INDONESIA
IN PERSPECTIVE:
A COUNTRY BRIEFING

East Asia and Pacific Region, Country Department III
SUMMARY

Indonesia in Perspective: A Country Briefing

East Asia and Pacific Region, Country Department III

Staff from the World Bank's Indonesia Operations and Policy Division worked with sectoral specialists and the resident mission in Jakarta to compile this comprehensive briefing for World Bank President James D. Wolfensohn's 1996 visit to Indonesia.

This abridged version offers a thorough overview of the country, outlining the Bank's perspective on the country's economic, political, and social situations; taking a look at the various sectors; and examining key issues facing the country.

Discussion Papers present results of country analysis undertaken by the department as part of its normal work program. To present these results with the least possible delay, the typescript of this paper has not been prepared in accordance with the procedures appropriate for formal printed texts, and the World Bank accepts no responsibility for errors. Some sources cited in this paper may be informal documents that are not readily available. The World Bank does not guarantee the accuracy of the data included in this publication and accepts no responsibility for any consequence of their use.
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POVERTY and SOCIAL

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<thead>
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<th>Indonesia</th>
<th>East Asia</th>
<th>Lower-middle-income</th>
</tr>
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<tbody>
<tr>
<td>Population mid-1994 (millions)</td>
<td>190.1</td>
<td>1,735</td>
<td>1,097</td>
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<td>GNP per capita 1994 (US$)</td>
<td>880</td>
<td>890</td>
<td>1,680</td>
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Average annual growth, 1990-94

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<tr>
<td>Population (%)</td>
<td>1.6</td>
<td>1.4</td>
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<tr>
<td>Labor force (%)</td>
<td>2.2</td>
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Most recent estimate (latest year available since 1989)

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<td>Poverty: headcount index (% of population)</td>
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<td>Life expectancy at birth (years)</td>
<td>63</td>
<td>68</td>
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<tr>
<td>Infant mortality (per 1,000 live births)</td>
<td>56</td>
<td>35</td>
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<td>Access to safe water (% of population)</td>
<td>42</td>
<td>67</td>
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<tr>
<td>Illiteracy (% of population age 15+)</td>
<td>23</td>
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<tr>
<td>Gross primary enrollment (% of school-age population)</td>
<td>114</td>
<td>104</td>
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KEY ECONOMIC RATIOS and LONG-TERM TRENDS

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<tr>
<td>Gross domestic investment/GDP</td>
<td>23.7</td>
<td>26.2</td>
<td>30.1</td>
<td>31.5</td>
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<td>Exports of goods and non-factor services/GDP</td>
<td>23.2</td>
<td>22.6</td>
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<tr>
<td>Gross domestic savings/GDP</td>
<td>25.9</td>
<td>29.1</td>
<td>31.5</td>
<td>31.8</td>
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<tr>
<td>Gross national savings/GDP</td>
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<td>24.2</td>
<td>27.8</td>
<td>28.0</td>
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<tr>
<td>Current account balance/GDP</td>
<td>-3.5</td>
<td>-2.1</td>
<td>-1.9</td>
<td>-3.5</td>
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<td>Interest payments/GDP</td>
<td>1.0</td>
<td>2.3</td>
<td>2.5</td>
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<td>Total debt/GDP</td>
<td>15.1</td>
<td>28.9</td>
<td>31.6</td>
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<td>Total debt service/exports</td>
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<td>51.3</td>
<td>..</td>
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<tr>
<td>Present value of debt/GDP</td>
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<td>..</td>
<td>181.8</td>
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Economic ratios

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<th>Indonesia</th>
<th>Lower-middle-income group</th>
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<tr>
<td>GDP (average annual growth)</td>
<td>7.2</td>
<td>8.0</td>
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<tr>
<td>GNP per capita</td>
<td>4.5</td>
<td>6.2</td>
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<tr>
<td>Exports of goods and nfs</td>
<td>-0.6</td>
<td>11.1</td>
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STRUCTURE of the ECONOMY

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<th></th>
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<tr>
<td>(% of GDP)</td>
<td></td>
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<tr>
<td>Agriculture</td>
<td>30.2</td>
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<td>17.4</td>
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<td>Industry</td>
<td>33.5</td>
<td>35.9</td>
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<td>Manufacturing</td>
<td>9.8</td>
<td>16.0</td>
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<td>Services</td>
<td>36.3</td>
<td>40.9</td>
<td>41.9</td>
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<tr>
<td>Private consumption</td>
<td>66.1</td>
<td>59.1</td>
<td>60.2</td>
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<tr>
<td>General government consumption</td>
<td>9.0</td>
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<td>8.2</td>
<td>10.2</td>
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<tr>
<td>Imports of goods and non-factor services</td>
<td>21.0</td>
<td>19.8</td>
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<td>24.0</td>
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Growth rates of output and investment (%)

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<tr>
<th></th>
<th>1975-84</th>
<th>1985-95</th>
<th>1994</th>
<th>1995 e/</th>
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<tbody>
<tr>
<td>GDP (average annual growth)</td>
<td>4.3</td>
<td>3.4</td>
<td>0.3</td>
<td>4.0</td>
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<tr>
<td>Industry</td>
<td>7.1</td>
<td>9.4</td>
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<tr>
<td>Manufacturing</td>
<td>14.4</td>
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<td>12.0</td>
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<td>Services</td>
<td>9.5</td>
<td>8.1</td>
<td>7.5</td>
<td>8.2</td>
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<tr>
<td>Private consumption</td>
<td>9.1</td>
<td>6.5</td>
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<td>10.4</td>
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<tr>
<td>General government consumption</td>
<td>11.4</td>
<td>4.8</td>
<td>2.9</td>
<td>3.0</td>
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<tr>
<td>Gross domestic investment</td>
<td>14.5</td>
<td>9.5</td>
<td>12.1</td>
<td>13.5</td>
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<tr>
<td>Gross national product</td>
<td>6.7</td>
<td>6.0</td>
<td>7.3</td>
<td>8.2</td>
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Note: 1996 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.
### Prices and Government Finance

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic Prices (% Change)</th>
<th>Government Finance (% of GDP)</th>
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<tr>
<td></td>
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<tr>
<td>1976</td>
<td>19.1</td>
<td>15.9</td>
</tr>
<tr>
<td>1986</td>
<td>4.4</td>
<td>15.9</td>
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<tr>
<td>1994</td>
<td>9.6</td>
<td>15.9</td>
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<tr>
<td>1996</td>
<td>9.0</td>
<td>6.0</td>
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#### Trade

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<thead>
<tr>
<th>Year</th>
<th>Export and Import Levels (mill. US$)</th>
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<tr>
<td></td>
<td>Total Exports (fob)</td>
</tr>
<tr>
<td>1976</td>
<td>...</td>
</tr>
<tr>
<td>1986</td>
<td>...</td>
</tr>
<tr>
<td>1994</td>
<td>...</td>
</tr>
<tr>
<td>1996</td>
<td>...</td>
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#### Balance of Payments

<table>
<thead>
<tr>
<th>Year</th>
<th>Export and Import Levels (mill. US$)</th>
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<tr>
<td></td>
<td>Exports of goods and factor services</td>
</tr>
<tr>
<td>1976</td>
<td>...</td>
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<td>1986</td>
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<td>1994</td>
<td>...</td>
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<tr>
<td>1996</td>
<td>...</td>
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### External Debt and Resource Flows

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Debt Outstanding and Disbursed (mill. US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>...</td>
</tr>
<tr>
<td>1986</td>
<td>...</td>
</tr>
<tr>
<td>1993</td>
<td>...</td>
</tr>
<tr>
<td>1994</td>
<td>...</td>
</tr>
</tbody>
</table>

#### World Bank Program

- Commitments: 211, 1,068, 924, 1,538
- Disbursements: 164, 777, 1,195, 1,184
- Principal repayments: 0, 133, 782, 1,259
- Net flows: 164, 644, 413, -78
- Interest payments: 3, 262, 861, 922
- Net transfers: 160, 382, -448, -998

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**Note:**
1. Government finance and trade fiscal year (April to March).
2. New National Accounts Series has been used.
3. a/ indicates estimates for 1996.
### Indonesia

#### Resources and Expenditures

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<thead>
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<th>Indicator</th>
<th>Unit of measure</th>
<th>Latest single year</th>
<th>Most recent estimate</th>
<th>East Asia</th>
<th>Lower-middle income</th>
<th>Next higher income group</th>
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<tbody>
<tr>
<td><strong>HUMAN RESOURCES</strong></td>
<td></td>
<td>1970-75</td>
<td>1980-85</td>
<td></td>
<td></td>
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<tr>
<td>Population (mre=1994)</td>
<td>thousands</td>
<td>132,589</td>
<td>163,036</td>
<td>190,389</td>
<td>1,734,703</td>
<td>1,096,881</td>
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<tr>
<td>Age dependency ratio</td>
<td>ratio</td>
<td>0.82</td>
<td>0.73</td>
<td>0.62</td>
<td>0.53</td>
<td>0.63</td>
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<td>Urban</td>
<td>% of pop.</td>
<td>19.4</td>
<td>26.2</td>
<td>33.6</td>
<td>31.9</td>
<td>55.9</td>
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<tr>
<td>Population growth rate</td>
<td>annual %</td>
<td>2.4</td>
<td>1.8</td>
<td>1.6</td>
<td>1.3</td>
<td>1.3</td>
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<tr>
<td>Urban</td>
<td></td>
<td>4.8</td>
<td>4.9</td>
<td>3.6</td>
<td>2.8</td>
<td>2.7</td>
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<tr>
<td>Labor force</td>
<td>thousands</td>
<td>52,166</td>
<td>69,179</td>
<td>88,651</td>
<td>977,170</td>
<td>488,667</td>
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<td>Agriculture</td>
<td>% of labor force</td>
<td>62</td>
<td>56</td>
<td>55</td>
<td>67</td>
<td>36</td>
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<td>Industry</td>
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<td>11</td>
<td>13</td>
<td>14</td>
<td>16</td>
<td>26</td>
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<tr>
<td>Female</td>
<td></td>
<td>33</td>
<td>37</td>
<td>39</td>
<td>44</td>
<td>40</td>
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<tr>
<td>Labor participation rates</td>
<td>% of pop.</td>
<td>39</td>
<td>42</td>
<td>47</td>
<td>56</td>
<td>45</td>
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<td><strong>NATURAL RESOURCES</strong></td>
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<tr>
<td>Area</td>
<td>thou. sq. km</td>
<td>1,904.57</td>
<td>1,904.57</td>
<td>1,904.57</td>
<td>16,367.16</td>
<td>40,594.43</td>
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<td>Density</td>
<td>pop. per sq. km</td>
<td>69.62</td>
<td>85.60</td>
<td>98.41</td>
<td>104.65</td>
<td>26.66</td>
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<td>Agricultural land</td>
<td>% of land area</td>
<td>21.12</td>
<td>21.72</td>
<td>24.76</td>
<td>44.90</td>
<td>41.05</td>
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<td>Change in agricultural land</td>
<td>annual %</td>
<td>-0.11</td>
<td>6.20</td>
<td>-4.60</td>
<td>1.2</td>
<td>-1.38</td>
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<td>Agricultural land under irrigation</td>
<td>%</td>
<td>10.19</td>
<td>10.83</td>
<td>10.74</td>
<td>13.14</td>
<td>11.40</td>
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<td>Forests and woodland</td>
<td>thou. sq. km</td>
<td>1,216.69</td>
<td>1,295.69</td>
<td>1,295.69</td>
<td>4,057.84</td>
<td>5,969.25</td>
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<td>Deforestation (net)</td>
<td>% change, 1980-90</td>
<td>0.4</td>
<td>1.04</td>
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<td>Household income</td>
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<td>Share of top 20% of households</td>
<td>% of income</td>
<td>52</td>
<td>41</td>
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<td>Share of bottom 40% of households</td>
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<td>21</td>
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<td>Share of bottom 20% of households</td>
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<td>9</td>
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<tr>
<td>Food</td>
<td>% of GDP</td>
<td>30.2</td>
<td>31.1</td>
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<td>Staples</td>
<td>% of GDP</td>
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<td>13.1</td>
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<td>Meat, fish, milk, cheese, eggs</td>
<td>% of GDP</td>
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<td>13.4</td>
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<td>Cereal imports</td>
<td>thou. metric tonnes</td>
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<td>1,447</td>
<td>3,105</td>
<td>29,997</td>
<td>68,936</td>
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<td>Food aid in cereals</td>
<td>% of GDP</td>
<td>30.1</td>
<td>27.0</td>
<td>40</td>
<td>447</td>
<td>5,771</td>
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<td>Food production per capita</td>
<td>% of GDP</td>
<td>18.8</td>
<td>18.8</td>
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<td>118</td>
<td>102</td>
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<td>Fertilizer consumption</td>
<td>kg/ha</td>
<td>12.8</td>
<td>50.1</td>
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<td>74.5</td>
<td>46.3</td>
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<td>Share of agriculture in GDP</td>
<td>% of GDP</td>
<td>30.2</td>
<td>23.2</td>
<td>17.4</td>
<td>18.1</td>
<td>14.0</td>
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<td>Housing</td>
<td>% of GDP</td>
<td>8.2</td>
<td>8.2</td>
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<td>Average household size</td>
<td>persons per household</td>
<td>5.0</td>
<td>4.8</td>
<td>4.5</td>
<td>4.2</td>
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<td>Urban</td>
<td>% of GDP</td>
<td>5.0</td>
<td>5.3</td>
<td></td>
<td>5.3</td>
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<tr>
<td>Fixed investment: housing</td>
<td>% of GDP</td>
<td>3.5</td>
<td>3.5</td>
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<td></td>
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<td>Fuel and power</td>
<td>% of GDP</td>
<td>4.2</td>
<td>4.2</td>
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<tr>
<td>Energy consumption per capita</td>
<td>kg of oil equiv.</td>
<td>102</td>
<td>191</td>
<td>393</td>
<td>659</td>
<td>1,602</td>
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<td>Households with electricity</td>
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<tr>
<td>Urban</td>
<td>% of households</td>
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<td>46.7</td>
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<td>Rural</td>
<td>% of households</td>
<td>10</td>
<td>10</td>
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<td>Transport and communication</td>
<td>% of GDP</td>
<td>2.6</td>
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<tr>
<td>Fixed investment: transport equipment</td>
<td>% of GDP</td>
<td>1.9</td>
<td>1.9</td>
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<tr>
<td>Total road length</td>
<td>thou. km</td>
<td>105</td>
<td>207</td>
<td>244</td>
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<tr>
<td><strong>INVESTMENT IN HUMAN CAPITAL</strong></td>
<td></td>
<td></td>
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<tr>
<td>Health</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population per physician</td>
<td>persons</td>
<td>26,888</td>
<td>9,412</td>
<td>7,028</td>
<td>1,063</td>
<td>3,064</td>
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<tr>
<td>Population per nurse</td>
<td></td>
<td>4,805</td>
<td>1,255</td>
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<tr>
<td>Population per hospital bed</td>
<td></td>
<td>1,222</td>
<td>1,796</td>
<td>1,503</td>
<td>612</td>
<td>592</td>
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<tr>
<td>Oral rehydration therapy (under-5)</td>
<td>% of cases</td>
<td>-</td>
<td>78</td>
<td>32</td>
<td></td>
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</tr>
<tr>
<td>Education</td>
<td></td>
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<tr>
<td>Gross enrollment ratios</td>
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<td></td>
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<tr>
<td>Secondary</td>
<td>% of school age pop.</td>
<td>20</td>
<td>41</td>
<td>43</td>
<td>56</td>
<td>63</td>
</tr>
<tr>
<td>Female</td>
<td>% of school age pop.</td>
<td>15</td>
<td>23</td>
<td>23</td>
<td>39</td>
<td>52</td>
</tr>
<tr>
<td>Pupil-teacher ratio: primary</td>
<td>pupils per teacher</td>
<td>29</td>
<td>23</td>
<td>23</td>
<td></td>
<td></td>
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<tr>
<td>Pupil-teacher ratio: secondary</td>
<td>pupils per teacher</td>
<td>16</td>
<td>17</td>
<td>16</td>
<td></td>
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<tr>
<td>Pupils reaching grade 4</td>
<td>% of cohort</td>
<td>18</td>
<td>19</td>
<td>19</td>
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<tr>
<td>Repeater rate: primary</td>
<td>% of total enroll</td>
<td>11</td>
<td>11</td>
<td>10</td>
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</tr>
<tr>
<td>Literacy</td>
<td>% of pop. (age 15+)</td>
<td>43</td>
<td>28</td>
<td>16</td>
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</tr>
<tr>
<td>Female</td>
<td>% of fem. (age 15+)</td>
<td>37</td>
<td>22</td>
<td>24</td>
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</tr>
<tr>
<td>Newspaper circulation</td>
<td>per thou. pop.</td>
<td>17</td>
<td>18</td>
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### Indonesia

#### Priority Poverty Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Unit of measure</th>
<th>Latest single year</th>
<th>Most recent estimate</th>
<th>Same region/income group</th>
<th>Next higher income group</th>
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<tbody>
<tr>
<td></td>
<td>1970-75</td>
<td>1980-85</td>
<td>East Asia</td>
<td>Lower-middle-income</td>
<td></td>
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<tr>
<td><strong>POVERTY</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Upper poverty line</td>
<td>local curr.</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Headcount index</td>
<td>% of pop.</td>
<td>45</td>
<td>17</td>
<td></td>
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</tr>
<tr>
<td>Lower poverty line</td>
<td>local curr.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Headcount index</td>
<td>% of pop.</td>
<td>29</td>
<td>15</td>
<td></td>
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</tr>
<tr>
<td>GNP per capita</td>
<td>USS</td>
<td>230</td>
<td>520</td>
<td>880</td>
<td>890</td>
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<tr>
<td><strong>SHORT TERM INCOME INDICATORS</strong></td>
<td></td>
<td></td>
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<tr>
<td>Unskilled urban wages</td>
<td>local curr.</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Unskilled rural wages</td>
<td></td>
<td></td>
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<tr>
<td>Rural terms of trade</td>
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<td>Consumer price index</td>
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<tr>
<td>Lower income</td>
<td></td>
<td></td>
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<tr>
<td>Food</td>
<td></td>
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</tr>
<tr>
<td>Urban</td>
<td></td>
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<tr>
<td>Rural</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>SOCIAL INDICATORS</strong></td>
<td>% of GDP</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public expenditure on basic social services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary</td>
<td>% of pop.</td>
<td>117</td>
<td>14</td>
<td>116</td>
<td>104</td>
</tr>
<tr>
<td>Male</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Female</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortality</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infant mortality</td>
<td>per thou. live births</td>
<td>80</td>
<td>53</td>
<td>35</td>
<td>36</td>
</tr>
<tr>
<td>Under 5 mortality</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Immunization</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Measles</td>
<td>% of pop.</td>
<td>15.0</td>
<td>80.0</td>
<td>93.0</td>
<td>77.4</td>
</tr>
<tr>
<td>DPT</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Child malnutrition (under-5)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Life expectancy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>%</td>
<td>49</td>
<td>63</td>
<td>68</td>
<td>67</td>
</tr>
<tr>
<td>Female advantage</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total fertility rate</td>
<td>births per woman</td>
<td>4.1</td>
<td>2.7</td>
<td>2.2</td>
<td>2.7</td>
</tr>
<tr>
<td>Material mortality rate</td>
<td>per 100,000 live births</td>
<td>450</td>
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#### Supplementary Poverty Indicators

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<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Social security coverage</td>
<td>% econ. active pop.</td>
<td>11.0</td>
<td>37.8</td>
<td>41.6</td>
<td>67.2</td>
<td>86.2</td>
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<td></td>
<td></td>
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<tr>
<td>Access to safe water: total</td>
<td>% of pop.</td>
<td>41.0</td>
<td>43.0</td>
<td>65.0</td>
<td>83.5</td>
<td>94.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Urban</td>
<td></td>
<td>41.0</td>
<td>43.0</td>
<td>65.0</td>
<td>83.5</td>
<td>94.0</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rural</td>
<td></td>
<td>4.0</td>
<td>36.0</td>
<td>31.7</td>
<td>61.4</td>
<td>64.8</td>
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<td></td>
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<td></td>
<td></td>
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<tr>
<td>Access to health care</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
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</tbody>
</table>

### Development Diamond

- **Indonesia**
- **Lower-middle-income**

**a.** See the technical notes, p.387.  
**b.** The development diamond, based on four key indicators, shows the average level of development in the country compared with its income group. See the introduction.
## Bank Group Activities in Indonesia

<table>
<thead>
<tr>
<th></th>
<th>FY94-95 (Average)</th>
<th>FY96</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Proj.</td>
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<tr>
<td><strong>IBRD Administrative Budget</strong></td>
<td></td>
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<tr>
<td>Lending</td>
<td>7.7</td>
<td>9.4</td>
</tr>
<tr>
<td>Portfolio Management</td>
<td>5.2</td>
<td>5.7</td>
</tr>
<tr>
<td>ESW</td>
<td>3.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Other</td>
<td>5.2</td>
<td>5.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>21.8</td>
<td>23.7</td>
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<tr>
<td>HQ Budget</td>
<td>15.0</td>
<td>17.6</td>
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<tr>
<td>Field Budget</td>
<td>6.1</td>
<td>6.1</td>
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<tr>
<td><strong>IFC Administrative Budget</strong></td>
<td>4.3</td>
<td>4.5</td>
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<table>
<thead>
<tr>
<th></th>
<th>FY93-95</th>
<th>FY96-98</th>
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<tbody>
<tr>
<td></td>
<td># projects</td>
<td>$US million</td>
</tr>
<tr>
<td><strong>IBRD Lending</strong></td>
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<td></td>
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<tr>
<td>Agr., Nat. Resources</td>
<td>8</td>
<td>571</td>
</tr>
<tr>
<td>Human Resources</td>
<td>8</td>
<td>575</td>
</tr>
<tr>
<td>Industry, Finance, Telecom</td>
<td>5</td>
<td>1,395</td>
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<tr>
<td>Power, Energy, Prvt Sect Dev</td>
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<td></td>
</tr>
<tr>
<td>Infrastructure</td>
<td>9</td>
<td>1,235</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>30</td>
<td>3,775</td>
</tr>
<tr>
<td><strong>IBRD Portfolio under Implementation</strong></td>
<td>74</td>
<td></td>
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<tr>
<td><strong>GEF/MP Approvals</strong></td>
<td>2</td>
<td>$24</td>
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<tr>
<td><strong>IFC Investments</strong></td>
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<td>Agribusiness</td>
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<td>9</td>
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<td>Capital Markets</td>
<td>9</td>
<td>43</td>
</tr>
<tr>
<td>Chemicals, Fertilizers</td>
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<td>47</td>
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<tr>
<td>Manufacturing</td>
<td>12</td>
<td>234</td>
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<tr>
<td>Infrastructure</td>
<td>1</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>25</td>
<td>342</td>
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<tr>
<td><strong>IFC Portfolio</strong></td>
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<tr>
<td>Loans</td>
<td>232</td>
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<tr>
<td>Equity</td>
<td>109</td>
<td></td>
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<tr>
<td><strong>MIGA</strong></td>
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<tr>
<td>Guarantees</td>
<td>2</td>
<td>65 (est.)</td>
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</table>
## INDONESIA: SELECTED INDICATORS OF PORTFOLIO PERFORMANCE AND MANAGEMENT

