at time when IDA disbursements are well below projections, there is considerable scope to increase Indonesia' s IDA allocation without reducing lending to other IDA eligible countries.