INDONESIA: CAS Progress Report

I would like to commend the Staff for the quality of the CAS presentation. I also find it extremely beneficial that today’s Board review of the CAS Progress Report was preceded by a CODE discussion of the Indonesia Country Assistance Note. I would like to commend the OED for preparing a very good CAN and thank CODE for its green sheet report.

The CAS paper provides a useful update of the Government’s policy response to the crisis. It contains a clear and candid depiction of the difficult challenges facing the country in the year 1999 and beyond. This is a critical period for Indonesia, and we are pleased to note signs of improvement in macroeconomic conditions as well as progress in policy reforms.

For instance, significant progress has been made in implementing reforms of both import and export policies, reforms to improve competition on the domestic market, and reforms of investment policy. Important government programs to protect the poor have been launched although their implementation has not been uniform. The increasing attention the Government is giving to addressing the long-standing problem of corruption is encouraging.

At the same time we agree with the Report that a lot remains to be done on the current reform agenda. Particularly this relates to bank and corporate restructuring. Serious shortcomings of Indonesia’s banking system and private sector were at the root of the crisis and have to be rectified without delay.

Of course a full understanding of the crisis and what has gone wrong or could have been done better will take some time. However, the severity of Indonesia’s situation makes it imperative that the Government as well as the Bank respond quickly and effectively. Therefore we appreciate the Report’s attempt to assess critically recent performance, derive at least initial lessons and incorporate them into the Bank’s strategy. In this regard we tend to agree with the notion that the main failure of both the Government and the Bank was on the microeconomic front, a failure of institutional policy in the first place. Accordingly, we endorse the priority attention of the revised CAS to the issues of financial health of banks and corporations, good governance, and transparency in both the public and private sectors.

We also welcome the proposed modification of the CAS approach to poverty alleviation by emphasizing direct measures in support of the Government’s social safety net programs. The crisis has put at risk Indonesia’s remarkable achievements in poverty reduction and living standards over the past three decades: unemployment has increased significantly and large numbers of people have fallen below the poverty line. Progress in health and education has been
slowed. These and other social implications of the crisis are a cause of great concern and necessitate a stronger CAS focus on protecting the poor and preserving human assets.

I appreciate very much the Report’s thorough consideration of the issues of institutional foundations of the economy. I fully agree that they must lie at the very center of policy reform package in Indonesia. Weakness of Indonesia’s institutions exacerbated the crisis and now has become one of the main impediments to restarting the economy. Failure to address this problem in a profound manner would render any efforts of economic reform and recovery unsustainable.

Regretfully, the portfolio performance of the Bank’s ongoing projects in Indonesia has been severely affected by the crisis. We understand that in response a full restructuring of the portfolio has been launched. It is not clear, however, at what stage this important exercise is at the moment. We would also like to get clarification on whether the portfolio restructuring is viewed as a part of a broader Portfolio Improvement Plan discussed in the paper separately.

We concur with the overall design of the lending program and scenarios. Concerning its particularities, we note that the base case scenario proposes a high degree of front-loading. We are ready to endorse this bold approach which involves high risks, on the one hand, and high strategic rewards, on the other. We believe that during the period of uncertainty, until a new government emerges, the Bank Group can and should play an important role in helping to maintain economic and social stability in Indonesia. At the same time we would like to be reassured that due consideration has been given to the issue of timing and sequencing (including tranching) of the planned adjustment lending over the whole period until the appointment of a new Cabinet. As regards the low case scenario, the suggested degree of flexibility seems quite relevant in the light of the remaining great economic, social and political uncertainties.