<table>
<thead>
<tr>
<th>Indicator</th>
<th>FY93 1/</th>
<th>FY94 1/</th>
<th>FY95</th>
<th>FY96 (Proj.)</th>
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</thead>
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<tr>
<td><strong>Portfolio Performance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Number of projects under implementation</td>
<td>75</td>
<td>72</td>
<td>75</td>
<td>76</td>
</tr>
<tr>
<td>Average Age of Projects in Portfolio (years)</td>
<td>4.2</td>
<td>3.8</td>
<td>3.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Percent of problem projects</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Development objectives</td>
<td>1.3</td>
<td>4.2</td>
<td>2/</td>
<td>4.0</td>
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<tr>
<td>Implementation progress</td>
<td>2.7</td>
<td>5.6</td>
<td>12.0</td>
<td>11.8</td>
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<tr>
<td>Canceled during FY in US$mn</td>
<td>65.2</td>
<td>57.6</td>
<td>336.1</td>
<td>73.1</td>
</tr>
<tr>
<td>Disbursement ratio (%)</td>
<td>22.7</td>
<td>24.4</td>
<td>22.7</td>
<td>20.0</td>
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<tr>
<td>Disbursement lag (%)</td>
<td>14.7</td>
<td>19.5</td>
<td>18.6</td>
<td>19.0</td>
</tr>
<tr>
<td>Memorandum item: % completed projects</td>
<td>27.0</td>
<td>8.0</td>
<td>29.0</td>
<td>25.0</td>
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<tr>
<td>rated unsatisfactory by OED</td>
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<td></td>
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<tr>
<td><strong>Portfolio Management</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total supervision resources (US$'000)</td>
<td>3329.1</td>
<td>3569.3</td>
<td>3421.0</td>
<td>3648.0</td>
</tr>
<tr>
<td>Average supervision (US$'000/project)</td>
<td>44.4</td>
<td>49.6</td>
<td>45.6</td>
<td>48.0</td>
</tr>
<tr>
<td>Supervision resources (US$'000) for:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Projects rated HS or S</td>
<td>44.7</td>
<td>47.8</td>
<td>44.5</td>
<td>43.2</td>
</tr>
<tr>
<td>Projects rated U or HU</td>
<td>51.5</td>
<td>80.2</td>
<td>53.8</td>
<td>79.6</td>
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<tr>
<td>Supervision resources by location (in %)</td>
<td></td>
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<tr>
<td>Percent headquarters</td>
<td>65.4</td>
<td>66.2</td>
<td>73.7</td>
<td>60.0</td>
</tr>
<tr>
<td>Percent resident mission</td>
<td>34.6</td>
<td>33.8</td>
<td>26.3</td>
<td>40.0</td>
</tr>
<tr>
<td>Memorandum item: date of last/next CPPR</td>
<td>Last: Feb/Mar 1994</td>
<td></td>
<td></td>
<td>Next: May 1996</td>
</tr>
</tbody>
</table>

1/ Comparisons across years not possible because earlier data (FY93/FY94) based on staff-weeks not on $-budget.
2/ In FY94, EA3 adopted more stringent criteria for ratings which resulted in downgrading several projects.
3/ In FY95, several projects experienced considerable savings due to lower than expected prices in procurement of project input. Among these were Power Transmission Project ($104 mil), Rural Electrification ($55.5 mil), Industrial Restructuring ($45 mil).
4/ Direct costs only.

- Since the 1994 CPPR, Government and Bank have focused on improving implementation and results on the ground.
- Financial audits are being supplemented with technical audits for all projects to better measure development outcome.
- RSI procurement/supervision team has been strengthened with locally hired Bahasa Indonesian speaking personnel.
- Projects are being restructured and unsuccessful components dropped during implementation in a timely manner.
COUNTRY PERSPECTIVE
Republic of Indonesia

Geography
Indonesia is the largest archipelago in the world, consisting of more than 13,600 islands stretching across 3,200 miles of sea and comprising an area of 1,919,443 sq km. Its largest city is Jakarta, the capital. The country is divided into 27 provinces and two major regions: Western Indonesia, comprising the islands of Sumatra and Java; and Eastern Indonesia, including Kalimantan (Borneo), Maluku, Nusa Tenggara, Timor, and Irian Jaya (New Guinea).

Climate
The climate of Indonesia is tropical, with two monsoon seasons — a wet season from November to March and a dry season from June to October. Humidity averages about 80 percent; the daily temperatures range from 20°C to 32°C (70°F to 90°F) in Jakarta.

Resources
The rich volcanic soil, tropical temperatures, and monsoonal rains prevalent in Java and Bali are ideal for growing crops. These areas together support 65 percent of Indonesia's people on only 7 percent of the land. By contrast, the sparsely populated eastern islands are characterized by a drier climate and poorer soils. Indonesia has over one tenth of the tropical rainforest area in the world, located primarily on the islands of Sumatra, Kalimantan, Sulawesi, and Irian Jaya (New Guinea). These areas contain some of the richest biodiversity on earth. Indonesia also has between 10 and 20 percent of the world's coral reefs. In an effort to halt the degradation of these resources, Indonesia plans to set aside 10 percent of its land and marine areas as protected sites. Major mineral resources include tin, bauxite, petroleum, natural gas, copper, nickel, and coal.

Population
Indonesia is the fourth most populous country in the world, with an estimated 190.4 million people in 1994.

Ethnic Groups
The most distinct ethnic groups are the Javanese (40 percent of the population) and the Sundanese (15 percent) on Java; the Balinese on Bali; and the Bataks and Acehnese on Sumatra. Other minority groups include the Madurese, the Dayaks (on Kalimantan), the Ambonese (on Maluku), the Timorese, and numerous indigenous groups in Irian Jaya. The country also includes a sizable Chinese population.

Language
More than 100 languages are spoken in Indonesia, but Bahasa Indonesia is the official and most widely spoken tongue, containing elements of Chinese, Indian, Dutch, and English.

Religion
Freedom of religion is guaranteed by the constitution. Islam is practiced by 87 percent of the population. Other religions include Christianity and Buddhism. Hinduism, once a major influence, is confined primarily to Bali.

Bahasa Indonesia is based on Malay, the market language of coastal towns.
Government
Indonesia is a constitutional republic headed by President Soeharto. The president, elected for a 5-year term by the 1,000 member People's Consultative Assembly (MPR), is both head of state and head of government. Half of the members of the MPR are elected through general parliamentary elections, while the other half are appointed directly by the president. The MPR meets once every five years to approve the State Policy Guidelines.

Cabinet ministers are appointed directly by the president. Legislative power in Indonesia is vested in the parliament (the MPR), which also approves the annual budget. The president is not directly responsible to the parliament. GOLKAR, the ruling political party, which has close ties to the Army, has dominated elections since 1971. The other two political parties are the United Development Party (PPP), an Islamic group, and the Indonesian Democratic Party (PDI), a nationalist and socialist group.

Indonesia's 27 provinces are subdivided into 243 rural districts (kabupaten) and 51 urban districts (kotamadya), subdistricts (kecamatan), and villages (desa). Both provincial and district governments have their own legislatures. The heads of the provinces (gubernors), rural districts (bupati), and urban districts (walikota) are elected by local parliaments for a period of five years.

Pancasila, the Indonesian state philosophy is embodied in five principles: Belief in one God; belief in a just and civilized humanity; unity of Indonesia; democracy and commitment to the process of consensus and government by wise policies; and social justice for all people. Every decision, law, or policy is evaluated in terms of how well it reflects, or how it will affect, these five principles.

History
Southeast Asia's long history of extensive migrations has created the present mixture of more than one hundred ethnic and linguistic divisions in the archipelago. In the early centuries of the Christian era — before the penetration of Indian influences — many people on these islands lived in political groups rarely larger than family-based tribal units. Irrigated wet rice (sawah) cultivation is believed to have originated two thousand years ago amongst coastal people, and such cultural expressions as the wayang (shadow puppet) theater, the gamelan orchestra, and batik techniques may also predate Indian influences.

Indian culture, however, later exerted a powerful influence on the states that developed in the archipelago. By the 7th century, two principal types of political units had emerged: the maritime trading states along the coasts of Sumatra, North Java, Borneo (Kalimantan), Sulawesi, and some of the other eastern islands; and the rice-based inland kingdoms, particularly of East and Central Java.

Sri Vijaya, a Mahayana Buddhist kingdom on Sumatra's southeast coast, was the center of trade with India and China, and for approximately 500 years monopolized much of China's trade with the western archipelago.

Indian culture had a profound influence on the religious and political organizations of the Hindu-Buddhist kingdoms of Central and East Java, as evidenced by the temples, buildings, and inscriptions that still exist, including the Borobodur temple in Central Java, built in the mid-9th century. In 1293, King Vijaya repelled a Mongol invasion of Java and founded the greatest Javanese empire, Majapahit, which claimed sover-
eignty over much of what is now Indonesia and parts of Malaya.

Islam arrived in northern Sumatra in the late 13th century and was propagated by coastal merchants. The first major Islamic center was the sultanate of Malacca (Melaka) on Malaya’s west coast, which became a major diffusion center for spices to the West and for Islam through contacts with coastal Javanese merchants. Following the fall of Malacca to the Portuguese in 1511, several competing Muslim states arose to capture the trading routes: Aceh in northern Sumatra, Makassar in southwest Sulawesi, Bantam in South Sumatra, and the new Muslim kingdom of Mataram in Central Java.

The Dutch East India Trading Company expanded into the Spice Islands in the early part of the 17th century. The company established its headquarters in Batavia (now Jakarta), creating a monopoly of the spice trade by limiting clove cultivation to Ambon and nutmeg and mace to the Banda Islands in Maluku. Dutch trading rights were easily converted into effective political control when the company was dissolved in 1799 and the Dutch government assumed control of its East Indian possessions. The Dutch annexed large areas of Central Java in the early 1800s and by 1858 had taken a large part of Sumatra as well.

As oil, tin, and rubber replaced coffee, sugar, and tobacco as the main exports to Europe, the Dutch took over areas outside Java — including Sulawesi, the Moluccas, the Lesser Sundas, and most of Borneo.

At the beginning of the 20th century, the Dutch introduced their Ethical Policy, which led to the development of limited health and educational services and the expansion of railways, roads, and inter-island shipping. With the new class of entrepreneurs and Western-educated Indonesians that this policy helped to create came increased resentment of colonial rule, contributing to the rise of anti-Dutch nationalist movements from 1912 to the 1940s.

Sukarno, who founded the Indonesian Nationalist Party in 1927, was among the major leaders of this movement. He and Muhammad Hatta, another nationalist leader, proclaimed the Republic of Indonesia’s independence on August 17, 1945 at the end of World War II — the Japanese, who had occupied the country since 1943, had surrendered to the Allies just two days earlier. Sukarno and Hatta were chosen the country’s first president and vice president. In 1949, the Netherlands agreed to transfer sovereignty to the new republic.

Under Sukarno’s Guided Democracy (1959-1965), which extended broad authority to the president, the country pursued an active foreign policy, including the annexation of West Irian from the Dutch in 1962. However, the domestic economy declined, resulting in growing tensions between the army and the Indonesian Communist Party (PKI). On September 30, 1965, General Soeharto, head of the army’s strategic command, suppressed a coup attempt and then himself ousted Sukarno and took over as head of state. In the aftermath, army units and some Muslim groups killed an estimated 300,000 to 1 million supporters of PKI and arrested hundreds of thousands more accused of involvement in the coup attempt.

Assuming a basically pro-Western stance, Soeharto’s New Order ended confrontation with Malaysia and has since been a major promoter of and participant in the regional Association of Southeast Asian Nations (ASEAN). Advised by Western-trained economists, the army-led government has encouraged direct foreign investment and procured Western loans.
In 1975 the state-owned oil enterprise, Pertamina, was unable to meet repayments of $10.5 billion in debts, and the crisis threatened Indonesia's financial structure. Only through project cancellations, renegotiations of loans, and help from the United States and other Western governments was Jakarta able to salvage the situation by late 1977. Subsequently, world oil prices and increased oil production and exports aided Indonesia's economic recovery. Another crisis that arose in 1975 was Indonesia's invasion and annexation of the former Portuguese colony of East Timor, where, human rights organizations claim, the army may have killed more than 100,000 people.

Most opposition to the Soeharto regime has come from Muslim groups who have never accepted the government's authority and from university students alienated by the regime's corruption and human rights violations. The greatest long-term danger to the Soeharto regime, however, has been the growing social and economic inequality, particularly increasing landlessness among the Javanese peasantry. This has been exacerbated by population growth, despite a relatively successful family-planning program in Java. In response, the government has launched extensive transmigration programs, and more recently, has begun to focus on regional development in the eastern part of Indonesia. A recent poverty program (Inpres IDT) has culminated nearly two decades of steady progress in alleviating poverty in rural areas. Running unopposed, Soeharto won reelection in March 1988 and again in March 1993.

Culture
Indonesian performing arts are rich in tradition. The wayang kulit, or shadow puppet shows, include different puppets for each character in the play. The dalang (puppet master) brings these puppets to life by adjusting his voice to the character's mood, while weaving an atmosphere of passion, anger, friendship, or forgiveness.

Of all the drum-and-song ensembles of Indonesia, the gamelan is the best known. In Java and Bali, Hindu-Buddhist influence resulted in the development of unusually large musical cycles, sometimes comprising more than 500 beats. The largest and best-quality gamelans require about 30 musicians; such ensembles were once owned by regional kings. The multiplicity of tunings in the gamelan ensembles is designed to reflect happiness, bravery, or melancholy, depending on the ensemble.

Indonesian dance has three main traditions: the Javanese in eastern Java; the Sundanese in western Java; and the Balinese. Javanese and Sundanese dances include both folk and courtly styles, but Balinese dances are shared by all social classes. In general, Indonesian dances are slow in tempo, with controlled, reserved motions. The dance dramas often portray episodes from Hindu epics such as Ramayana. In Bali, ritual often consists of dance, and spirit possession is believed to occur in ceremonies such as the barong dance drama. Other important forms of Indonesian dance include the wayang orang (the large-scale staged dance adaptation of the puppet theatre), and the wayang topeng, or masked dance, a solo interpretation drawn from Hindu legends.

Indonesia handicraft tradition includes woodcarving in Bali, the Sumatran region of Lake Toba, and Irian Jaya; silver artifacts in Bali and in Kota Gede, Yogyakarta; and batik fabrics produced throughout the archipelago.

Sources:
Microsoft Encarta, Embassy of Indonesia.
The Economic and Political Situation

I. The Economic Situation

After a quarter century of steadily rising incomes (the economy grew at an average rate of 6.7 percent a year during 1965-1995), Indonesia has become:

- **more diversified**: nonoil and gas exports now account for almost 80 percent of total exports, up from only 25 percent a decade ago;

- **more industrialized**: manufacturing now accounts for around 21 percent of GDP, up from 12 percent in the early 1980s; the share of manufactures in total exports rose from only 8 percent in 1983 to 48 percent in 1993;

- **more urbanized**: the urban share of Indonesia's population increased from 22 percent in 1980 to 31 percent in 1990;

- increasingly driven by private initiative: the share of private investment in total fixed investment increased from 57 percent in 1985 to 67 percent in 1995; and

- **more integrated into the global economy** and prominent in the international arena: Its chairmanship of the Non-Aligned Movement ended in October 1995. It chaired APEC in 1994, is a critical member of ASEAN, and occupies a revolving seat on the UN Security Council.

Indonesia's poor have benefitted from a growing economy. By any international measure, Indonesia's record on poverty reduction is impressive:

- **The incidence of poverty** has declined from around 60 percent (70 million persons) at the beginning of the 1970s to around 14 percent (26 million persons) today; and

- Universal primary education has been achieved, secondary and tertiary enrollment has risen sharply, and the adult illiteracy rate has fallen by almost two thirds to 23 percent.

Most regions have shared in the benefits of growth. In 1983-93, per capita GDP, per capita consumption, and social indicators improved in all provinces. Sources of growth, however, have differed across the regions. In Java/Bali, first rice-based agriculture and subsequently manufacturing and tourism have been the engine of growth, compared to resource-rich Kalimantan and Sumatra, where natural resources (forestry, oil, gas, mining) have been critical to growth. Some resource-poor outer islands have depended heavily on fiscal transfers, and may suffer in the future if budgetary constraints limit such transfers.

Short-Term Challenges

While the economy continued to grow rapidly in 1995, with real GDP growth of 8.2 percent and nonoil GDP growth of 8.6 percent, short-term economic stability is threatened by several factors:

First, there are signs of overheating in the economy. This was reflected in:

- **inflation** of 9 percent in 1995, and

- a widening **current account deficit**, estimated at $8 billion (4 percent of GDP) in fiscal year 1995/96. Rapid private consumption growth spilled over into sharp increases in nonoil imports, shifting the trade balance into deficit for the first time in many years. Nonoil imports grew at 25.5 percent, while the estimated nonoil export growth was only 15 percent.
While Government has tightened monetary policy in response to these indicators, its fiscal policy, as reflected in the next fiscal year’s budget, is not considered contractionary enough to cool the economy.

Second, the picture for financial flows is mixed. Investment increased by 15 percent in 1995. Direct foreign investment inflows amounted to about $5.7 billion, up from $2.5 billion in 1994, and approvals in 1995 surged to $40 billion. Foreign direct investment and other capital inflows easily financed the current account deficit and increased international reserves by $2.1 billion. However, there are three areas of concern:

- Indonesia’s relatively high debt stock (the Bank estimates US$96.5 billion at end 1994) the servicing of which takes up 30 percent of export earnings.
- An open capital account with a sizable amount of short-term debt. The last few years have seen a greater volume of short-term, relatively volatile funds going in and out of the Indonesian stock market and banking system. As the recent experience of Mexico shows, such flows can move with great rapidity and generate severe macroeconomic problems.
- Despite the central bank’s gradually tightening control and prudential legislation, Indonesia’s banking system is weak, with over 10 percent nonperforming assets at end-1995, due in large part to crony-related lending and other unsound practices in state commercial banks.

Long-Term Challenges

With rising incomes have come new challenges that require greater attention to human resource development, environmental concerns, regional issues and institutional performance. The longer-run development challenges facing Indonesia are being shaped by fundamental structural transformations underway in the country and the coexistence of very different development dynamics in various regions. At a broad level, three transitions are underway:

- The shift from a primarily natural resource-based economy (oil/gas, minerals, forestry, agriculture) to a more human capital/productivity-based economy;
- The transition from a largely rural economy to a more urban society, primarily in Java, and the consequent environmental management, social, and infrastructure challenges; and
- A political transition featuring more open debate of public policy issues and a rethinking of the role of government, private sector, and community organizations.

The pace of the transition differs from region to region, reflecting differences in endowments and comparative advantage. In the more industrialized, urbanized, densely populated Java/Bali regions, issues of industrial/urban pollution, quality of health and education, private provision of infrastructure and services, and access to urban land dominate the agenda. In resource-rich Kalimantan, Sumatra, and Irian Jaya, the major development issues are sustainable exploitation of natural resources and greater participation by indigenous groups in the management of these resources. The resource-poor eastern islands pose yet a different type of challenge: these remain heavily dependent on agriculture but cannot benefit from agricultural technology improvements that have been successful in Java/Bali; at the same time, they lag behind the rest of the country in basic education,
health, and infrastructure.

The major long-term challenges emerging from these transitions in a country of rising income levels are:

(i) **Maintaining growth with macrostability through appropriate fiscal and monetary policy, careful debt management, and a stronger domestic savings effort.** During 1996-99, real GDP is expected to grow at around 8 percent. This is predicated upon continued strong growth of the nonoil, nonagricultural sector, led by rising domestic and foreign private investment. Optimism with regard to rising private investment is justified by several indicators, including: (a) a continuing emphasis by Government on trade and investment deregulation; (b) a receptive official attitude toward private investment in infrastructure, especially in telecommunications and power; and (c) a tremendous increase in foreign investor interest (as shown by rising investment applications).

(ii) **Enhancing competitiveness through increased deregulation, reduced cost of finance, and provision of better infrastructure services.** Indonesia remains committed to further deregulation: it undertook a major liberalization of its foreign investment regime in June 1994 and announced a rules-based, pre-programmed trade liberalization schedule in May 1995 which, if implemented as planned, will cut average tariffs to 7 percent by 2003. Further financial reforms and prudential regulation aimed at reducing banking system risk should help cut the relatively high cost of capital in Indonesia. The Government is also committed to reducing infrastructure bottlenecks through both private and public investment.

(iii) **Making public institutions more effective to deal with the major structural changes underway in the economy.** Improving public sector management involves adapting to changes in the functions of government by re-assessing the size, skill mix, and incentives of the civil service, and by decentralizing or privatizing functions when this will enhance efficiency and effectiveness. Special attention needs to be given to ministries whose functions have changed or are expected to change significantly (e.g., Industry and Trade as a result of deregulation, Public Works as a result of decentralization), and to interagency coordination as a result of environmental and other issues (e.g., water resource management and land markets).

(iv) **Reducing poverty through increased access of the poor to basic urban, education, and health services; targeted programs for the hard-core poor; raising agricultural productivity in the eastern islands; and greater involvement of the poor in program design and implementation.** Indonesia’s impressive record on poverty reduction is attributable to sustained employment-intensive growth in agriculture and industry as well as expansion of basic infrastructure and health and education services. But a large fraction of the population still lives just barely above the poverty level and remains vulnerable to shifts in overall economic performance. Some social indicators, such as infant and maternal mortality, have not improved proportionately to real income gains. Further reduction of poverty will require: (a) targeting programs to reach the hard-core poor; (b) allowing poor communities, households, and especially women to have a greater role in specifying the services they need; and (c) developing a productivity-enhancing agricultural growth strategy for the resource-poor outer is-
lands.

(v) Enhancing human resource development through improvements in the delivery, efficiency, and quality of health and education services. First, meeting the targets of increasing compulsory education from six to nine years over the next 15 years, enhancing quality at all levels, and expanding education to poorer groups and remote regions will require cost-effective policy interventions to ensure maximum enrollment and adequate quality. Second, to upgrade labor quality and provide sufficient skilled labor to meet the needs of a more complex economy requires greater attention to improving the quality of primary and secondary education, in order to provide a foundation for subsequent training. The emphasis is now on improving the efficiency of public institutions through increased autonomy, upgrading the quality and relevance of education and training institutions through accreditation and performance-based funding, and increasing access to higher education.

(vi) Managing resources sustainably through more effective policies for land, water, and forest resources; strengthening of institutional capacities in environment conservation activities; and reducing urban and industrial pollution. The growing attention to environmental quality and sustainability in the Government’s development strategy reflects an increased awareness of the costs and risks of the worsening environmental conditions due to past growth, and the potential for continued environmental degradation in the future. Three areas of concern have been identified for urgent attention: (a) water supply, environmental sanitation, and solid waste management; (b) vehicle emission and industrial pollution control (mainly on Java); and (c) the sustainable management of forests, fisheries, and coastal zones.

II. The Political Situation

The next parliamentary elections are scheduled for April 1997; the president will be selected soon thereafter and the inauguration will take place in March 1998. It is widely expected that President Suharto will be a candidate once again and that he will win; the opposition to him, while growing, is still weak and subject to serious electoral disadvantages.

Four main interest groups influence political developments in Indonesia:

- the Armed forces, which have traditionally supported Suharto but may be concerned about his efforts in recent years to undercut their power and privileges; in December 1995, Suharto put his son-in-law in charge of the elite Special Forces Command (Kopassus);

- Golkar, the ruling political party, which represents primarily bureaucrats (both central and local level), retired army officers, and a broad mass of farmer, business, intellectual and political groups that have benefitted from Suharto’s policies and patronage;

- Religious parties, including the well-established Nahdlatul Ulema, which have a social/religious development agenda on the surface but a political anti-Suharto agenda below the surface. It is widely thought that its official sponsorship of an organization of Muslim intellectuals (ICMI) is a way of curbing the influence of other religion-based parties; and

- Opposition political parties (three are legal), such as the one led by the daughter of former President Sukarno; these parties are weak but have attracted increasing support in the last decade or so, especially from intellectuals, students, and urban labor.
Recent years have seen a rising level of unrest among workers, students, journalists, and non-mainstream groups. Serious riots took place in Medan in 1994 in which Chinese-owned businesses were attacked by workers and others. The frequency of strikes and other forms of industrial unrest has been rising; students and journalists have been increasingly supporting more openness with respect to the right of expression (e.g., in the print media), the functioning of courts and the judiciary, and the quality of governance. Nonmainstream groups (e.g., tribes, forest dwellers, environmentalists) have mounted several protest actions, including serious disturbances at the site of the Freeport mines in Irian Jaya. The situation in East Timor also continues to be marked by unrest.

There is a perception that nepotism and cronyism are becoming more entrenched in Indonesia; the President’s family or cronies, in particular, have been involved in almost every major business transaction in recent years. The most recent example involves the award of significant tax exemptions to a car manufacturing joint venture controlled by one of the President’s sons.

In many respects Indonesia today is like Korea in the mid 1980s; despite substantial economic progress and sharing of gains, the lack of democracy and transparency and the perception of rising inequality are fostering both an increasing sense of resentment and expressions of unrest; Indonesia has been likened to a “smoldering volcano” (Far Eastern Economic Review).
Republic of Indonesia

Civil Society

Background

- Indonesia is (still) a society dominated by traditional polarized relations between a dominant state and a passive society.
- GOI is not accountable to the legislature (DPR), only to the People's Congress (MPR), which convenes only when a new government is elected.
- Private sector influence on governance and accountability is limited.
- Up to the late 1980s, the "security approach" aimed at stability to allow economic growth. In the 1990s, officially sanctioned "openness" emerged but has been inconsistently applied.
- Approximately 11,000 NGOs (some 3,600 registered) are becoming more outspoken, but remain weak and fragmented as a force (passive society).
- In November 1994, GOI established the independent National Human Rights Commission which has won careful praise both locally and abroad.

Key Issues

- Elections (mid 1997): more open opposition to GOI's dominance of procedures; an independent nongovernmental "watchdog committee" was established in March 1996 consisting mainly of NGO activists.
- Freedom of expression. Printed media are very much under GOI scrutiny; periodicals without GOI license are considered illegal.
- GOI accountability. NGOs have been pushing for this and have taken GOI (incl. the President) to court; most efforts are unsuccessful, but appeal by the banned TEMPO magazine has been upheld twice and now awaits Supreme Court ruling.
- Restrictive environment for NGOs. Nonprofit sector is hampered by unclear legal status of organizations and bureaucratic controls. Arbitrariness further aggravates confusing environment for NGOs. Access to funding is subject to GOI approval and procurement of GOI contracts by NGOs is problematic. Income tax exemptions for private foundations were abolished in the latest tax law.

Government Position

- Stability is still paramount requirement for development.
- Development still focused on economy, but more participatory government is urged ("society is the main player").
- NGOs (and by implication "civil society") must all adhere to the government's policy of collective good, Pancasila, and profess "nationalism"; criticism is seen as going against these, in particular if vented in international fora.

World Bank Position

- GOI should establish better working relations with NGOs and involve them more in development activities.
- GOI should make legal framework more conducive to development of nonprofit sector and abolish distorting bureaucratic restrictions (deregulation of nonprofit sector).
- NGOs should be more professional.
- GOI should improve accountability as a way to enhance the scope and quality of service delivery.
World Bank Group Country Perspective

Background

- Indonesia is the world's fourth most populated country, spreading over more than 13,000 islands and 3,200 miles. Java and Bali account for 60 percent of the population. The urban population has grown rapidly from 22 percent in 1980 to 34 percent today.
- Indonesia's GNP per capita was US$980 in 1995; it was classified by the Bank as a middle-income country in 1993. In the last 10 years, per capita income growth (6 percent) ranked among the top 10 percent of all developing countries.
- Dependence on oil and gas has fallen to just over 20 percent of exports and government revenues (compared to around 80 percent in the mid 1980s). Manufacturing accounts for 21 percent of GDP, up from 12 percent in the early 1980s.
- Labor-based growth has reduced absolute poverty to 14 percent, but economic growth has lagged in some regions of Indonesia, particularly in East Timor, Irian Jaya, and Nusa Tenggara.
- Universal primary education has been achieved, secondary and tertiary enrollment have risen sharply, and the adult illiteracy rate has fallen to 23 percent. Health indicators, however, are low for Indonesia's income group.
- Indonesia's business environment continues to develop strongly, with inflows of foreign direct investment (FDI) of $5.7 billion in 1995, up from $2.5 billion in 1994, and 1995 approvals totaling $40 billion. The FDI framework is one of the most attractive in the region.
- As of January 1996, Indonesia had investment grade ratings of Baa3 from Moody and BBB from S&P. As of December 1995, the Jakarta Stock Exchange (JSE) had more than 230 listed companies, capitalized at $66.6 billion.
- Financial access. Tight monetary policy and high costs of financial intermediation have pushed local interest rates to about 20 to 22 percent. Major business groups borrow at lower rates offshore, but middle- and smaller-tier companies still have difficulty accessing offshore credit.
- Indonesia has partially privatized its domestic and international telecommunications companies ($1.2 billion and $2.9 billion). It has also offered concessions in the power and transportation sectors. The concession process, however, has sometimes been uncompetitive.
- Corruption. Members of the President's family and associates are heavily involved in nontransparent deals involving concessions (forestry, telephones, infrastructure), and special protection (automobiles, petrochemicals, airplanes, shipbuilding). Corruption reaches to lower levels with the need to pay for petty licenses.
- Civil society. Freedom of expression is limited; government is not accountable to the legislature; the environment for NGOs is restrictive.

Current Challenges

- Overheating of the economy, reflected in a 9 percent inflation rate, and a widening current account deficit estimated at close to $7 billion (3.5 percent of GDP) in FY95/96, as rapid private consumption growth spilled over into sharp increases in nonoil imports.
- Need to improve the competitiveness of private Indonesian firms so they can prosper in a more open business environment.
- A relatively high debt stock (estimated at $96.5 billion in 1994) and sizable amount of short-term debt in the context of an open capital account; and a weak banking system with nonperforming assets amounting to over 10 percent in 1995, in large part due to crony-related lending and other unsound practices by commercial banks.
- Regional disparities and growing gap between parts of the country despite broad-based economic growth.
- Environmental degradation, especially in key urban areas, arising from unsafe disposal of human and solid waste, vehicle emissions and industrial pollution, particularly on Java, and the unsustainable management of natural resources and ecosystems (groundwater aquifers on Java and forests, fishery and other marine resources in the outer islands).
- Rising social tensions due to increasing competition for land and other scarce resources (especially when traditional community rights are not respected), as well as pollution from mining and industrial sources, often compounded by ethnic and religious differences and perception of special privileges for "outsiders" and well-connected businessmen over local/indigenous people.
Political Perspective

- Indonesia’s development record over the past 25 years has earned it a place among the elite “Asian Miracle” grouping of countries. As late as 1966, however, Indonesia was poor (per capita income less than $50), its government bankrupt, its economy spiraling out of control (inflation hit 635 percent that year), its over 100 million people hungry (average consumption 1,650 calories from mainly cassava and maize), its social fabric ripped apart by one of the great domestic bloodbaths of modern history (it is said that more than 400,000 people died in the aftermath of the aborted 1965 coup), and its government in disarray. Indonesia hardly qualified as a country: 13,000 islands (7,000 inhabited) stretching over 3000 miles, containing in excess of 300 diverse ethnic, linguistic and religious groups drawn together more by historical accident than by natural grouping. Few observers at that moment in history would have bet on Indonesia’s survival as a nation let alone on its ascension into the ranks of Asian success stories.

- Indonesia’s rise from among the world’s poorest countries to the ranks of the lower middle income countries came about by its government’s systematic application of conventional neoclassical economic policy: to grow well a country needs a stable macroeconomic environment, high saving rates, heavy investment in human capital, a desire to work with its comparative advantages and, above all, a reasonable level of stability.

- How was Indonesia able to apply this recipe when most others could not? Part of the answer lies in a unique relationship between its president for the past 30 years, Soeharto, and a small group of “technocrats” who shaped economic policy and sold it to the president. This group, led quietly and effectively by Prof. Widjojo Nitisastro, is largely responsible for Indonesia’s success. Widjojo and his team sought advice widely (from the World Bank, among others), while the policy advice they gave the president was uniquely Indonesian.

- Indonesia did more than just manage its macroeconomy well. It also did a good job of channeling its resources into two key investment areas: rural infrastructure and human resources. Unlike many developing countries, Indonesia promoted rather than taxed its agricultural sector. President Soeharto’s rural roots and near-obsession with rice self-sufficiency led to one of the world’s more successful agricultural investment programs. Since most Indonesians were — and still are — rural, this emphasis on food production had the added benefit of spreading Indonesia’s growth widely among its people, leading to one of the best poverty reduction records of the past 50 years (from 60+ percent poor in 1970 to around 14 percent today).

- Breaking with its successful past is, in many ways, Indonesia’s greatest challenge. From a natural-resource-based, centrally managed economy, the country now needs to continue its push to strengthen its private sector, and to streamline and decentralize its public administration. This challenge is perhaps best illustrated by Soeharto himself. One of the most underrated national leaders alive today (he made virtually all the final decisions that produced the Indonesian miracle), Soeharto must now undertake the most difficult task of his career: managing his own succession. Having controlled Indonesia for more than half of its independence his mark is everywhere, except where it may be most needed, on the succession issue. There is little doubt that he will run again. But how he will eventually disentangle himself from government while protecting his family’s huge financial interests remains unclear and the source of great speculation.

- Soeharto’s record of development management underscores his extraordinary decision making and judgmental capabilities. Soeharto does, however, have his weaknesses. Two of the most critical are his children and B.J. Habibie, Indonesia’s Minister of Technology.

- President Soeharto’s willingness to ensure his children’s business success has long been a source of irritation among Indonesians; more recently, the President torpedoed old business alliances to favor his family, in the process raising concern internationally. As to Mr. Habibie, the President seems willing to expend considerable public resources to underwrite the minister’s vision of a high-tech Indonesia. No one has been able to convince the President to rein in either the First Family or Mr. Habibie and both are costing Indonesia efficiency and reputation.
Republic of Indonesia

IFC Country Perspective

Business Environment

• **Macroeconomic stability.** Proceeding from over 20 years of prudent macroeconomic policies and a 6 percent p.a. growth rate in the last decade, Indonesia attained lower middle income country status in 1993 with per capita income of $880 in 1994. The objective of GOI's current development plan for 1995-99 is to sustain a 7 percent economic growth rate by (i) increasing productivity and efficiency in the private market-based economy, (ii) providing better infrastructure, and (iii) strengthening human resources. Short term, Indonesia has to contend with signs of overheating (see separate brief).

• **International competitiveness.** The APEC Bogor Declaration, resulting from meetings chaired by Indonesia in November 1994, envisions free trade in the region by 2020, with substantial liberalization set to occur by 2010. GOI is implementing an appropriate policy framework focusing on the need for competition with imports and among local manufacturers to encourage a more efficient private sector and spur nonoil sector growth. However, there have been recent setbacks, as discussed below (see Deregulation).

• **Foreign direct investments.** In the 1995-99 development plan, the capital investment requirement is estimated at US$360 billion, of which about 65 percent is expected to come from the private sector. Indonesia now has foreign investment regulations that are among the most attractive in the region. This has yielded a record FDI approvals of US$23 billion in 1994, surpassed again by US$40 billion FDI in 1995.

• **Infrastructure.** The GOI has encouraged the growing interest among foreign and domestic private investors in the infrastructure sector. Twenty-four power BOO schemes totaling 9,175 MW have been committed, and 9 projects totaling 4,305 MW have been signed with the independent power producer (IPP). In telecoms, 2 million of the 5 million planned new lines have been awarded to 5 private sector consortia under a joint operating scheme (JOS) with GOI’s Telkom. In toll roads, GOI has offered 19 toll road projects covering 770 km with a total investment of $2.15 bn. For 4 toll road projects in West (3) and East Java (1), covering 143.5 km and with a total cost of $481 mn, awards are expected in August 1996.

• **Privatization.** Since late 1994, GOI has successfully partially privatized Indosat (international telecom) for US$1.1 billion, Tambang Timah (tin mining) for US$130 million, and Telkom (domestic telecom) for US$2.9 billion.

• **Debt reduction.** Foreign debt stands at close to US$100 billion. Over the last 2 years, GOI has utilized proceeds from the above privatizations to prepay US$1.04 billion of the US$2.15 billion loans with interest higher than 10 percent a year from IBRD and ADB. GOI’s COLT (Commercial Offshore Loan Team) will now closely monitor private sector foreign borrowings, in addition to GOI-related and bank borrowings. This is expected to result in a greater scrutiny of foreign projects, and given IFC’s scrutiny of projects, a bigger role for IFC to ensure that foreign borrowings are well spent.

• **Capital Markets.** The domestic stock market has been depressed for the last year and a half with the general withdrawal of foreign funds from emerging markets. With the recent privatizations,
stock market capitalization increased to about US$66.6 billion by the end of 1995, representing 238 listed companies. The JSE index rose marginally in a dull market year from 460 to around 500. In terms of total market capitalization, in 1994 Indonesia was ranked 27th in the world and 10th in Asia. The New Company Law and the Capital Markets Law are in place. The regulatory framework for fund management has recently been issued. Open-end mutual funds are now allowed and may be 100 percent foreign-owned, but no one shareholder may own more than 1 percent.

- **Financial access.** The domestic banking sector is able to take care of the short-term financing requirements of industry. However, for medium-term project financing, domestic rates are high (20-22 percent). In the last three years, major business groups and state enterprises have successfully tapped the international debt and equity/quasi-equity markets. Second-tier entities still have limited access, mainly via bank loans.

- **Multilateral and bilateral institutions.** IFC remains the most active multilateral institution in project financing. Bilaterals continue to be active in medium-size project financing and in extending credit to financial institutions. They generally welcome IFC leadership in large-scale financing. AFIC, the ADB-affiliated regional merchant bank, is an active participant in IFC syndications.

- **IFC pipeline.** IFC’s project pipeline in Indonesia continues to develop strongly. Projects are in general manufacturing (second-tier companies), capital markets, agribusiness (including the poultry and palm oil sectors), infrastructure (including power, telecom, ring-road in Jakarta), chemicals and petrochemicals, treasury and advisory sectors (including privatization of electricity utility). While Indonesia’s credit standing has improved, there are serious problems raising large amounts of long-maturity debt, without full recourse to the sponsor’s balance sheet, due to the continued perception of high country risk. However, under IFC’s umbrella, most of the commercial banks agree to lend longer term. IFC’s ability to provide and to syndicate longer maturity loans makes projects more competitive by reducing funding uncertainties. IFC’s presence as a neutral organization helps these companies to overcome the lack of confidence in and experience with foreign investors and to prepare for international markets.

- **IFC rupiah bond issue.** IFC has over the past year been in active discussion with Indonesian authorities (MOF, the securities commission Bapepam, the credit rating agency Pefindo) on the merits of allowing multilateral institutions to float rupiah-denominated bonds, which would help establish a benchmark in the nascent local bond market. An IFC rupiah bond floatation would be the maiden issue. The Minister of Finance, the Governor of the Bank of Indonesia (BI), and the Chairman of Bapepam are in principle supportive of this IFC initiative. Technical issues, in particular the tax status and rating of IFC bonds, have to be resolved.

**Private Sector Issues**

- **Strengthening banks and the financial sector.** BI will encourage bank mergers to overcome systemic problems and to enhance competitiveness. To reduce the overhang of bad debt and the high cost of borrowing, bank restructuring efforts will require political will at the highest levels to improve collection, upgrade supervision, raise provisioning, and meet international capital adequacy standards. There is also significant scope for mobilizing long-term finance, through pension funds and other contractual saving industries, by addressing regulatory and tax barriers.

- **Deregulation.** The May 1995 trade deregulation package was a rules-based package reducing the average tariff to 15 percent, with a pre-announced schedule to reach a 7 percent average tariff by
2003. A new reform package was unveiled in January 1996 to boost exports by way of a 5-20 percent tariff reduction on 428 items, mostly capital goods and raw materials for export manufacture (6 percent of those subject to tariff). The package fell below the business sector’s expectations, however, particularly in terms of reducing the high informal cost of doing business. Recent events have dealt a major blow to the deregulation program. A 20 percent import surcharge on propylene and ethylene, on top of an existing 5 percent duty, has been granted to Chandra Asri, the US$1.7 billion olefins project associated with President Soeharto’s second son Bambang. In the automotive sector, a new ruling conferred to 100 percent Indonesian-owned companies a pioneer status and exemption from tariff for components (up to 125 percent) and luxury sales tax (30 percent). The ruling immediately benefits only the KIA (Korea)-Timor joint venture of the President’s youngest son Tommy, but may also benefit the Hyundai Bimantara of Bambang in the near future.
World Bank Group
Country Assistance Strategy

The major features of Indonesia's development strategy are:

- **Maintaining growth with macroeconomic stability** through appropriate fiscal and monetary policy, careful debt management, and a stronger domestic savings effort. During 1996-99, real GDP is expected to grow at around 8 percent a year, based on continued strong growth in the nonoil, nonagricultural sector, led by rising domestic and foreign private investment.

- **Enhancing competitiveness** through increased deregulation, reduced costs of finance, and provision of better infrastructure services and education.

- **Reducing poverty** and improving social equity through increased access of the poor to basic urban, educational, and health services, targeted programs for the hard-core poor, raising agricultural productivity in the Eastern Islands and greater involvement of the poor in program design and implementation.

- **Enhancing human resources development** through improvements in the delivery, efficiency and quality of health and education services.

- **Managing resources sustainably** through more effective policies for land, water and forest resources, strengthening of institutional capacities in environment conservation activities, and reducing urban and industrial pollution.

The Bank Group is helping Indonesia meet development objectives in the following ways:

**Bank:**

- Continuing the 25-year tradition of lending and of **policy dialogue** with GOI on a broad range of macroeconomic and sector issues. GOI continues to be interested in a Bank presence (through both lending and advisory work) in all major sectors.

- A **lending program** of about $1.2 billion a year (limited by Bank exposure constraints) addressing critical needs in infrastructure, agriculture, human resources, and public sector management. As private sector participation increases in the industrial, finance, telecommunications, and power sectors, Bank lending in these areas is expected to decline.

- A **technical assistance** program (including the use of IDF resources) aimed at improving the capability of the public sector to plan, prepare, and implement development projects. In recent years, the focus of our technical assistance program has shifted increasingly to building local government capacity.

- An **Economic and Sector Work (ESW)** program designed to analyze increasingly complex issues; Bank advice is being sought, inter alia, in the development of (a) macro strategies; (b) sector strategies; and (c) a suitable framework for private provision of infrastructure, financial sector, environmental management, labor, and regional development issues.

- A **portfolio management** approach that features increasing government involvement, increased attention to results on the ground, and more cost-effective methods of supervision and procurement in some 76 ongoing projects.

- Increased attention to **environmental and social impact** issues in policy dialogue, economic and sector work, and lending operations. A substantial pipeline of Bank-supported, Montreal Protocol, and GEF projects is under preparation as Indonesia addresses various facets of natural resource management and renewable energy.

- Working increasingly with **community groups, foundations, and NGOs** to improve project design and development impact. The extent and quality of our outreach to such groups is improving over time and is proving valuable, especially in projects involving resettlement, participation, and other social impact considerations.

- Setting **poverty reduction** as the primary objective of almost two-thirds of the Bank's program in Indonesia through promotion of an outward-oriented, employment-intensive growth strategy, more targeted delivery of services, and the development of more region-specific interventions.
IFC

- Strengthening private sector activities through an expected $225 million program in 1996 ($790 million including participants); Indonesia is IFC’s sixth largest exposure in the world and the third largest in Asia, with a portfolio of $460 million held for its own account and $443 million for the account of participants.
- Working with second-tier, smaller, family run companies and helping them access international financial markets.
- Proactively seeking viable projects in lesser developed areas of the country and assisting private sector into nontraditional sectors such as health care (e.g. Siloam Gleneagles Hospital).
- Introducing Indonesian companies to innovating financing sources with the objective of diversifying the borrowing sources and reducing overall cost of funding (e.g. Commercial Paper program).
- Working with larger companies in sectors that increasingly rely on private financing, such as infrastructure, power, telecommunications, industry and finance; seeking transparent transactions with objective to create a “second force” of competitive companies to compete with protected cartels.
- IFC also intends to strengthen the banking sector by selectively upgrading the private banks through the introduction of foreign technical partners, introducing sound operating policies and guidelines, improving capital adequacy and lengthening the maturities of liabilities.
- IFC would like to support the development of the capital market’s infrastructure by establishing specialized institutions such as depositories. IFC has offered its assistance to BAPEDAM (the Indonesian SEC) in this context.
- Investing in agri-business projects where country has a significant cost advantage or which contribute to development of rural areas.
- With the objective of introducing new financing products and develop the domestic bond market, IFC has discussed permission to float Rupiah denominated bonds. The Indonesian Government is supportive, but technical issues remain to be resolved.

MIGA

- Supporting the development of the private sector through political risk insurance to foreign equity investors and financial institutions through a current portfolio of $101.5 million which is expected to increase significantly.
- Completed projects include (a) P.T. Freeport Indonesia, a guarantee signed in 1/90 covering risks of war and breach of contract with maximum guarantee of $50 million; (b) P.T. Hokuriki United Forging Industry, a $1.4 million guarantee to Komatsu Ltd, which manufactures and exports forged machinery parts for construction equipment and commercial vehicles; (c) P.T. Paiton Energy Company (first Indonesian privately operated power project), a guarantee of $50 million to the General Electric Capital Corporation of the U.S. for its equity investment.
IMPACT
Republic of Indonesia

Project Implementation Issues

Our experience with project implementation in Indonesia over the past twenty-five years has been
good, as reflected in OED ratings of lending operations — 87 percent satisfactory in dollar volume,
compared with a Bank-wide average of 73 percent. Both the Bank and GOI, however, want to do
better. Accordingly, we have redoubled our efforts in recent years to ensure that only high-priority
investments are selected, and that projects are implemented efficiently and achieve their develop-
ment objectives.

The last CPPR, in February 1994, was a pathbreaking exercise for both GOI and the Bank, and resulted
in a heightened appreciation of the respective roles and responsibilities of the borrower and the Bank,
and a shift of attention from disbursement issues to those of effective and sustainable development.
The key recommendations of the action plan included:

• greater involvement of GOI agencies at all levels (and other stakeholders) with project selection,
  preparation, and implementation, including the specific requirement of effective ownership;
• increased attention to the need for monitoring both implementation progress and development
effectiveness, and a quicker response in restructuring projects and canceling loan funds whenever
they are not likely to be used effectively;
• simpler project design, with fewer but better defined objectives;
• less onerous procurement processes and other initiatives to reduce delays in the hiring of consult-
ants on GOI’s side (a major source of delay in project implementation), and more delegation of
authority and responsibility to resident mission (RSI) staff for no-objection letters on the Bank’s
side (initiated in FY94 for all local procurement, and working extremely well); and
• a conscious effort by both GOI and the Bank to reduce the overall level of technical assistance while
making it less costly and more effective.

While there has been significant progress in many of these areas, more remains to be done. We have,
therefore, accelerated the timing of the next CPPR. There have been discussions between GOI line
agencies and Bank sectoral managers, and there was a Plenary Meeting the week of May 20, 1996.
Other initiatives underway on the Bank’s side include:

• further strengthening of our Portfolio Management and Environmental and Social Impact Units in
RSI, focusing on both upstream project preparation issues (especially for our provincially focused
regional development projects) and downstream implementation issues;
• continued support to GOI for capacity building in key areas, including two highly successful IDF
grants, one to help establish a National Procurement Resource Center for improved policy and
guidelines on implementation, and another on Performance Evaluation as a key input for improv-
ing development effectiveness; and
• increasing attention to “quality at entry,” including GOI ownership, clear and simple project objec-
tives, careful consideration of alternatives, clearly defined performance indicators (and M&E ar-
rangements), sound economic analysis, participation of stakeholders, etc.
IFC Implementation Issues

IFC is facing the following issues in Indonesia:

- **Lack of transparency**, especially in the bidding process for large (infrastructure) projects, continues to be of primary concern. IFC has refrained from financing a number of major projects in Indonesia where it could have a significant role to play due to lack of transparency in the bidding process and award of concessions/licenses. Typical examples are projects in power, transportation, and telecommunications sectors.

- Another equally important issue is favoritism. The President’s friends and family get better treatment from the government which results in reduced efficiency and higher economic cost. This unfair competition also creates a lack of trust and shakes investors’ confidence. The most recent example is the case of the national car, where the President’s second son’s car company will get a tax holiday.

- **Substantial increase in foreign debt** has resulted in GOI more closely scrutinizing foreign borrowing, including by the private sector. This could be the first step towards a “pre-borrowing-approval,” which would not only add yet another hurdle and increase the hidden cost but could also result in significant delays with back-and-forth on terms of the loans.

- At present, financial institutions, (in particular, banks), are required to obtain an annual pre-approved borrowing limit from PKLN. The limit tends to be very small (the typical limit for most banks for 1995/96 is US$5 million). This is inconsistent with the treatment of the corporate sector, which has no borrowing limit. This partial control of foreign borrowing is, in effect, fairly meaningless and should be scrapped.

- Although the Bank Indonesia and the Ministry of Finance in principle like the idea of IFC rupiah bond issue, IFC still hasn’t received formal approval, especially on the issue of IFC immunity on withholding taxes and rating of the proposed bond by Pefindo, the rating agency.
OED

Indonesia: Evaluation Findings

- The Bank’s Operations Evaluation Department (OED) has evaluated a total of 167 loans to Indonesia, amounting to $11.3 billion. The outcome of 87 percent of the lending amount was rated satisfactory, much above the Bank-wide average of 73 percent. Sustainability ratings are high (75 percent likely), and institutional development is also high (56 percent substantial). These latter ratings are also well above Bank averages (55 and 37 percent, respectively).

- OED findings show that the Bank has been closely associated with several elements of Indonesia’s remarkable economic and social transformation. Five sectors (agriculture, power, transport, human resources, and structural adjustment) make up 80 percent of the evaluated portfolio. The proportion of satisfactory project outcomes is high for all sectors, ranging from 100 percent in power and structural adjustment to 95 percent in human resources, 94 percent in transport, and 75 percent in agriculture. Even the low ratio for agriculture compares favorably with the Bank-wide average of slightly below 65 percent for agricultural projects.

Structural Adjustment

- Indonesia’s economic stabilization and adjustment program started in 1983 and intensified after the collapse of oil prices in 1986. The main areas of policy reform have included public expenditure restraint, judicious exchange rate management, trade reform, and liberalization of the financial markets and of the foreign investment regime. Bank lending for adjustment, evaluated by OED, consisted of two trade policy loans and two private sector development loans (totaling $1.2 billion). The outcome of all four operations was rated as satisfactory. An important distinguishing feature of these loans was that the policy measures they supported were announced prior to loan appraisal. This procedure of “ex post conditionality” was justified because: (a) the prior consultation between the Bank and GOI resulted in agreement on the measures to be taken, (b) it was agreed at the beginning that these measures were part of a medium-term adjustment program, and (c) GOI’s initial policy steps and commitment to their continuation made it clear that the reform was an ongoing process. In short, GOI fully owned the reform program.

Agriculture

- The Bank has been lending for agriculture since 1968. Sixty-two projects have been evaluated, representing $2.9 billion in lending. By value, the proportion of satisfactory project outcomes is 75 percent. However, in absolute numbers one half of the unsatisfactory project outcomes in Indonesia are in the agricultural sector.

- Lending for irrigation has been substantial, accounting for about 40 percent of the projects evaluated. This program has been largely successful: the outcome of 19 out of 22 evaluated projects was rated satisfactory. However, OED audits frequently noted inadequate operation and maintenance (O&M), wrong assumptions about upstream water control and distribution and about farmer group efficiency, and, until recently, ineffective cost recovery. Recent Bank initiatives to devolve responsibility for O&M and cost recovery to water user associations appear to be working.

- The Bank participated in Indonesia’s transmigration program through five projects, financing about 10 percent of total investments during the 1979-1989 period which covered less than five percent of
the families settled. Nevertheless, the Bank’s role has been controversial. An OED review of five Bank-supported projects found that, in general, settler incomes increased, women’s participation and roles expanded, and social infrastructure improved. However, little attention was paid to the indigenous people who lived in the resettlement areas and were adversely affected by the projects. Also, attention to environmental aspects was weak, and the inconsistent application of Bank and government guidelines was a concern. The outcome of two of the five projects was rated unsatisfactory. (Country Department Note: The Bank stopped supporting transmigration projects in 1987.)

- The Bank’s involvement in multipurpose dam and irrigation works at Kedung Ombo has also provoked controversy. Farm incomes increased substantially, but the program to resettle displaced people was poorly planned and badly managed.

- The Bank also provided considerable support to develop estate and smallholder tree crops. The benefits of these projects were substantial: of the sixteen projects only three had unsatisfactory outcomes. The main purpose of many of these projects was to use an existing estate and/or management organization as the nucleus to develop outlying areas for cultivation by landless people, hence creating employment and raising incomes. This model worked well during implementation. But for benefits to be sustained, more attention is required to rehabilitate substandard plantings and provide efficient extension to the smallholders (the intensive project unit support system during the investment phase cannot be maintained during the operation phase).

- Bank support improved the country’s agricultural research capacity considerably. Extension coverage expanded through the training and visit system but needs to be improved and adapted to the diverse cultural and socioeconomic environments in Indonesia. Also, further funding of these programs, which have relied heavily on external financing, poses a challenge.

**Infrastructure**

- In *highways*, the Bank has been instrumental in developing a capable highway administration and has provided substantial assistance in physical improvements. Recently, the Government, with Bank support, initiated a restructuring of the highway administration, whose main aim is decentralization of decisionmaking. The Bank also assisted in implementing an up-to-date management system. In addition, the Bank has now expanded its involvement in multi-mode and urban transport issues, both of which are crucial.

- In the *urban sector*, a series of projects has contributed significantly to long-term development of urban settlements and local municipal structures. A housing sector project assisted the housing mortgage bank to streamline management systems and introduce automated operations. It also helped GOI revise existing regulations and policies that restricted access to mortgage bank loans and expand the role of private developers in low-cost housing. Projects focusing on *kampung* improvement programs (KIP) — very dense low-income settlements in urban areas — reaped very high economic rates of return. KIPs also upgraded the quality of life of *kampung* residents through infrastructure improvements and were replicated through successive operations in urban areas throughout Indonesia.

- In *water and sanitation*, the outcome of four of the five evaluated projects was rated satisfactory. The devolution of implementation responsibility to the provinces through local agencies was an important achievement of the projects. The projects found that poverty alleviation strategies can be
addressed through both careful targeting and project design, including location of public taps, favorably priced house connections, and well-directed incentives to water agencies.

- In ports, good timing and policy reforms were responsible for project achievements. The promulgation of regulatory reforms accelerated port efficiency improvements that might have been harder to achieve with a project alone. But weak institutions required more Bank resources than in other sectors for the supervision of technical assistance.

- The outcome of all fifteen evaluated power projects (US$2.2 billion in lending, representing a fifth of the Bank's total evaluated portfolio) was rated satisfactory. Through these operations, the Bank has made a substantial contribution to the financing and institutional strengthening of the sector since the 1960s. These projects—carried out through the late 1980s—supported the rapid expansion of the system (with a tripling of generating capacity during the 1980s alone) and helped the state utility (PLN) to improve its project management and operational capacity. Policy dialogue in that period focused mainly on sector planning and tariffs, with reasonable success. More recent (ongoing) operations have also dealt with private sector participation and sector restructuring.

Education

- Out of the economic and social chaos of the mid 1970s, Indonesia has achieved one of the most significant transformations in education in the developing world. The Bank has lent more for education to Indonesia than to any other country, committing more than $2.2 billion for 35 projects since FY71. All 19 evaluated projects in this diverse portfolio had successful outcomes.

- Early Bank assistance was designed to educate and train the future work force through secondary and post-secondary vocational and technical training. With Indonesia's rapid economic development, the scope of these investments has broadened over the years to include professional and scientific research training in polytechnics and universities, supported by reforms aimed principally at improving quality, cost effectiveness, management efficiency, and a greater involvement of the private sector.

- A second generation of Bank projects began to focus on widening access and improving quality in primary and general secondary education, following the country’s success in building primary schools across the nation. Ongoing operations target the children of the poor in rural areas. A notable success story is the ongoing assistance to poor and illiterate adults who have benefitted from nonformal programs designed to impart income-generating skills along with literacy.

- Evaluation findings show that the objective of expanding access at all levels has been achieved. Policy, structural, and institutional reform has succeeded unevenly and more slowly, but there have been some notable successes (e.g., in teacher training). The increased participation of girls in polytechnic training was noted in a recent audit.

Health and Population

- Indonesia is among the most active clients in the population, health and nutrition sectors, reflecting the country’s strong political and administrative commitment to improving human resources and to equity in the distribution of social services.

- The lending program in population shows a strong record of success, with the outcome of all four completed projects rated as satisfactory and sustainable. Factors contributing to this success include the strong institutional capacity of the lead implementing agency (the National Family Plan-
ning Coordinating Board, or BKKBN) and the development, over time, of effective systems for stimulating and maintaining community involvement in family planning and health activities. A fifth population project to train village-level midwives and target services to hard-to-reach populations is nearing successful completion.

- Projects in the health sector present a good example of development learning. The first two projects produced mixed results, and their outcome was rated unsatisfactory, due largely to implementation difficulties resulting from construction delays, and difficulties in strengthening local and district-level capacity and accountability. A subsequent project overcame these difficulties by setting more explicit institutional development goals and adapting community development lessons from the family planning program to health program design.

- The nutrition project, the first stand-alone project in the Bank’s nutrition portfolio, produced valuable lessons on organizational arrangements for the management of nutrition education efforts, which are now incorporated into ongoing health projects that include nutrition objectives. Two ongoing projects in the health sector focus on improving the quality of local health services and on resource mobilization for the sector.

Microenterprise and Small-Scale Industry Lending

- While the outcome of several financial intermediation projects was rated satisfactory, three projects addressing small-scale enterprises (SSE) were designed to increase capacity and employment, as well as improve the administration of the SSE program, but they failed to do so. Credit subsidization undermined the borrowers’ financial discipline. Many of the funds ended up refinancing existing loans rather than increasing capacity. The project outcomes were thus rated unsatisfactory. Having learned from this experience, however, the Bank designed a new type of project (KUPEDES, approved in FY87), which provides unsubsidized credit to small borrowers, thereby encouraging saving by poor small entrepreneurs. The KUPEDES project outcome was highly satisfactory and is now being replicated by the private sector.

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Agriculture/Rural Development/Agribusiness
Sector Summary

Key Sector Data (1993)

- Cultivable land: 55.4 million ha (28% of land area — 0.29 ha/capita)
- Cultivated land: 37.5 million ha
- Estate crops: 12.1 million ha
- Farm families: 21.8 million
- Share of labor force: 55%

- Share of GDP: 17%
- Irrigated land: 6.5 million ha
- Area under shifting cultivation: 11.8 million ha.
- Rice production: 45.6 million
- Other important agricultural products: palm oil, rubber, fish, coffee, cocoa

Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>22</td>
<td>334.4</td>
<td>369.4</td>
<td>703.8</td>
<td>19.3%</td>
</tr>
<tr>
<td>1981-90</td>
<td>15</td>
<td>—</td>
<td>826.5</td>
<td>826.5</td>
<td>7.7%</td>
</tr>
<tr>
<td>1991-96</td>
<td>6</td>
<td>—</td>
<td>342.5</td>
<td>342.5</td>
<td>4.3%</td>
</tr>
<tr>
<td>1997-98 (est.)</td>
<td>5</td>
<td>—</td>
<td>308.0</td>
<td>308.0</td>
<td>12.3%</td>
</tr>
</tbody>
</table>

Key Sector Issues

- Maintaining rice self-sufficiency.
- Deregulation of price and trade regimes (bans, taxes, licensing) for key commodities and livestock trade.
- Reduction of agricultural productivity gaps between Java/Bali and Outer Islands.
- Development of nonrice technology packages.
- Decentralization and progress on privatization of key agricultural services and input supply systems.
- New approaches to develop rural financial services.
- Commercialization of agribusiness.

Sector Work, FY90-96

- Various deregulation studies on: sugar, cocoa and coffee (FY95 & FY96)
- Eastern Islands Rural Sector Strategy Review (FY95)
- Report on Government Estate Companies (FY94)
- Agricultural Transformation: Challenges and Opportunities (FY93)
- Land Resources Management and Planning (FY91)

Major Sectoral Targets and Achievements

- Development of decentralized agricultural services, improvement of regional planning and implementation, and targeting public investments to poorer areas with low agricultural productivity.
- Continuing deregulation of price and trade regimes to set up framework for private sector participation in agriculture and agribusiness development, and make progress towards privatization of parastatals.
- Introducing integrated approach to water resource management, and strengthening participatory irrigation management.

Comments

- Despite significant growth in other sectors, agriculture continues to be a vitally important sector from the point of view of employment, output, and export generation. Also, since poverty remains predominantly a rural phenomenon in Indonesia, the agricultural sector is important for the objective of poverty reduction.
- The Bank has launched a major effort (involving both lending and analytical work) in this sector which emphasizes: promotion of income-earning opportunities for rural communities, especially in the remoter and less-developed regions; development of nonrice agricultural technologies, deregulation of price and trade controls on important commodities, and innovative approaches to providing finance.
Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>Tree Crops Processing Project</td>
<td>118.2</td>
</tr>
<tr>
<td>1989</td>
<td>Agriculture Research Management Project</td>
<td>35.3</td>
</tr>
<tr>
<td>1991</td>
<td>Yogyakarta Upland Area Development Project</td>
<td>15.5</td>
</tr>
<tr>
<td>1992</td>
<td>Agriculture Financing Project</td>
<td>106.1</td>
</tr>
<tr>
<td>1992</td>
<td>Tree Crops Smallholder Development Project</td>
<td>87.6</td>
</tr>
<tr>
<td>1993</td>
<td>Integrated Pest Management Training Project</td>
<td>32.0</td>
</tr>
<tr>
<td>1995</td>
<td>Second Agriculture Research Management Project</td>
<td>63.0</td>
</tr>
<tr>
<td>1996</td>
<td>Nusa Tenggara Agriculture Area Development Project</td>
<td>27.0</td>
</tr>
</tbody>
</table>

Proposed Future Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Southeast and Central Sulawesi Rural Development Project</td>
<td>26.8</td>
</tr>
<tr>
<td>1997</td>
<td>Maluku Regional Development Project</td>
<td>45</td>
</tr>
<tr>
<td>1997</td>
<td>Sumatra Regional Development Project</td>
<td>120</td>
</tr>
<tr>
<td>1998</td>
<td>Micro Credit Project</td>
<td>25</td>
</tr>
<tr>
<td>1998</td>
<td>Decentralized Agricultural Extension</td>
<td>50</td>
</tr>
<tr>
<td>1998</td>
<td>Jambi/West Sumatra Regional Development Project</td>
<td>68</td>
</tr>
</tbody>
</table>

IFC’s Agribusiness Strategy in Indonesia

IFC’s agribusiness investments in Indonesia emphasize the following elements:
- Improving efficiency and competitiveness in production and marketing (technology transfer, infrastructure improvement, etc.);
- Strengthening competitiveness of traditional crops (e.g., palm oil, rubber) while supporting production diversification, particularly toward products with high-income demand elasticity (poultry, livestock, dairy products) and good export potential (banana, seafood products);
- Supporting broad-based rural income growth, with employment- and smallholder-intensive projects, particularly in less-developed islands where off-farm work opportunities are limited;
- Regional development, with specific emphasis on the less-developed islands.

IFC Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>“A” Loan</th>
<th>US$ million “B” Loan</th>
<th>Equity/Quasi Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>P.T. Agri Muko</td>
<td>10.5</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>P.T. Dharmalo Agri Food</td>
<td>20</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>P.T. Asian Agri</td>
<td>40.0</td>
<td>40.0</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>P.T. Kalimantan (KSP Agri)</td>
<td>20.0</td>
<td>15.0</td>
<td>5.0</td>
</tr>
</tbody>
</table>
Urban Sector Summary

Key Sector Data

Urban population > 55 million, > 30% of population, 6% growth p. a. 

Urban poverty: 17%

Urban infrastructure service levels: only 20-25% of urban population has access to piped water supply, 40% to adequate sanitation.

Estimated investment backlog of over $5 billion for the five major subsectors of piped water supply, sanitation, solid waste, urban roads, and drainage.

Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>5</td>
<td>—</td>
<td>171.2</td>
<td>171.2</td>
<td>4.7%</td>
</tr>
<tr>
<td>1981-90</td>
<td>8</td>
<td>—</td>
<td>832.4</td>
<td>832.4</td>
<td>7.8%</td>
</tr>
<tr>
<td>1991-96</td>
<td>10</td>
<td>—</td>
<td>1,267.1</td>
<td>1,267.1</td>
<td>15.9%</td>
</tr>
<tr>
<td>1997-98 (est.)</td>
<td>4</td>
<td>—</td>
<td>457.0</td>
<td>457.0</td>
<td>18.2%</td>
</tr>
</tbody>
</table>

Key Sector Issues

- Serious infrastructure service level deficiencies and O&M backlogs.
- Need to manage water resources in an integrated fashion taking into account domestic, industrial, and agricultural needs and protection of water quality.
- Need for much greater focus on sanitation issues, both human waste and solid waste.
- Complex relationships among local, provincial, and central agencies.
- Need for economic pricing policies for services and adequate cost recovery.
- Need for a proper policy framework for private sector participation in the provision of services.

Sector Work, FY90-96


Major Government Actions and Events

- Increased decentralization of urban infrastructure planning and implementation of projects to provincial and local governments.
- Plans for greater role for private sector in service delivery (advanced for Jakarta water supply).
- Enactment of improved legislation for environmental impact assessment, mitigation, and monitoring measures; issuance of presidential decree for land acquisition for development of public facilities.

Comments

- GOI's evolving urban policy agenda is closely linked to issues highlighted in the 1995 CAS (improving service delivery to the poor, greater decentralization of responsibilities, and improved environmental management).
- Policy dialogue with GOI is critical on key sectoral issues such as: strategy for managing the development of Jabotabek, economic provision of water supply and sanitation services, framework for private sector participation in urban service delivery.
- It is imperative to develop capacity in GOI for much faster development of investment projects, speedier implementation, and improved O&M.
- Bank program includes one ongoing and one planned operation (Village Infrastructure) with specific poverty focus.
### Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>Second Jabotabek Urban Development Project</td>
<td>190.0</td>
</tr>
<tr>
<td>1991</td>
<td>Third Jabotabek Urban Development Project</td>
<td>61.0</td>
</tr>
<tr>
<td>1991</td>
<td>East Java and Bali Urban Development Project</td>
<td>180.3</td>
</tr>
<tr>
<td>1991</td>
<td>Sulawesi-Irian Jaya Urban Development Project</td>
<td>100.0</td>
</tr>
<tr>
<td>1994</td>
<td>Surabaya Urban Development Project</td>
<td>175.0</td>
</tr>
<tr>
<td>1994</td>
<td>Semarang-Surakarta Urban Development Project</td>
<td>174.0</td>
</tr>
<tr>
<td>1995</td>
<td>Kalimantan Urban Development Project</td>
<td>136.0</td>
</tr>
<tr>
<td>1995</td>
<td>Village Infrastructure Project</td>
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</table>

### Proposed Future Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Second Sulawesi Urban Development Project</td>
<td>145.6</td>
</tr>
<tr>
<td>1996</td>
<td>Second East Java Urban Development Project</td>
<td>142.7</td>
</tr>
<tr>
<td>1997</td>
<td>Second Village Infrastructure Project</td>
<td>162.0</td>
</tr>
<tr>
<td>1997</td>
<td>Bali Urban Infrastructure Project</td>
<td>150.0</td>
</tr>
<tr>
<td>1998</td>
<td>Lombok Urban Infrastructure Project</td>
<td>50.0</td>
</tr>
<tr>
<td>1998</td>
<td>Jabotabek Waste Management Project</td>
<td>95.0</td>
</tr>
</tbody>
</table>
**Education Sector Summary**

### Key Sector Data

<table>
<thead>
<tr>
<th></th>
<th>Gross Enrollment Rate</th>
<th>No. of Students</th>
<th>Public/Private (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary school</td>
<td>111%</td>
<td>29.7 million</td>
<td>83/17</td>
</tr>
<tr>
<td>Junior secondary</td>
<td>54%</td>
<td>7.8 million</td>
<td>59/41</td>
</tr>
<tr>
<td>Senior secondary</td>
<td>34%</td>
<td>4.2 million</td>
<td>47/53</td>
</tr>
<tr>
<td>University</td>
<td>10%</td>
<td>1.9 million</td>
<td>33/67</td>
</tr>
</tbody>
</table>

**Government Expenditures on Education:** 2.9% of GDP, 14.5% of total spending

**Distribution:** 66% for basic education / 12% for senior secondary / 12% for higher education / 9% for administration

### Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects (US$ million)</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total Lending</th>
<th>Share of Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>8</td>
<td>73.3</td>
<td>105.0</td>
<td>178.3</td>
<td>4.9</td>
</tr>
<tr>
<td>1981-90</td>
<td>17</td>
<td>—</td>
<td>1,320.2</td>
<td>1,320.2</td>
<td>12.3</td>
</tr>
<tr>
<td>1991-96</td>
<td>12</td>
<td>—</td>
<td>836.6</td>
<td>836.6</td>
<td>10.5</td>
</tr>
<tr>
<td>1997-98 (est.)</td>
<td>5</td>
<td>—</td>
<td>400.0</td>
<td>400.0</td>
<td>15.9</td>
</tr>
</tbody>
</table>

### Key Sector Issues

- The education system suffers from low quality despite impressive achievements in enrollment. With universal primary enrollment, overall retention and repetition rates are very low, with wide variations among provinces and between urban and rural areas.
- Quality problems are pervasive and not easy to solve. They include uneven teacher training and distribution, insufficient financing for materials/books, insufficient community and parental support, and the difficulties faced by children who are raised in a variety of local languages but must study in Bahasa Indonesia.
- The Bank has advocated greater autonomy and decisionmaking at lower levels and continued involvement of private institutions.
- The private sector, encouraged by Government policies, is now the largest provider of training. The challenge for GOI is to move into accreditation, licensing, and school/work experimentation.

### Sector Work, FY90-96

- Indonesia - Basic Education Study, 1989
- Secondary Teachers in Indonesia: Supply, Demand and Initial Preparation, 1992
- Indonesia - Public Expenditures, Prices, and the Poor, 1993
- Training and the Labor Market in Indonesia, 1996

### Sectoral Achievements and Targets

#### Achievements
- Universal primary enrollment, including girls education, was attained within 10 years (from 1973 to 1983).

#### Targets
- Universal junior secondary enrollment by 2010.
- Free provision of textbooks to all primary and secondary students by 2000.
- Upgrading of teachers, both pre-service and in-service.
- Restructuring of universities to achieve greater autonomy and improve quality and relevance of public and private education.
- Maintaining private sector involvement in education, especially in the secondary and tertiary levels.
- Increasing public spending on basic education, without crowding out the private sector.

#### Comments

The Bank is advocating both expansion and quality improvements in basic education. Difficult issues of distance and geographic remoteness in service delivery and teacher distribution are being addressed, but progress has been slow and uneven.
### Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>Ministry of Public Works Institutional Development Project</td>
<td>36.1</td>
</tr>
<tr>
<td>1990</td>
<td>Second Secondary Education and Management Project</td>
<td>154.2</td>
</tr>
<tr>
<td>1992</td>
<td>Third Non-Formal Education Project</td>
<td>69.5</td>
</tr>
<tr>
<td>1992</td>
<td>Primary School Quality Improvement Project</td>
<td>37.0</td>
</tr>
<tr>
<td>1992</td>
<td>Primary School Teacher Development Project</td>
<td>36.6</td>
</tr>
<tr>
<td>1994</td>
<td>Skills Development Project</td>
<td>27.7</td>
</tr>
<tr>
<td>1995</td>
<td>University Research for Graduate Education Project</td>
<td>58.9</td>
</tr>
<tr>
<td>1995</td>
<td>Second Professional Human Resources Develop. Project</td>
<td>69.0</td>
</tr>
<tr>
<td>1995</td>
<td>Book and Reading Development Project</td>
<td>132.5</td>
</tr>
<tr>
<td>1996</td>
<td>Secondary School Teacher Development Project</td>
<td>60.4</td>
</tr>
</tbody>
</table>

### Future Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Higher Education Support Project</td>
<td>65.0</td>
</tr>
<tr>
<td>1996</td>
<td>East Java/ NTT Secondary Education Project</td>
<td>105.0</td>
</tr>
<tr>
<td>1997</td>
<td>Central Indonesia Secondary Education Project</td>
<td>100.0</td>
</tr>
<tr>
<td>1997</td>
<td>Human Resources Capacity Building Project</td>
<td>20.0</td>
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<tr>
<td>1997</td>
<td>Sumatra Secondary Education Development Project</td>
<td>100.0</td>
</tr>
<tr>
<td>1997</td>
<td>Higher Education Quality Project</td>
<td>60.0</td>
</tr>
<tr>
<td>1998</td>
<td>West Java Basic Education Project</td>
<td>60.0</td>
</tr>
<tr>
<td>1998</td>
<td>Child Development I</td>
<td>60.0</td>
</tr>
</tbody>
</table>
Health and Population Sector Summary

Key Sector Data

<table>
<thead>
<tr>
<th>Population (millions)</th>
<th>193</th>
<th>Contraceptive prevalence rate</th>
<th>55.0%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infant mortality/1,000 live births</td>
<td>57</td>
<td>Percent of children &lt;1 immunized (DPT3)</td>
<td>85</td>
</tr>
<tr>
<td>Crude birth rate</td>
<td>24</td>
<td>Percent of children &lt;5 malnourished</td>
<td>46</td>
</tr>
<tr>
<td>Crude death rate</td>
<td>8</td>
<td>Maternal mortality rate/100,000 births</td>
<td>390</td>
</tr>
<tr>
<td>Total fertility rate</td>
<td>2.9</td>
<td>Public health expenditures (% GDP)</td>
<td>0.7%</td>
</tr>
<tr>
<td>Private health expenditures (% GDP)</td>
<td>1.3%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Lending (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>4</td>
<td>12.9</td>
<td>56.7</td>
<td>69.6</td>
<td>1.9</td>
</tr>
<tr>
<td>1981-90</td>
<td>5</td>
<td>—</td>
<td>169.6</td>
<td>169.6</td>
<td>1.6</td>
</tr>
<tr>
<td>1991-96</td>
<td>4</td>
<td>—</td>
<td>310.1</td>
<td>310.1</td>
<td>3.9</td>
</tr>
<tr>
<td>1997-98 (est.)</td>
<td>2</td>
<td>—</td>
<td>120.0</td>
<td>120.0</td>
<td>4.8</td>
</tr>
</tbody>
</table>

Sector Work, FY90-9

Planning and Budgeting, 1991
Family Planning Perspectives in the 1990s, 1991
Public Expenditures, Prices, and the Poor (Health Chapters), 1993
Health Work Force: Issues and Options, 1994

Key Sector Issues

- Key health indicators remain poor relative to Indonesia’s development status.
- Disparities in health status and distribution of health work force remain across regions and economic groups.
- Deficiencies in quality and efficiency of services.
- Inadequate financial resources (public and private) in the sector. There has been some private investment in the sector, however, and IFC has recently approved an investment in a hospital in Indonesia.
- Existing health financing system provides inappropriate incentive structure for providers.

Major Sectoral Targets and Achievements

- Decline in infant mortality rate from 142 to 57 over the last thirty years.
- Decline in total fertility rate from 5.2 to 2.9 over last twenty years
- Immunization coverage (DPT3) has increased from less than 10 percent to 85 percent over twenty years.
- National coverage has been achieved with community-based primary health services (posyandu).
- New budgeting, management, and planning policies are supporting decentralization efforts.

Comments

- An internationally recognized family planning program, the world’s first expanded program of immunization, and government-supported, community-based primary services have contributed to gains in health. GOI is taking some first steps to move away from hierarchical expenditure programs and toward greater reliance on the private sector, more community control, and decentralization. A program of contracting doctors for rural areas is having some success at redressing the poor distribution of health workers, but it needs strengthening.
- More spending is needed on the poor and on services in rural communities. Critical areas for support are nutrition and services for maternal and child health, administrative improvements, and institutional changes in health finance and service delivery.
### Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>Third Health Project</td>
<td>43.5</td>
</tr>
<tr>
<td>1991</td>
<td>Fifth Population Project: Family Planning and Safe Motherhood</td>
<td>104.0</td>
</tr>
<tr>
<td>1993</td>
<td>Third Community Health and Nutrition Project</td>
<td>93.5</td>
</tr>
<tr>
<td>1993</td>
<td>Water Supply and Sanitation for Low Income Communities</td>
<td>80.0</td>
</tr>
<tr>
<td>1995</td>
<td>Fourth Health Project: Improving Equity and Quality of Care</td>
<td>88.0</td>
</tr>
<tr>
<td>1996</td>
<td>AIDS and STDs Prevention and Management Project</td>
<td>24.8</td>
</tr>
</tbody>
</table>

### Proposed Future Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>Safe Motherhood and Family Development</td>
<td>80.0</td>
</tr>
<tr>
<td>1998</td>
<td>Micro Nutrient Project</td>
<td>40.0</td>
</tr>
</tbody>
</table>

### IFC Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>P.T. Gleneagles Hospital Corporation</td>
<td>25.8</td>
</tr>
</tbody>
</table>
Transportation Sector Summary

Key Sector Data

- Roads are the predominant mode of land transport for both passengers and freight. Road density is low (130km/1,000 km²; 1.5km/1,000 population), with large regional variations.
- Railways (one network on Java; three smaller ones on Sumatra) account for only an estimated 4% of total transport.
- Sea transport accounts for 56% of freight movements, mostly bulk oil and coal by producers.
- Traffic demand is growing rapidly (7% per year, slightly faster than the economy).

Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Portfolio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>10</td>
<td>89.0</td>
<td>449.3</td>
<td>538.3</td>
<td>14.7</td>
</tr>
<tr>
<td>1981-90</td>
<td>11</td>
<td>—</td>
<td>1557.6</td>
<td>1557.6</td>
<td>14.5</td>
</tr>
<tr>
<td>1991-96</td>
<td>6</td>
<td>—</td>
<td>943.5</td>
<td>943.5</td>
<td>11.8</td>
</tr>
<tr>
<td>1997-98(est.)</td>
<td>3</td>
<td>—</td>
<td>422.0</td>
<td>422.0</td>
<td>16.8</td>
</tr>
</tbody>
</table>

Key Sector Issues

- Need for transparent and consistent framework for public/private transactions in roads/ports/airlines/railways.
- Highways: increasing congestion in high-growth areas; ineffectiveness of road investments in outlying regions; deficiencies in implementation and quality of public works.
- Railways: excessive government interference; growth in traffic constrained by capacity.
- Intermodal transport: development stymied by inconsistencies in regulatory regimes across different forms of transport.

Sector Work, FY90-96

- Railway Investment Review (1990)
- Road Sector Study (1996)
- Private Sector Participation in Indonesia Public Ports (1994)

Major Sectoral Targets and Achievements

- GOI is likely to achieve its 5-year plan target of 100% of national/provincial roads in good condition by 1999, but unlikely to achieve it for district roads (60% target, currently 45%).
- The Public Works Department has developed (with Bank assistance) and is using a state-of-the-art road management system.
- GOI has decided to turn the railways into a financially autonomous enterprise, and to obtain greater private participation.

Comments

- Capacity expansion and road development, in the context of regional development, represent major challenges which could justify a 30% increase in sector expenditures.
- Sector agencies, at the central and local levels, need to be better equipped for dealing with challenges in a coordinated manner, including building up a pipeline of sound and well-prepared investments.
- There are considerable opportunities for efficiency improvements in the allocation of funds.
## Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>Jabotabek Urban Development Project</td>
<td>150.0</td>
</tr>
<tr>
<td>1992</td>
<td>Third Kabupaten Roads Development Project</td>
<td>215.0</td>
</tr>
<tr>
<td>1993</td>
<td>Eastern Indonesia Kabupaten Roads</td>
<td>155.0</td>
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<tr>
<td>1993</td>
<td>Flores Earthquake Reconstruction Project</td>
<td>42.1</td>
</tr>
<tr>
<td>1994</td>
<td>Second Highway Sector Investment Project</td>
<td>350.0</td>
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<td>1994</td>
<td>Fifth Kabupaten Roads Project</td>
<td>101.5</td>
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</table>

## Proposed Future Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Strategic Urban Roads Infrastructure Project</td>
<td>79.9</td>
</tr>
<tr>
<td>1997</td>
<td>Railway Efficiency Project</td>
<td>72</td>
</tr>
<tr>
<td>1997</td>
<td>Regional Roads (Sumatra)</td>
<td>100</td>
</tr>
<tr>
<td>1998</td>
<td>Second Regional Roads Project (Kalimantan)</td>
<td>100</td>
</tr>
<tr>
<td>1998</td>
<td>Strategic Urban Roads II</td>
<td>150</td>
</tr>
</tbody>
</table>
Telecommunications Sector Summary

Key Sector Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Call Completion Rate (in %)</th>
<th>Main Lines per 100 Inhabitants</th>
<th>Main Telephone Lines/Employee</th>
<th>Telephone Faults 100 Main Lines per Month</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>43</td>
<td>1.0</td>
<td>45</td>
<td>2.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>55</td>
<td>3.7</td>
<td>71</td>
<td>4.3</td>
</tr>
<tr>
<td>Malaysia</td>
<td>50</td>
<td>12.6</td>
<td>80</td>
<td>6.5</td>
</tr>
<tr>
<td>Singapore</td>
<td>70</td>
<td>43.5</td>
<td>172</td>
<td>1.1</td>
</tr>
<tr>
<td>Japan</td>
<td>84</td>
<td>45.4</td>
<td>258</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Lending (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>1</td>
<td>12.7</td>
<td>—</td>
<td>12.7</td>
<td>0.3</td>
</tr>
<tr>
<td>1981-90</td>
<td>2</td>
<td>—</td>
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<td>326.9</td>
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<tr>
<td>1991-96</td>
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<td>—</td>
<td>700.0</td>
<td>700.0</td>
<td>8.8</td>
</tr>
<tr>
<td>1997-98 (est.)</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
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</tr>
</tbody>
</table>

IFC

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Project</th>
<th>&quot;A&quot; Loan US$ million</th>
<th>&quot;B&quot; Loan Equity/Quasi Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>1</td>
<td>50</td>
<td>300</td>
</tr>
</tbody>
</table>

Key Sector Issues

- Bring telecom service standards and choices throughout Indonesia up to the levels of competitor countries.
- Establish effective regulatory oversight to ensure high quality at lowest possible cost.
- Mobilize the capital needed for massive investments to accelerate network expansion and technology upgrading.
- Develop PT TELKOM into a modern, efficient, and business-oriented company.

Sector Work, FY90-96

- Telecommunications Sector Study Report, June 1990
- Seminar on Strategic Options for Telecommunications Sector Development, December 1991
- Workshop on Telecommunications Sector Restructuring, June 1992
- Seminar on Financing Options For Telecommunications Sector Development, September 1993

Major Sectoral Targets and Achievements

- Corporatized the domestic telecommunications operator (TELKOM), September 1991.
- Separated management responsibility from sector regulatory and oversight functions, 1993.
- Allowed entry of private operators in the provision of telephone service, 1993.
- Listed international telecommunications carrier in both domestic and international stock exchanges, November 1994.
- Awarded concessions to five international consortia to provide basic telephone service in all of Indonesia outside Jakarta and Surabaya, October 1995.
- Opened the cellular segment to competition, 1995.
- Listed domestic telecommunications carrier in domestic and international stock exchanges, November 1995.
Comments
The Indonesian telecommunications sector is going through a period of structural transformation from almost total state monopoly to a competitive, multi-operator environment, a predominance of private investment, elimination of unmet demand, and dramatic improvements in operational efficiency and customer service with declining prices. Indonesia's telecom sector is the most deregulated in East Asia and has the highest participation of private investment. During the current five-year development program, about 50 percent of new investment in the sector will be private. It is expected that the telecommunications law will have been overhauled to eliminate the requirement for TELKOM or INDOSAT to have equity stakes in basic service operators.

Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Name of Project</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>Third Telecommunications Project</td>
<td>350.0</td>
</tr>
<tr>
<td>1992</td>
<td>Fourth Telecommunications Project</td>
<td>375.0</td>
</tr>
<tr>
<td>1995</td>
<td>Telecommunications Sector Modernization Project</td>
<td>325.0</td>
</tr>
</tbody>
</table>

IFC's Telecommunications Strategy
IFC's investments in the telecommunications sector will emphasize:

- Continued reform of the telecommunications sector, leading to full liberalization.
- Increased private sector participation.
- Existence of an independent regulatory body with transparent procedures for granting licenses, setting tariffs, and resolving disputes, particularly about interconnection.
- Development of telecommunications systems on off-Java regions.
- Upgrading and expanding telecommunications networks.
- Structuring and mobilizing funds for large projects on a limited recourse basis.
Trade and Privatization Sector Summary

Key Sector Data

Trade Sector:
- Total merchandise exports rose from $28.1 million in 1990/91 to $46.5 million in 1995/96, as a result of strong manufacturing exports that offset the gradual decline in oil and gas exports.
- Total imports rose from $25.8 billion in 1990/91 to $46.2 billion in 1995/96 following recent acceleration of non-oil import growth.
- Current account deficit fluctuated around 2.5% of GDP in last five years, but has widened to $7 billion (3.5%) in 1995/96.
- Deregulation measures in May 1995 and January 1996 resulted in reduction of average import tariffs and surcharges to 14%, and a commitment to reduce them further in line with multilateral and regional trade liberalization initiatives.

Privatization:
- Progress has been slow: of 180 state enterprises, only 4 have been partly privatized through stock market listings.
- Concessions for some private toll roads, ports, water supply, and two power generation plants have been negotiated since 1990.
- Advances in telecommunications have been greatest, with partial international listings of the PT TELKOM (domestic telephony) and PT SATELINDO (international telephony), a concession for basic telephony to 5 international consortia under a private/public operating scheme in all areas outside Jakarta and Surabaya, and licensing of a private operator for international telephony and various private/public operators for wireless telephony.

Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Lending (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1981-90</td>
<td>3</td>
<td></td>
<td>950.0</td>
<td>950.0</td>
<td>8.9</td>
</tr>
<tr>
<td>1991-96</td>
<td>3</td>
<td></td>
<td>308.0</td>
<td>308.0</td>
<td>3.9</td>
</tr>
<tr>
<td>1997-98 (est.)</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Key Sector Issues

Trade Sector:
- Following increasingly liberalized trade and 1995 announcement of 5-10% tariff reduction by 2003, the unfinished agenda includes elimination of NTBs on imports (in particular in agriculture and manufacturing) and of export restrictions (affecting two-thirds of agricultural exports as well as other sectors).
- Ad hoc Government interventions in favor of connected firms affect transparency of the trade regime (e.g., recent favorable treatment of car manufacturer and upstream plastics producer).

Privatization:
- Lack of a political consensus and strategy for privatization of public enterprises.
- Lack of a transparent and competitive framework for the sale of equity and concessions, and for the sectors themselves.
- Lack of an institutional focal point for developing a privatization program.

Sector Work, FY90-96

Trade Sector:
- Trade sector report, 1991
- Selected papers for Deregulation Conference, 1995
- Regular reviews of external trade sector in CEMs, annual

Privatization:
- Conference on deregulating the telecom sector, 1992
- In-country workshop on private participation in power, 1993
- Privatization of industrial public enterprises, 1993
- Framework paper on private participation in ports, 1994
- Framework paper on private participation in solid waste management, 1994
- In-country workshops on private participation in water supply, 1995 and 1996
- Road sector report reviews private participation in toll roads and state construction firms, 1996
Major Sectoral Targets and Achievements

Trade Sector:
* Government committed to reducing import tariffs down to 5-10% by 2003 on virtually all products.
* Indonesia would move further toward free trade status by removing tariff protection on automobiles, opening the strategic state enterprises to import competition, removing export taxes on forest products, and removing agricultural NTBs.

Privatization:
* Develop political consensus and institutional oversight for privatization and private provision of public services.
* Develop a transparent and competitive framework for sale of equity/assets or concessions.
* Besides infrastructure, accelerate privatization of public enterprises in competitive markets (industry, trade, agriculture).
* Develop transparent regulatory frameworks for sectors with less competitive markets.

Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>Industrial Restructuring Project</td>
<td>284.0</td>
</tr>
<tr>
<td>1991</td>
<td>Technical Assistance for Public and Private Prov. of Infrastruct.</td>
<td>30.0</td>
</tr>
<tr>
<td>1995</td>
<td>Second Tech. Assistance for Public and Private Prov. of Infrastruct.</td>
<td>28.0</td>
</tr>
</tbody>
</table>

IFC Activities
IFC's Corporate Finance Services Group has been in discussion with a number of state-owned companies, including PLN and Hotel Indonesia Group, regarding the provision of advisory services, and with the Ministry of Transport and Communications regarding the privatization of four ports and Garuda, the national airline.
Natural Resources and Conservation Sector Summary

Key Sector Data

- Indonesia is a country with enormous biodiversity; it contains 10% of global flowering plants, 12% of all mammal species, and 35% of all fish species.
- About 7% of land and 2% of marine area is in conservation reserves.
- Forests cover about 55% of land area and are the largest in Asia; forest sector output is $8-9 billion/yr., accounting for 7% of GDP and 20% of exports. The sustainable yield is 22 million cubic meters (m$^3$/yr). The Bank estimates production in excess of 40 million m$^3$; GOI estimates it at around 32 million m$^3$.
- Twenty percent of forest area is slated for agricultural conversion, 20% for watershed protection.
- Fish production is 3.5 million MT; it comprises 2% of GDP and 15-20% of dietary protein.

Net Sector Lending

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Lending (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>2</td>
<td>10.0</td>
<td>-</td>
<td>10.0</td>
<td>0.3</td>
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<tr>
<td>1981-90</td>
<td>4</td>
<td>-</td>
<td>66.1</td>
<td>66.1</td>
<td>0.6</td>
</tr>
<tr>
<td>1991-96</td>
<td>4</td>
<td>-</td>
<td>171.1</td>
<td>171.1</td>
<td>2.1</td>
</tr>
<tr>
<td>1997-98 (est.)</td>
<td>2</td>
<td>-</td>
<td>65.0</td>
<td>65.0</td>
<td>2.6</td>
</tr>
</tbody>
</table>

Key Sector Issues

- Forest management is unsustainable; GOI should increase taxation. There are links between forest concessions and the plywood industry and political interests.
- High export tariff on logs reduces internal log prices and subsidizes plywood mill inputs;
- Indonesia leads many countries in its stated conservation initiative, but institutions remain weak and there is encroachment and logging in conservation areas.
- Fisheries and coral reefs are often over-exploited and require improved management.
- Watershed management is needed for sustainable upland agriculture.

Sector Work, FY90-96

- Production Forestry: Achieving Sustainability and Competitiveness (October, 1993)
- Indonesia: Environment and Development (1994)
- Fisheries in Eastern Indonesia (Background Paper for Eastern Islands Rural Strategy Review) (May, 1994)
- The Economics of Long Term Management of Indonesia’s Natural Forests (August, 1995)
- Economic Analysis of Indonesian Coral Reefs (Draft, January 1996).

Major Government Actions and Events

- Intention to place 10% of land and marine area (30 million hectares) in reserves — 31 out of a planned 40 national parks have been identified or established.
- GOI is publicly committed to reaching sustainable timber harvests by 2000 under International Timber Trade Organization Guidelines and is rapidly expanding plantations to take pressure off natural forests.
- National Regreening Program targeting 39 watersheds, 11 of which are “critical.” Goals are soil and water conservation, sustainable production systems and income generation for poor upland farmers.
- GOI supports a national Coral Reef Program with Bank and GEF as major donors.

Comments

- Government does not wish to borrow from the Bank in this sector because of the easy availability of grant funds from a variety of sources. Accordingly, our relationship is limited to policy dialogue and GEF-sponsored projects.
### Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>Forestry Institutions and Conservation Project</td>
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<tr>
<td>1991</td>
<td>Yogyakarta Upland Area Development Project (watershed)</td>
<td>15.5</td>
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<tr>
<td>1994</td>
<td>National Watershed Conservation and Management Project</td>
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<td>1995</td>
<td>Land Administration Project</td>
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<td>1994</td>
<td>GEF Biodiversity Collections Project</td>
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</table>

### Proposed Future Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
<th>GEF (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Kerinci-Seblat Integrated Conserv. and Dev. Project</td>
<td>19.1</td>
<td>15.0</td>
</tr>
<tr>
<td>1997</td>
<td>Coral Reef Rehabilitation and Management Project</td>
<td>25.0</td>
<td>12.0</td>
</tr>
<tr>
<td>1998</td>
<td>Regional Watershed Development I</td>
<td>40.0</td>
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</tr>
</tbody>
</table>
**Energy Sector Summary**

**Key Sector Data**

- Oil is Indonesia's most important export, but Indonesia will become a net oil importer in next ten years.
- Private oil companies account for almost all Indonesian oil production, and have operated through production sharing contracts (PSC). PERTAMINA, the state oil company, receives government's share of the oil and overseas contracts, while operations are conducted largely by foreign companies. The downstream oil refining and marketing business is a PERTAMINA monopoly, although foreign oil companies (e.g., BP) have operated in the refinery sector in a service role.
- Indonesia has substantial gas reserves that could be tapped to meet rising domestic energy requirements. But development of the domestic gas sector has been at a standstill due to state domination of the sector and the lack of a sector strategy, incentives for producers and infrastructure to bring gas to the market.
- Indonesia is the world's largest exporter of liquefied natural gas, but the domestic gas sector has yet to be developed, despite enormous potential.
- There is rapid and sustained electricity sales growth: sales have doubled every 5 years for the last 15 years, and 1.5 million consumers are connected every year (the largest growth rate of any utility in the world).
- Indonesia has two types of electricity systems: on Java, there is a modern, profitable integrated grid; outside Java, there are many isolated grids that are loss-making.
- The power sector until recently has been dominated by the state-owned integrated utility, PLN (Perusahaan Listrik Negara), but sector restructuring is underway: (i) PLN has signed MOUs with private sector IPPs for supply of over 4,000 MW of power; (ii) PLN is being reorganized into subsidiaries under a holding company as an initial step towards partial divestiture.

**Net Sector Lending**

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Portfolio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>9</td>
<td>101.8</td>
<td>699.0</td>
<td>800.8</td>
<td>21.9</td>
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<tr>
<td>1981-90</td>
<td>13</td>
<td>—</td>
<td>2687.2</td>
<td>2687.2</td>
<td>25.1</td>
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<tr>
<td>1991-96</td>
<td>6</td>
<td>—</td>
<td>1730.7</td>
<td>1730.7</td>
<td>21.7</td>
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<td>1997-98</td>
<td>5</td>
<td>—</td>
<td>741.0</td>
<td>741.0</td>
<td>29.5</td>
</tr>
</tbody>
</table>

IFC has no oil or gas projects in Indonesia.

**Key Sector Issues**

**Electricity**

- **Institutional/technical:** Bottlenecks exist in transmission and distribution; power supply quality and reliability are low.
- **Policy:** Electricity tariffs need to be increased to finance sector growth and meet Bank covenants; power sector has been opened to private entry but rules for entry need to be better defined and regulatory oversight strengthened.
- **Investment:** Access to electricity remains low, especially in rural areas; construction of first nuclear power plant is under consideration.

**Gas**

- **Allocation is on an administrative basis, including highly subsidized sales to public enterprises. There is little transmission pipeline capacity. Many end users — industrial and residential — do not have access to gas, despite Indonesia's large reserves of nonexportable gas.**
- **To develop the sector requires:** improving incentives for gas producers; establishing an unbundled, open-access transmission system and independent distribution companies; implementing a regulatory framework to promote private investment, efficiency, and competition; developing a transparent and competitive mechanism for recruiting foreign gas companies to help develop the gas system.

**Sector Work, FY90-96**

- Energy Sector Pricing Study, 1990
- Natural Gas Development Planning Study, 1992
- Options for Private Participation in PGN, the State Gas Company, 1994
- IPP Pricing, 1994
- Framework for Power Sector Development, 1995
- Power Supply Reliability, 1996
- Natural Gas Development Planning Study, 1992
- NORPLAN Study on Electricity Sector Restructuring Options, 1993
- Policy Note on Reform of the Gas Sector, 1994
- PLN Financial Targets, 1995
- Power Sector Regulatory Oversight, 1996
- Development of Private Power, 1996
Major Sectoral Targets and Achievements

Electricity

- Sustained rapid growth and substantial efficiency improvements; rural electrification target of 100% of villages by about 2010.
- PLN corporatized and unbundling begun on Java.
- Introduction of private power w/ construction underway of first large private power plant (Paiton1).
- Introduction of automatic electricity tariff adjustment mechanism and small power purchase tariff.
- Legislation to promote downstream oil and gas competition is being prepared.
- Effective regulatory oversight for electricity sector to be finalized this year.

Gas

- Decision made to end the monopoly of the national oil company, PERTAMINA, in gas transmission and convert the state-owned gas company, PGN, into a limited liability company to pave the way for investment in the company by international gas utilities (1994).
- Revision of the oil and gas laws to promote private investment and competition in the downstream oil and gas industries has gone to the Cabinet (1996).
- Development of an open access national gas grid which could yield net savings of $800 million per annum in addition to substantial environmental benefits through the substitution of cleaner natural gas for petroleum products.

Comments

- GOI has relied heavily on Bank advice in developing and reforming the power and domestic gas sectors.
- All seven active projects in the Bank energy portfolio are rated satisfactory or higher.
- Future power and gas projects will focus on: regulatory reform, private sector participation, transmission and distribution, renewable energy, and rural electrification.

Active Lending Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Name of Project</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>Gas Utilization</td>
<td>104</td>
</tr>
<tr>
<td>1991</td>
<td>Power Transmission</td>
<td>172</td>
</tr>
<tr>
<td>92</td>
<td>Suralaya Thermal</td>
<td>424</td>
</tr>
<tr>
<td>1993</td>
<td>Cirata Hydro Phase II</td>
<td>104</td>
</tr>
<tr>
<td>1994</td>
<td>Sumatera and Kalimantan</td>
<td>261</td>
</tr>
<tr>
<td>1995</td>
<td>Second Rural Electrification</td>
<td>398</td>
</tr>
<tr>
<td>1996</td>
<td>Second Power Transmission and Distribution</td>
<td>373</td>
</tr>
</tbody>
</table>

Future Operations

<table>
<thead>
<tr>
<th>FY</th>
<th>Project Name</th>
<th>Total Lending (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>Gas Transmission</td>
<td>166</td>
</tr>
<tr>
<td>1997</td>
<td>Solar Home Systems</td>
<td>25</td>
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<tr>
<td>1997</td>
<td>Renewable Energy Development</td>
<td>100</td>
</tr>
<tr>
<td>1998</td>
<td>Java Distribution Project</td>
<td>350</td>
</tr>
<tr>
<td>1998</td>
<td>Power Distribution Outside Java</td>
<td>100</td>
</tr>
</tbody>
</table>

IFC Strategy in Indonesian Power Sector

IFC's strategy for investment in this sector includes support for projects with the following characteristics:

- Competitive IPP generation providing catalytic and demonstration benefits without any involvement of the friends or family of the president.
- Economically viable IPP generation utilizing renewable resources (e.g., hydro, wind, solar, biomass, and geothermal).
- Private sector transmission and distribution, to the extent that they become feasible under Indonesian regulations.

MIGA Strategy in Indonesian Power Sector

MIGA has so far issued one contract for a power project in Indonesia. It provided a US$50 million guarantee to Global Indonesia Power (General Electric Capital Corporation) for its investment in the Paiton 7/8 project in FY96. MIGA also expects to issue a guarantee for another power project (ENRON, East Java) in FY96. In addition, MIGA has a number of applications pending, and might participate in other power projects, subject to its country and sector limits.
Sector Note

Mining Sector Summary

Sector Profile

- Mining accounts for about 10% of GDP. In 1994, Indonesia earned US$1.84 billion from exports of mainly coal and copper (4.6% of total exports).

- Having reasonably attractive mining laws and market-oriented policies, Indonesia has been able to attract substantial foreign direct investment and world-scale mineral producers, e.g., CRA and BHP in coal mining, INCO in nickel, Freeport McMoran and Newmont in copper and gold. The mining sector has also been reasonably successful in attracting long-term financing from international commercial lenders.

- With encouragement from the World Bank, the Government has recently privatized P.T. Aneka Tambang (general mining, nickel, bauxite) and P.T. Tambang Timah (tin). By law, the state coal mining company, P.T. Tambang Batubara Bukit Asam, owns Indonesia’s coal resources and private operators obtain concessions via contracts of work in exchange for a set royalty (generally 13.5% of coal output).

Copper:

- Freeport Indonesia is the only copper producing company in Indonesia. Its production exceeded 1 million tons for the first time in 1994. Virtually all was exported in the form of concentrate since Indonesia does not yet have a copper smelter. Export earnings in 1994 were US$858 million. The main markets for Indonesian copper concentrate are Japan, USA, Germany, and South Korea.

Coal:

- The rapid increase in coal-fired power generating capacity in Indonesia and in the region has led to high growth in coal production. In 1994, Indonesia produced 28 million tons as compared to 10 million tons in 1990. Export earnings amounted to US$915 million up from 18 million tons in 1994. The country’s total coal reserves are estimated at 37 billion tons, 85% of which are low-sulfur lignite or sub-bituminous, suitable for thermal power generation.

Gold:

- In recent years, there has been spectacular growth in gold exploration and production. In 1994, Indonesia produced about 44,000 kg (41,000 kg of which was exported) as compared to 6,700 kg in 1990. This growth is partially associated with the growth of copper production, since gold is a by-product of copper concentrate produced at the Freeport mines in Irian Jaya.

IFC’s Role

- IFC’s role in the Indonesian mining sector has been limited. Mining ventures in Indonesia have been able to attract long-term financing from commercial sources.

- IFC’s most significant involvement has been in the US$650 million Gresik Copper Smelter project, in which IFC originally worked with Metallgesellschaft, which did not proceed with implementation. The project was taken over by Mitsubishi Materials which, together with Freeport Indonesia, invited IFC to participate. Nevertheless, due to the publicity associated with OPIC’s cancellation of its insurance of the Freeport copper mines, the sponsors decided to withdraw their request for IFC financing of the smelter. IFC expects to pursue a role in projects involving smaller companies which are venturing into Indonesia for the first time. In addition, IFC seeks to promote smaller coal mining projects involving Indonesian sponsors.
Financial Sector

Key Sector Data

- Commercial banks are the predominant participants; there are more than 240 such banks with more than $100 billion in assets.
- The stock market is robust if volatile, with more than 230 listed firms, more than $60 billion in market capitalization, and more than 200 brokerages.
- Recent Initial Public Offerings (IPO) have been enlivened by divestment of large public enterprises, including PT INDOSAT, PT TELEKOM, and the scheduled IPO of a large state bank, Bank Negara Indonesia.
- Fixed-income securities are less active, with $13 billion of money-market instruments and $2 billion of corporate bonds.
- There are many nonbank finance companies (more than 250, including leasing, factoring and consumer credit companies) and about 100 insurance companies, but the volume of business for these firms is very small (less than $10 billion of revenue for nonbank finance companies and less than $2 billion of written premiums for insurance companies).
- Banks and nonbank finance companies are regulated by Bank Indonesia (BI).
- Security markets are regulated by the Capital Market Supervisory Agency (BAPEPAM).
- Financial regulations have been progressively liberalized since 1983.

Sector Lending (IBRD)

<table>
<thead>
<tr>
<th>FY</th>
<th>No. Projects</th>
<th>IDA (US$ million)</th>
<th>IBRD (US$ million)</th>
<th>Total (US$ million)</th>
<th>Share of Total Lending (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969-80</td>
<td>6</td>
<td>19.6</td>
<td>154.8</td>
<td>174.4</td>
<td>4.8</td>
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<tr>
<td>1981-90</td>
<td>3</td>
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<td>538.8</td>
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<td>5.0</td>
</tr>
<tr>
<td>1991-96</td>
<td>1</td>
<td>-</td>
<td>307.0</td>
<td>307.0</td>
<td>3.9</td>
</tr>
<tr>
<td>1997-98</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Key Sector Issues

- High level of nonperforming bank assets, 10% earning assets for the banking system and 17% for the state banks.
- Mixed compliance with prudential banking regulations, particularly on capital adequacy and legal lending limits by borrowers.
- High interest rates and over-collateralization of loans, which adversely affects small firms.
- Uneven development of financial markets, with relatively illiquid capital markets, limited supply of term finance, and lack of significant institutional investors.

Sector Work, FY1990-96

- External Debt Management, 1992
- Non-Bank Financial Sector Study, 1994
- The Emerging Asian Bond Market — The Case of Indonesia, 1995
- The Indonesian Pension System, 1996
- Financial Sector Update, FY96
Key Sector Objectives

- Restructuring and privatization of state banks.
- Market-based facilities for housing finance, including secondary markets for mortgages.
- Growth of institutional investors, particularly contractual savings institutions including mutual funds, insurance companies and pension funds.
- Deepening of financial markets to provide more services and flexibility, including access of small firms to equity markets, to longer-term debts, both domestic and abroad, and developing securitization as a financing alternative.

IFC Strategy

- Selectively assisting private sector banks to enhance their level of sophistication in products, services, and operations by introducing foreign technical partners together with an IFC equity investment.
- Financing SMEs, which are typically crowded out of the financial sector by larger and better connected corporates, by providing credit lines to mid-sized private banks for onlending to this segment of the market.
- Developing an institutional investor base in Indonesia through the establishment and/or expansion of mutual funds, venture capital funds, insurance companies, and pension funds.
- Improving the capital market infrastructure through the establishment of depositories.
- Facilitating investments by establishing and/or expanding brokerages offering reliable service and sophisticated research.
- Developing and deepening of the Indonesian bond market.
IFC: Detailed Financial Sector Brief

Sector Profile

- Indonesia's financial sector has been liberalized in stages since 1983 and has become considerably more sophisticated since then. In mid 1989, a comprehensive regulatory framework (the Capital Market Decree of 1990) was established to attract foreign institutional investors.

- The stock market has grown from a dormant institution with a total capitalization of US$101 million and 19 listed companies to one consisting of 238 listed companies and a market capitalization of US$67 billion (as of December 1995). This growth does not reflect qualitative changes such as better settlement procedures, better research availability, and higher standards of professionalism in the securities industry.

- In January 1996, PT Merrill Lynch Indonesia became the first majority-owned U.S. securities firm to be granted a license by the Indonesian Capital Markets Supervisory Agency, BAPEPAM.

- The IPO market has been dominated by state offerings such as the recent IPOs of Tambang Timah, a state-owned tin mining firm and PT TELKOMUNIKASI, a state-owned telecommunications firm. Both issues were floated on the London, Jakarta, and Surabaya stock exchanges. Several other state-owned firms including PT Jasa Marga (a tollroad operator), PT Krakatau Steel (a power generator), Perusahaan Listrik Negara (a power generator and distributor), and Bank Negara Indonesia 1946 are scheduled for flotation in 1996.

- The banking system has improved considerably in the last decade, particularly after the 1988 reforms which permitted the entry of new private banks and joint ventures with foreign banks. The number of commercial banks in Indonesia has doubled in the past five years to reach 240, of which 60 have foreign technical partners. Loan growth increased in tandem with the increase in the number of banks. In 1994, outstanding loans grew by 27 percent. Deposits have not increased as sharply, rising by only 17 percent in 1994. As a result, the loan-to-deposit ratio increased by 3 percent to 82 percent in December 1994.

- However, this growth has frustrated Bank Indonesia (the Indonesian central bank) in its efforts to reduce the level of bad loans in the banking system. The latest estimates released by Bank Indonesia show that 4 percent of outstanding credits from Indonesian commercial banks have been in arrears for more than 2 years. State banks, which controlled 43 percent of Indonesia's 188.6 trillion rupiah (US$84.8 billion) in total outstanding credits in 1994, have an even higher proportion of bad loans. Bank Indonesia is also concerned with the high level of real estate lending done by many private banks.

- Government officials are expecting a gradual consolidation of the banking industry, which is expected to occur through a series of bank mergers. In 1995, 10 banks were either bought out by independent groups or acquired by rival banks. The state-owned banks are expected to continue to be plagued by bad debts and to see their role in the banking system diminish.

- Indonesia has a large number of finance companies which are involved in a range of credit-related activities including leasing, consumer financing, factoring and credit cards. There are currently 253 finance companies registered with the Finance Ministry, of which 197 are private, 54 are joint ventures, and two are state owned. In 1995, Indonesian finance companies financed 25 trillion rupiah (US$10.9 billion), an 80 percent increase from the previous year. In December 1995, the Finance Ministry stopped issuing new licenses to finance companies as part of a series of measures to squeeze credit growth and cool the overheating economy. Equity investments by finance companies have been limited to investments in the financial sector and capped at 25 percent of paid-up capital.

- Life insurance is a young business in Indonesia. In 1994 (latest data available), only about 15 million individuals had life insurance coverage, representing 7.8 percent of the total population of 190 million. In contrast with other large emerging markets such as China and India, which are still working out procedures for deregulation, the Indonesian life insurance market has been deregulated considerably since the release of the Insurance Policy Package (IPP) in 1988. As a result of the deregulation brought about by the IPP, between 1989 and 1994 the number of insured grew from 5.3 million to 14.9 million and the proportion of population insured from 3.0 percent to 7.8 percent. A substantial proportion of the growth came from group business, which accounted for over 83 percent of the total number of lives insured in 1994. The number of individual lives insured was only 2.5 million (1.3 percent of the population) in 1994.
This low level of insurance penetration, combined with a population of more than 190 million, population growth of over 1.5 percent, forecast economic growth of over 6 percent a year over the next 5 years, and an estimated 20 million uninsured middle class professionals (the group most targeted for life insurance products), suggest that there is a substantial need for further development of the Indonesian life insurance market. By mid 1995, the 50 life insurance companies in Indonesia consisted of one state-owned firm, 39 local private companies, and 11 joint venture operations. In 1994, the state-owned firm wrote 16 percent of total life policies outstanding but only 12 percent of the total sum (in rupiah) insured. The local companies accounted for 82 percent of total life policies outstanding and 72 percent of the total sum insured. Although the joint venture companies wrote only 2 percent of total life policies outstanding, they accounted for 16 percent of the total sum insured, reflecting their focus on the growing better-paid middle-class sector.

Indonesia's commercial debt market is relatively small. Periodic local banking scandals have caused wary foreign lenders to only offer short-term funding at high interest rates. As of December 1994, outstanding bond issues by Indonesian issuers consisted of US$13 billion equivalent of bonds and money market instruments with a maturity of less than one year and US$2.1 billion equivalent of corporate bonds. Corporate bond issues for the whole of 1994 totaled only US$336 million equivalent. Unlike its Malaysian and Thai counterparts, the Indonesian Government has not issued any government bonds with a final maturity of over 1 year. Recent large issues by corporations have included a US$310 million Yankee bond issue by the Sinar Mas conglomerate, which raised US$310 million.

Demand for bond financing is increasing due to the strong growth of the Indonesian economy, coupled with the inadequate size and depth of its equity markets. In the latter half of 1995, an electronic exchange, clearing, and settlement system was set up for bond trading. A rating agency, Pefindo, was recently set up in response to a directive from Bank Indonesia requiring all commercial paper to be rated by a company approved by the Capital Market Supervisory Board. These measures will facilitate the growth of the Indonesian bond market.

Sector Work, FY90-96

- Project to encourage backward linkages, April 1995
- Report on the dissemination of FDI-related data, February 1996

IFC’s Role

- IFC would like to help establish a brokerage house and/or an investment bank which would set the standards for the industry.

- In order to help small and medium-sized enterprises (SMEs) which cannot tap the stock market, IFC has helped, and will continue to help, develop the private equity/development capital industry.

- Since the availability of term finance is limited and tends to be channeled towards larger corporations with better access to the system, IFC has mobilized and channeled long-term money via leasing and finance companies to SMEs, and it intends to continue doing so in the near term.

- In addition to the focus on SMEs, it is also part of IFC’s strategy to assist appropriate (i.e., larger, more established) Indonesian institutions in accessing the international money and capital markets. IFC will selectively help Indonesian borrowers access the U.S. commercial paper market and help lengthen borrowing maturities for Indonesian institutions.

- Given the importance of mobilizing domestic savings, particularly long-term savings, IFC has supported, and continues to support, the establishment of contractual savings institutions such as life insurance companies.

- On the more sophisticated end of IFC’s work on capital markets in Indonesia, it has helped to promote the development of Indonesia’s asset-backed securities market by establishing a specialized securitization institution.

- More generally, IFC intends to keep working towards developing the domestic debt market, which it views as a vital component of the Indonesian capital market.
IFC: Chemicals, Petrochemicals and Fertilizers
Department Strategy for Indonesia

CPF Strategy

- Indonesia has a sufficiently large domestic market and enough raw materials to justify further development of its chemical and petrochemical industries, including fertilizers and refinery. Since most projects in these sectors are intensive in both capital and technology (know-how as well as marketing), the CPF Department can play a meaningful role in these sectors, especially in terms of (i) assessing and advising on the long-term strategic viability of projects; and (ii) acting as an honest broker in joint venture arrangements (North-South as well as South-South), such as the BKC projects between the Mitsubishi and Bakrie groups.

- CPF has not been very active in Indonesia because of two main issues. One, the Government’s privatization intentions and liberalization actions, especially for the refinery and fertilizer sectors, are still quite unclear. Two, the dividing line between the corporate and political sectors has been less and less clear in investment decisions, especially for large, capital-intensive, high-visibility projects as petrochemicals.

- We have focused, therefore, mostly on the chemical industries and medium-size companies. Although, with the keen interest from commercial banks in project financing, opportunities for a meaningful IFC role may be limited in the near term. We shall, however, maintain promotion efforts in Indonesia in view of its long-term strategic potential in the Asian markets.

World Bank

- The CPF strategy is consistent with the Bank’s assistance strategy for Indonesia.

Pipeline

- Projects under consideration at present are in early stage of development:

  - Maspion Group projects: (i) to set up a 120,000 tpa PVC joint venture project with Siam Cement, largely for the domestic market, with technology from Shin Dai-Ichi Vinyl Corporation (merged with Sumitomo Chemical’s PVC division in mid-1995). Maspion is a major producer of household sundry goods in Indonesia, including PVC pipes and cables; (ii) to set up a melamine project in joint venture with Srithai, a large melamine producer in Thailand.

  - LG project: to set up a 100,000 tpa PVC plant, being proposed by LG. The feasibility study is now under review by the LG board. If board approval is obtained, LG intends to request IFC support to help find and structure a local partnership.

Portfolio

- **BKC I & II - PTA plant.** Outstanding loans total US$150 million (including B loans in the amount of US$95 million) and equity investments total US$12.6 million. BKC I is doing well, and BKC II is under construction and due to be completed ahead of schedule in April 1996.

- **BK PET - PET resin plant downstream of BKC’s PTA operations.** Outstanding loans total US$12 million, with an equity investment of US$2 million. Project was completed ahead of schedule.
RELATIONSHIPS WITH OTHER ORGANIZATIONS
Relationships with Other Organizations

International Monetary Fund

Recent Contacts with the Fund

- Article IV consultation mission to Jakarta, May 6-17, 1996.
- First Deputy Managing Director Mr. Fischer visited Indonesia, May 21-24, 1996.

Background

- Indonesia rejoined the IMF in 1967. Between 1968 and 1973, Indonesia had one year standby arrangements, but made no purchases after 1971. Indonesia is on the standard twelve month Article IV consultation cycle, with a mid-year staff visit.
- Indonesia formally accepted the obligations of Article VIII, sections 2, 3, and 4 of the Fund Agreement as from May 7, 1988, and has no current account exchange restrictions. The capital account is also very open.

IMF Assessment of the Economy

- At the 1995 Article IV consultation (July 1995), directors emphasized that Indonesia faced a significant short-term challenge of overheating in the face of persistent inflation and a widening current account deficit. They urged the authorities to tighten both fiscal and monetary policies and recommended further steps toward a more flexible exchange rate policy.
- In IMF's most recent mid-year visit to Jakarta in December 1995, the staff noted that overheating pressures had increased. Rapidly rising domestic demand had caused the current account deficit to widen sharply, to close to 4 percent of GDP in 1995, while inflation remained nearly double the Repelita target of 5 percent. The authorities were strongly encouraged to reduce demand pressures and develop a disinflation strategy with a view to achieving their Repelita objectives.
- Emphasis should be placed on achieving a fiscal surplus of 2-3 percent in 1996/97. This would support moves to increase the flexibility of exchange rate policy and strengthen control over the growth of monetary aggregates.
- Recent information points to continuing overheating pressures, with inflation close to 10 percent in 1995/96. The budget for 1996/97 - aiming broad balance, following an expected surplus of about 1 percent in 1995/96 - does not go far enough toward achieving the desired surplus. The growth of money and credit remained well over 20 percent as of January 1996. While Bank Indonesia has taken steps to tighten monetary policy with more stringent reserve requirements and stronger moral suasion, monetary policy may still be insufficiently effective.
- To improve the effectiveness of monetary policy, it would be desirable to tighten central bank liquidity and further increase exchange rate flexibility. Bank Indonesia widened its rupiah-dollar intervention band to 3 percent on January 2, 1996. However, a resurgence of capital inflows in February led to large official purchases of foreign exchange and an easing of domestic liquidity conditions.
- Large minimum wage increases in recent years may have further entrenched inflation expectations.
- Although Bank Indonesia has been addressing problems in the financial systems, and the proportion of nonperforming loans has diminished, much more needs to be done to reduce nonperforming loans, restructure...
problem banks, and enforce regulations.

- Trade and investment liberalization has generally been broad based and supported competitiveness, but some recent measures, including preferential tax and tariff arrangements, could harm efficiency and impair the credibility of the policy direction.

Technical Assistance

- In recent years, IMF has provided technical assistance to the Indonesian authorities on various aspects of macroeconomic policy, especially fiscal reform, banking, and statistics. Missions have advised specifically on pension reform; budgetary procedures; banking supervision, regulation, and liquidation; management and operation of the payments system; and balance of payments statistics. In April 1996, missions advised further on financial regulation and supervision, tax administration, and the compilation of government finance statistics. Another mission on payments system reform is planned for later in the year.

Cooperation with the World Bank

- In its surveillance function, IMF concentrates on macroeconomic advice. The Fund and the Bank have recently shared similar macroeconomic views. The staffs of the two institutions have intensified collaboration efforts to emphasize areas of primary responsibility and ensure consistency of advice. On this basis, the Fund staff has been developing a disinflation strategy for a mission to Jakarta in May.

- The Fund’s macroeconomic advice has been assisted by World Bank work in a number of areas, in particular tax administration, expenditure reviews, public enterprise reform, and resolution of state bank difficulties. Efforts are being made to ensure better coordination of work programs. For example, Bank work on labor market issues and public expenditure priorities was very useful to the Fund staff in the context of the Article IV consultation in May 1996.

- The technical assistance provided by the Bank and Fund staffs on the banking system is closely coordinated and complementary.
Relationships with Other Organizations

Other Donors

- Indonesia receives development assistance from the bilateral aid agencies of more than 14 countries, as well as the Asian Development Bank (ADB) and UN agencies. For FY 1995/96, the Consultative Group commitments totaled US$5.36 billion, of which US$2.6 billion came from multilaterals, with the World Bank and ADB each committing US$1.2 billion. Japan is by far the largest bilateral external support agency (ESA), contributing US$2.1 billion in 1995/1996, a substantial increase over its previous year's commitment of US$1.7 billion. After Japan, the largest assistance providers among the bilateral ESAs are Great Britain, France, and Germany, which pledged US$155 million, US$139 million, and US$125 million, for 1995/96, respectively. Significant support is also provided by the United States, Australia, Kuwait, Austria, Canada, and Switzerland.

Asian Development Bank

- The Asian Development Bank's portfolio is large and covers many sectors, including education, energy, transport, agriculture, irrigation, water resource management, natural resource management and conservation, credit, and health. There are no joint cofinancing arrangements between ADB and the World Bank, principally because the resources available from each institution have been sufficient for individual project investments. However, the two institutions have financed many complementary programs. For example, ADB and the World Bank finance similar projects in urban development, environment, irrigation, roads, and education, but in different regions, provinces, cities, or institutions. In the case of the Flores earthquake rehabilitation program, the World Bank and ADB are providing parallel financing for complementary actions under separate agreements with GOI. A new ADB project in the environmental sector will directly build on a World Bank-financed project to strengthen GOI's environmental agency (BAPEDAL).

UN Agencies

- In 1994 a total of US$56 million in assistance was provided to Indonesia by all UN agencies, excluding the World Bank. The three most active agencies in terms of total disbursements were UNDP, UNICEF, and WFP, each disbursing between US$10 million and US$13 million. Many complementary actions are being financed by UN agencies and the Bank, including the Ozone Depleting Substances Phase-out Project, financed by the World Bank-administered Ozone Projects Trust-Fund (OTF) which also involves UNDP, UNIDO, and UNEP. Another important example of cooperation is the World Bank-executed, UNDP and World Bank-financed Regional Water and Sanitation Program for East Asia Pacific (RWSGEAP), based in Jakarta. The Community Water Supply Component of the E. Java Bali Urban Development Project was prepared and financed by UNDP through RWSGEAP; it is anticipated that collaboration with RWSGEAP will continue on other projects.

- In the area of HIV/AIDS, the World Bank's efforts are being coordinated with other ESAs through quarterly meetings organized by WHO. Collaboration with FAO is especially strong, since it has been asked by GOI to implement key TA activities under the Integrated Pest Management Training Project. With UNICEF, collaboration is beginning in the preparation of a new Early Childhood Development Project.

Bilateral Agencies

- Substantial interaction and information sharing with bilateral ESAs occur on a regular basis, by RSI as well as by HQ staff. Interaction has been
especially important with OECF (Japan) and GTZ (Germany). DANIDA, because of its interest in regional development, is currently financing the preparation activities for a new regional development project in Bengkulu province, Sumatra. In addition, Bank staff are in communication with USAID, especially regarding HIV/AIDS and public sector management efforts; with the Norwegians regarding natural resource management and environmental concerns; and with several other bilateral and nongovernmental ESAs such as CARE and WWF in other priority fields.

- **Japan.** Of the bilateral ESAs, the Japanese OECF and JICA are the most important in terms of amount of financing provided, with OECF providing approximately US$1.6 billion of Japan’s commitment of US$2.1 billion for 1995/96. In addition to providing balance of payment support, OECF funding is concentrated in infrastructure investments in the following sectors: transportation, water resources, communications, urban development, energy, and irrigation. Cooperation among the World Bank, OECF, and GOI has ensured the complementarity of OECF and World Bank investments. As in the case of ADB, OECF finances projects in urban development, rural roads, and irrigation which are often similar to projects financed by the World Bank, but are located in different regions. In a few instances, however, there is more direct cooperation. In JABOTABEK (the multi-city region including Jakarta and three neighboring cities), OECF is providing an additional US$45 million in parallel financing to complement the World Bank-financed JABOTABEK Urban Development II project. In the education sector, OECF finances the construction of school buildings, while a Bank loan focuses on improving the quality of instruction, rehabilitating existing facilities, and purchasing books and equipment. OECF also provides funding to the city of Surabaya, directed at supporting a separate but complementary set of activities and investments to the World Bank-financed Surabaya Urban Development Project.

- **Germany.** The German government, through GTZ, provides substantial technical assistance in the areas of rural and regional development, upland farming systems, rural finance, and public sector decentralization. In each area, Bank staff have benefitted by significant interaction with these projects. For example, the identification and preparation of the new group of Bank-financed regional development and integrated conservation projects is building on the experience of GTZ/GOI in Sumatra and Kalimantan. GTZ’s work with GOI in developing a group credit program is now being considered as a model to be expanded and financed under a new Bank operation. In addition, a Bank/GOI study on village institutions and participation will be done in collaboration with GTZ to take advantage of its work on decentralization and regional development.

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2. Similar programs are also located in South Asia, Africa, and South America.
Relationships with Other Organizations

NGOs

NGOs and the World Bank

- Direct NGO involvement in Bank Projects: Between 1989-1995 the Bank disbursed some $14.4 million dollars to local and international NGOs for consultant services on Bank-financed projects. Nearly 87 percent of these resources were used to support increased community participation; with improved service delivery being second, at 10 percent; and special studies comprising some 3 percent of consultancy contracts.

- EA3 has since 1994 initiated a program of activities to include NGO participants in project preparation and implementation. These activities have been carried out both by the Environment and Social Unit of the Resident Mission as well as by country operations, each sector division, and individual task managers.

- Since 1995, the resident staff in Indonesia has initiated a program of activities to increase NGO participation and partnership in Bank projects. This NGO Participation Program has three objectives: first, to use the Bank's leverage to encourage more contact between NGOs and the Government of Indonesia; second, to help identify constraints and ways to improve NGOs' working environment; third, to open a line of communication to NGOs on a more systematic basis than simple project consultations. The activities pursued by the Resident Mission to strengthen the Bank's partnership with NGOs are described below:

- Consultation Activities/Dialogue. The Participation Program has increasingly led to task managers seeking out NGOs working in their sector at both the national and the grassroots level. The program has also brokered NGO-Government dialogue through workshops in Irian Jaya, Nusa Tenggara Barat, and East Java. In the last six months nearly 70 NGOs joined discussion roundtables in the Resident Mission on several projects: "Safe Motherhood," "HIV/AIDS," and "Coral Reef Conservation and Rehabilitation Project." These discussions have led to the development of simplified mechanisms to allow NGO participation in Bank projects.

- Study on NGO Enabling Environment: The Resident Mission, with the assistance of BAPPENAS and local NGO specialists, has undertaken a review of the "Enabling Environment for Indonesian NGOs," including papers on legal issues, financing, and procurement. This study has helped foster a number of important meetings between NGOs and Government agencies.

Main Issues

Three principal issues stand out from our NGO Participation Program.

- The NGO landscape is more complex than we initially thought. NGO capacities, and operational relationships with Government and local communities vary significantly, and their potential for improving the effectiveness of development is uncertain. At the same time, the NGO presence is growing fast, and any Bank strategy must aim for where the sector will be in the near future.

- Despite an improved climate for Government-NGO relationships, NGOs are still restricted by the Government's overall policy, a general attitude of distrust, and a fairly restrictive operating environment. At the same time, there is clear evidence that increasing contact between Government and NGOs promotes better working relationships, since NGOs can often develop coping strategies that let them work relatively freely and at times even with direct Government support.

- We have learned that for NGOs to become significantly involved in any Bank projects will require careful preparation to overcome general resistance to anything other than a minor executing role. Some of the environment and health sector projects have started to address the operational procedure needed to make NGO involvement in Bank projects possible. A more concerted effort will be needed to convince Government that NGOs can achieve development objectives often more effectively than traditional Government agencies, particularly in poverty alleviation.
NGO Activities

The NGO Community in Indonesia

- The NGO community in Indonesia is relatively young and underdeveloped compared to other ASEAN countries such as the Philippines and Thailand. Indonesian NGOs describe themselves as *Lembaga Swadaya Masyarakat* (LSMs) or self-help community development institutions. Indonesian NGOs play a strategic role in developing partnerships between local government agencies and community-based groups such as informal credit and farmer groups. The larger NGOs, especially those based in Jakarta, often act as a channel for funds and technical support, and play an advocacy role with central Government on behalf of smaller grassroots NGOs and community groups.

- Although NGOs have been effective interlocutors in a few sectors such as irrigation and social forestry, their overall capacity to implement development activities remains weak: first, NGOs are often distrusted by local government for their advocacy work, which is viewed as critical of government policies and programs. This often leads to petty harassment of NGOs by local officials; second, NGOs have limited human and technical capacity to operate on an equal footing with counterparts from government agencies; third, they remain predominantly dependent on foreign funds for program support. This has left them unable to invest in institutional and human resources development, since most donor funds are tied to specific projects.

Numbers and Distributions

- The number of development-oriented NGOs has dramatically increased from less than 2,000 in 1985 to some 3600 registered in 1995. The main reasons are that (i) many of the best graduates from the national universities have established NGOs as a means of supporting social development efforts outside of a bureaucratic structure; and (ii) the policy environment encourages foreign donor investment in social development activities, which has fueled NGO activities.

- As Figure 1 indicates, nearly 50 percent of all NGOs are based on Java, which has nearly two-thirds of Indonesia's population. The second highest concentration is on the island of Sumatra. Generally, areas that have a strong tradition of group organization and community self-help, such as central Java, have large numbers of NGOs; areas such as Kalimantan, which have small dispersed settlements, have relatively few. NGOs have expanded their programs in eastern Indonesia, an area with an extremely high incidence of poverty, where Government programs have been slow to reach.

Resource Mobilization and Donor Support

- Between 1991-94, some US$127 million dollars were channeled to Indonesian NGOs from international agencies for social development activities. The largest contributor was USAID (about US$30 million). These funds were used predominately for social development activities (education, health, community training), including institutional support and capacity development for local NGOs. Indonesia has a long history of private philanthropy through local foundations, *yayasans*, in the areas of public health, culture, and education. The opportunities for individual and corporate support for local NGOs remain limited due to few tax incentives for charitable donations and a lack of transparency by the NGOs themselves regarding their activities and use of program funds.

National NGOs

- National NGOs can be characterized by their institutional format, their geographical coverage, on their primary program focus. The following types of NGOs are typical of Indonesia's NGO community:
• **Networking, Advocacy NGOs:** These NGOs are networks with central offices in Jakarta and regional chapters in the provinces. The regional chapters are usually represented by local NGOs with a similar program interest. Examples of these types of NGOs include: the Indonesian Legal Aid Foundation (YLBHI), which provides legal aid and monitors human rights abuses; the Indonesian Environmental Forum (WALHI) and the Forest Conservation Network (SKEPHI), which focus on environmental advocacy and community rights and access to resources; and the International Forum for Indonesian Development (INFID), a network of national and international NGOs which monitor development programs in Indonesia. These NGOs often find themselves in an adversarial position vis-à-vis Government, given the nature of their activities.

• **Large Community Development Foundations:** Several have offices in Jakarta and work across Indonesia. They receive funds from a variety of sources including Government contracts, and income from businesses that they operate (printing, consultancy services). Examples of such NGOs include Bina Swadaya and LP3ES.

• **Local NGOs:** Local NGOs typically work in one province or district. They are often established by local university graduates or retired civil servants and focus primarily on community development and local advocacy issues. An example of a successful local NGO is the Foundation for Community Development in Irian Jaya (YPMD) which works closely with local government on health and community income generating programs as well as issues relating to land rights for local indigenous groups.

**International NGOs**

• International NGOs are well represented in Indonesia. Grants made by international NGOs to local groups must be approved by the Government.

In some cases the international NGO negotiates a memorandum of cooperation directly with a specific line ministry.

• **Foundations Operating in Indonesia:** The Ford Foundation, Asia Foundation, and MacArthur Foundation give a range of grants to local environmental and advocacy NGOs, universities, and Government agencies.

• **International Conservation NGOs:** The Worldwide Fund for Nature (WWF), The Nature Conservancy (TNC), and Conservation International (CI) all have resident offices in Indonesia and work closely with the ministries of Forestry and Environment on biodiversity conservation.

• **Development-oriented NGOs:** CARE International, OXFAM, Save the Children, PACT, and PATH are some of the large development NGOs operating in Indonesia. These NGOs focus primarily on rural community development, health, and sanitation issues, with a strong geographical focus on eastern Indonesia.
KEY ISSUES
Key Issues

Poverty

Background

- Indonesia’s rapid and broad-based pattern of growth (an average rate of 4.2 percent per capita per annum, as compared to 1.4 percent for low- and middle-income economies) has had a spectacular effect on poverty reduction. In 1967, Indonesia’s per capita income was US$50, roughly half that of Bangladesh, India, or Nigeria. By 1993, Indonesia’s GNP per capita was (US$740), more than three times that of Bangladesh (US$220), and more than twice that of India (US$300) or Nigeria (US$300).
- In 1970, an estimated 60 percent of the population (about 70 million Indonesians) were living in absolute poverty. By 1990, the proportion of poor had declined to 20 percent (about 35 million people). Recent estimates indicate that the proportion of poor has now fallen to about 14 percent. Enormous improvements have also occurred in nutrition, life expectancy, and basic health and education.
- Despite this progress, Indonesia still has substantial numbers of poor people (some 26 million). Most of the poor are on Java; the Eastern Islands have fewer numbers but high concentrations of poverty. Increasingly, poverty in Indonesia is localized rather than widespread, by rural/urban residence, province, occupation, household size, age, gender, and other characteristics. The current Five Year Plan (Repelita VI) has set an ambitious target of reducing absolute poverty to about 6 percent of the population (12 million).
- A large number of EA3’s projects have poverty components. This is especially true of the urban, human resources, and agricultural development projects. EA3 is currently implementing a Village Infrastructure Project which is directly targeted to poor villages.

Key Issues

- There is a growing perception in Indonesia of an increased concentration of wealth. This is raising concerns that the pattern of growth that has emerged since the mid 1980s is leading to greater inequality of incomes between various social groups, such as workers and owners of capital; residents of Jakarta and others; and male and female workers.
- To further reduce absolute poverty, it is necessary not only to maintain broad-based growth (with special emphasis on human resource development) but also to:
  (a) target programs to reach the hard-core poor;
  (b) allow poor communities, households, and especially women to have a greater role in specifying the services they need; and
  (c) develop a workable agricultural growth strategy for the resource-poor outer islands.

Government Position

- The Government of Indonesia has already initiated an innovative program targeted to the poor: the INPRES Desa Teringgal (IDT) aims to channel US$600 million in grants to communities which have a high incidence of poverty. Notable features include the participation by beneficiaries in decisions about how to use project funds and the use of streamlined mechanisms to channel funds directly to targeted communities without going through traditional budget processes.
Key Issues

Gender

Background

- Compared to other Moslem countries, the position of women in Indonesia is fairly favorable. In general, education has not been segregated. Legally, the equality of men and women in Indonesia has been established without much struggle. Ingrained in the state philosophy, Pancasila, it is incorporated in the 1945 Constitution. Voting rights have been ensured through the ratification of the UN Convention on Political Rights of Women and the Convention on the Elimination of all Forms of Discrimination Against Women. The Government’s political commitment is expressed in the Guidelines of State Policy, GHBN, and the Five Year plans.

However, a wide gap still separates de jure from de facto discrimination against women in Indonesia, evident in:

- the low number of women in key political and bureaucratic decisionmaking bodies;
- occupational segregation, with a concentration of women in low-skilled, labor-intensive manufacturing sectors;
- substantially lower earnings of women relative to men; and
- the high maternal mortality rate.

Key Issues

- **Education:** Based on average national statistics, girls and boys have equal access to primary education, and there is not much gender inequality through the high school level. The Bank is designing a series of junior high school education projects at the provincial level which will take into account differences in girls' access in some parts of the country.

- **Health:** Indonesia’s maternal mortality rate of 450 per 100,000 live births is higher than that of countries with much lower per capita incomes, such as India (420) or Pakistan (270). This is an important indicator of the overall low quality of health services available to Indonesian women. The Bank is currently preparing a Safe Motherhood and Family Development Project (US$115 million) to tackle the problem.

- **Wage Labor:** Women workers have been major beneficiaries of the recent expansion in employment opportunities in labor-intensive manufacturing in Indonesia: between 1986 and 1994, formal sector employment for female workers has grown at over seven percent per annum (compared with five percent for males); and between 1989 and 1994, real wages of female workers have grown at almost eight percent per annum (compared with five percent for males). However, new problems have emerged, including the poor working conditions of women workers in the industrial sector and the absence of effective workers' organizations that can provide workers with some negotiating power.

- **Agriculture and Natural Resource Management:** Agriculture accounts for almost half of all employment for women workers and there are 15 million female farmers (and 23 million male farmers) in Indonesia. Despite women’s central role in agriculture, they have had less access than men...
to essential resources such as extension, training, and credit. Two recently negotiated regional development projects (Nusa Tenggara Agricultural Area Development and Sulawesi Agriculture and Area Development) will have components, such as training sessions, specifically targeted to women.

- **Financial Services:** Only a quarter of working women in Indonesia are employed in the formal sector, with the rest in either agriculture or the informal sector. Limited access to credit is often a cause of low incomes in these sectors. The Bank plans to examine, through future work in the financial sector, whether there is a need to promote/support schemes and mechanisms for providing small-scale credit for microenterprises, which tend to primarily benefit women.
Key Issues

Education and Training

Background
In the past two decades, Indonesia has had considerable success in dealing with the “first generation” education problems of a developing country: (a) providing basic education to the majority of children, and (b) producing a critical mass of skilled workers and leaders to make the economy, society, and government function effectively. There is now virtually universal access to primary education, with 89 percent of children aged 7-12 in primary school and a gross enrollment rate of 111 percent. Enrollment ratios in secondary and tertiary education (47 percent and 10 percent) are comparable to those of countries with twice Indonesia’s income per capita. Adult illiteracy has been reduced to 23 percent. Pre-employment and in-service training imparts additional skills to more than one and a half million workers annually. Moreover, the country has reaped the benefits of having a literate population: reductions in fertility, better nutrition and health status, improved farm productivity, labor mobility, and higher incomes for the poor. Despite these achievements, the quality of education in Indonesia leaves much to be desired, especially when compared to East Asian countries. Proportionately fewer Indonesian students have the background to go abroad for higher education.

Key Issues
Notwithstanding the progress achieved so far, the education and training sector faces several formidable challenges in the medium to long term:

- **Increasing retention and access of the poor to quality primary education.** The 11 percent of children aged 7-12 not in primary school are mainly from low-income groups in rural areas outside Java and are not as easily reached as the other 89 percent. The high private cost of schooling, late start of school, distances to school, and understaffing of many rural and remote schools all contribute to low retention.

- **Expansion of basic education to include three years of junior secondary.** The Government intends to universalize nine years of education over the next 15 years. This will require large investments in facilities, textbooks, upgrading of quality of teachers, and other inputs. The task of reaching potential students from low-income, rural, and remote areas is likely to be more difficult than it was for primary education.

- **Development of a coherent framework for a large and differentiated higher education system.** Indonesia today has 51 public and more than 1,000 private institutions of higher education. The role of the public sector is changing, moving away from micro-level planning and management towards setting broad sector policies and monitoring sector performance.

- **Redefinition of the role of government in providing and financing training.** The private training system has been expanding rapidly in the past decade, yet the public sector still is heavily involved in providing pre-employment training. Such publicly provided training has high costs, is often unrelated to employer (supply-driven) needs, and crowds out potential private-sector initiatives.

- **Decentralization and regional implementation.** It will now be necessary to decentralize planning and implementation so that the country’s regions can deal with the specific problems they face in an appropriate way.
**Government Position**

Government has a broad human resource development agenda featuring inter alia: improvements in the quality of, and access to, basic and higher education; capacity building in relatively less-developed areas (off-Java); and enhancement of skills to support a transition to an industrial and technologically sophisticated economy in the 21st century.

In education, government intends to do the following:

- **Target the poor and disadvantaged areas** through special strategies to ensure that: (i) all children have access to begin primary school at an appropriate age and (ii) parents understand the benefits of and returns to education.

- **Reduce drop-out and repetition in primary education** by improving the quality of education through training and better distribution of teachers, supply of textbooks and other teaching materials, and increasing the involvement of parents and the community.

- **Expand the supply of junior-secondary education** through provision and quality improvement of facilities, teachers, and supplies, abolishing fees, providing incentives to poor youths and their parents to attend school and continuing policies which generate a broad-based increase in average income levels.

- **Improve the quality of higher education**, both public and private institutions.

- **Maintain adequate levels of government spending** on education and training.

- **Build capacity at the regional levels of management of the education system**, to enable a more decentralized system to function effectively.

In the area of training:

- Government is experimenting with several schemes, including the dual-track apprenticeship scheme popular in Germany. Support for training activities is being received from many sources, including Germany and Korea.

**The Bank’s Position**

The Bank’s strategy for assisting the education and training sector in Indonesia includes:

(a) **In the Basic Education Subsector:**

- Help expand access to junior secondary schooling, particularly for the rural poor (provincial secondary education projects).

- Reduce drop-out and repetition in primary school through quality interventions.

- Encourage Government to maintain overall resource envelope for education, particularly primary education.

(b) **In the Higher Education Subsector:**

- Enhance the contribution of public higher education to economic development through higher quality and more relevant teaching and research.

(c) **In the Training and Skills Development Subsector:**

- Encourage the Government to move from providing skills training directly towards facilitating the efficient functioning of the private training sector.
Key Issues

Labor

Background

• There is a growing concern among policymakers in Indonesia that labor has not shared in economic growth. This concern is fueled by the perception of an increased concentration of wealth in a few monopolies and oligopolies, resulting in a widening of Indonesia’s social gap; and expressions of dissatisfaction from workers themselves, in the form of strikes and other industrial action.

• The Government has responded by taking a much more interventionist stance in the labor market, in terms of setting wages and benefits. It has:
  - increased minimum wages sharply;
  - passed an all-encompassing social security law that provides health insurance, life insurance, accident insurance, and pension benefits to all workers; and
  - passed a ruling that compels companies to pay their workers a 13th month of salary each year.

Key Issues

• Workers in Indonesia have made steady progress over the past decade and have shared in the benefits of Indonesia’s growth through sustained increase in wage employment (6 percent p.a. since 1986), and remove earnings (6 percent p.a. since 1989).

• Female workers have benefited from increased employment opportunities in labor-intensive manufacturing such as textiles, garments, and footwear.

• The benefits of growth have been spread widely over workers of different levels of education and in different regions of Indonesia.

• Even though the legal system provides for the right to form unions, it is not easy to set up a union in Indonesia. There is only one legally recognized union in the private sector — the SPSI (All Indonesia Workers Union), essentially a tightly controlled Government institution.

• Since the mid 1980s, there has been very rapid urbanization, industrialization, and formalization of the workforce; rising levels of education of workers; and signs of tightening labor markets in pockets of the country. These factors are leading to a growing demand for free trade unions to negotiate higher wages and better working conditions.

• Estimates of child labor in Indonesia range from about 2-3 million, small numbers by Asian standards; the overall number declined by 25 percent between 1986 and 1994, but the percentage working in urban areas doubled. Problems of children working extremely long hours for low wages in export-oriented, labor-intensive manufacturing have begun to receive widespread attention by some NGOs and donors in Indonesia and in the national press.
Key Issues

Urban Environmental Management and Industrial Pollution

Background

- The urban population is growing at 6 percent per year; by 2020, half the population may live in cities.
- Industrial output has expanded 8-fold since 1970 and is likely to expand another 13-fold by 2020, with most growth on Java.
- The pollution control agency is BAPEDAL; the Bank has been continuously associated with it since its creation in 1990; RSI manages the $17 million BAPEDAL Development Technical Assistance Project.

Key Issues

- **Air quality.** While industrial sources need attention, the most pressing problem is pollution from the rapidly increasing number of motor vehicles. Particulates and lead are the worst pollutants.

- **Solid waste management.** Most is improperly disposed of (open burning and uncontrolled dumps, causing air and groundwater pollution and disease). Uncollected waste is dumped in drains and waterways. An active, informal scavenger industry recycles paper, plastics, glass, and metals.

- **Water quality.** Surface waters in cities are highly polluted. Groundwater is contaminated by bacteria and nutrients from septic tanks, posing health risks to the many users of wells. Most cities do not have wastewater collection and treatment systems. Piped and groundwater supplies are unreliable and unsafe without boiling, and many urban poor do not have access to public supply.

Government Position

- **Air quality.** The “Blue Skies” program was initiated several years ago, but so far there has been little action on industrial sources or vehicles. Unleaded fuel has been discussed, but only a token amount is available in Jakarta.

- **Solid waste management.** Private sector participation is being encouraged. Progressive cities such as Surabaya have enhanced the status of scavengers to take full advantage of their valuable services. Annual “ADIPURA” awards to the cleanest cities are main GOI instrument to promote improved performance.

- **Water quality.** Public works investment policies give high priority to water supply, low priority to sewage treatment, rely primarily on septic systems.

- GOI plans to: extend PROKASIH (clean rivers program) to all provinces; expand newly developed PROPER program, monitoring pollution control of plants; strengthen BAPEDAL’s legislative basis for enforcement action and begin prosecuting violators; and expand cleaner production technology program.

World Bank Position

- **Air quality.** President should issue an order to switch to unleaded gasoline and low-sulfur diesel fuels; establish stricter emission standards for motor vehicles; implement motor vehicle inspection and maintenance program; and improve urban land use planning and control, traffic management, public transit systems.
• **Solid waste.** There should be a rational SW management planning process that allows for maximum private sector and informal sector (scavenger) participation.

• **Water quality.** The country needs to improve availability of safe water supply: expand systems, reduce leakage, improve O&M, support with proper cost recovery; improve septic system maintenance and sludge disposal, and begin to install cost-effective sewage collection and treatment systems where septic systems are ineffective; require large, new land developments to provide acceptable sanitation systems; and for industry, develop credible industrial wastewater discharge permit, monitoring and enforcement process, using economic instruments, public information, and public pressure.
Key Issues

Natural Resources Management and Conservation

Background

- Basic Law for Management of Living Environment enacted in 1982, one of the first in a developing country.
- State Ministry for Environment (MLH), established in 1983 as a policy-setting/coordination body.
- Environmental impact assessment (AMDAL) implemented in 1986, BAPEDAL (similar to US EPA) created in 1990.
- Other key agencies in natural resource management and conservation are: BAPPENAS; ministries of Agriculture, Forestry, Public Works; and Mines and Energy; Land Management Agency (BPN); National Institute of Sciences (LIPI); and Technology Assessment Agency (BPPT).

Key Issues

- **Land use** — encroachment of landless farmers into upland forests; conversion of coastal wetlands to agriculture; industrial expansion and urban sprawl around existing centers.
- **Forests** — Indonesia contains about 110 million hectares of “closed canopy” forest, including 10 percent of world’s remaining tropical rainforest. Approximately 60 million ha are designated as production forests, and GOI has granted more than 500 logging concessions. Regulations exist, but poor logging practices, agricultural conversion, and opening of new areas by logging roads contribute to annual forest cover loss of between 300,000 and 1.3 million ha.
- **Water resources** — emerging conflicts between competing water uses (agriculture, industrial, and municipal) and overuse of groundwater in urban areas, especially on Java. Unsafe water supply, poor sanitation, and flooding are serious urban problems.
- **Biodiversity** — Indonesia has a Biodiversity Action Plan which sets out a strategy for biodiversity conservation. Major issues are competing land use from mining, logging, agricultural conversion, and coastal tourism development and weak enforcement of existing conservation regulations.
- **Energy** — shift from oil exporter to importer expected as soon as 2000.

Government Position

- **Land Use** — Most basic policies in place. GOI agrees with Bank that institutions are weak and implementation is only beginning.
- **Forests** — GOI has prepared Tropical Forest Action Plan and declared intention to achieve sustainably managed forests by 2000. GOI has supported the establishment of an independent Ecolabeling Foundation for voluntary labeling of forest concessions and products. GOI is also encouraging the development of plantations, especially to meet demand for pulpwod.
- **Water Resources** — GOI is considering water management on an integrated river basin basis, including control of groundwater usage; few efforts have been successful. Only one true river basin authority exists, and it is weak. GOI has set aside 30 million ha of permanently protected forest to safeguard critical watersheds.
• **Biodiversity** — GOI has set aside 19 million ha as parks and reserves and proposed or designated 30 million ha as marine conservation areas.

**World Bank Position**

• **Land use** — improve efficiency in allocation by reducing and simplifying land regulations, expediting titling and registration, improving transparency and availability of land information, and relying wherever possible on public auctions to allocate public lands. Implement the recently improved processes for spatial planning and administration of land development. Improve agricultural research, extension, and design of farming systems to ensure that lands converted to agriculture can be used sustainably. Improve land policy through reform and implementation of basic agrarian and forest laws.

• **Forests** — Improve management of production forests by raising domestic log prices to international levels; changing duration of logging concessions; and making renewability conditioned on performance, intensifying research on sustainable logging and replanting practices, and strengthening enforcement of forest regulations. Ensure community participation in forest management decisionmaking. Combine conservation activities within protected areas with income-generating activities outside.

• **Water Resources** — Besides basin-wide management, implement improved pricing and cost-recovery policies for better demand-side management and funding of O&M and capital investments. Rationalize pricing structure and ensure that subsidies, where used, actually reach the poor.

• **Biodiversity** — Many critical ecosystems, such as commercially important lowland forests, are poorly represented in the protected area system. Insufficient numbers of trained staff, low budgets and lack of infrastructure constrain effective management. GOI should strengthen partnerships with NGOs, the private sector, and local communities to conserve biodiversity.

• **Energy** — Environmentally responsible fuel pricing, in the form of a pollution-based tax to cover the costs of environmental damage. Promote efficiency and pollution control in the transport, industrial, and power sectors. Enact regulatory measures to create a market for electric power, including removal of tariff subsidies and introduction of purchased power rates.
Key Issues

Land Acquisition and Resettlement

Background
Infrastructure projects mostly require land acquisition which affects and displaces people from project areas. In the past, a lot of the affected/displaced families did not receive sufficient compensation to find/buy a similar house/workplace on a new site. Land acquisition problems often delay project implementation and raise serious social and political issues.

Key Issues
- inadequate compensation (although there is already good progress).
- no resettlement option (they are beginning to work on it).
- people with no legal land status have received minimum/no compensation.
- insufficient information and consultation, nontransparent process.
- insufficient budget to cover land compensation.
- operational guidelines of Keppres 55 have not emphasized “real market value” compensation.

Government Position
- spending for compensation will slow down infrastructure development.
- providing higher compensation to squatters will invite thousands of them to settle on sites for urban infrastructure and other public land.
- those who are affected but not displaced will get high benefits from infrastructure investment (higher land value, better access, etc.).
- change/improvement should be introduced gradually.

World Bank Position
- the affected people should not be worse off after project implementation; there should be a policy and strategy going toward compensation; Keppres 55 should have clear operational guidelines to ensure fair compensation.
- all affected people recorded at the baseline survey are entitled to receive compensation for their lost assets; the level of compensation may vary.
- the benefits can be considered in the valuation, but should be determined through a fair, transparent, and rational process.
- the change/improvements may come about through gradual implementation, but a clear formal strategy should be defined and an action plan for the improvement should be available; all relevant agencies need to improve their procedures and technical guidelines.
- transparency is very important to improving the whole system.
Key Issues

Land Markets and Policy

Background
• 70 percent of land is designated state controlled land; including practically all forest land.
• Of the remaining 30 percent, only about 25 percent is registered, due to cumbersome procedures, unrealistic documentary requirements, and capacity problems with the responsible agency (BPN or the National Land Agency); 75 percent (including in many urban areas) is held under (insecure) customary land rights.
• The number and visibility of land disputes (mainly government/projects vs. the local population) is increasing, mainly because of insecurity of land tenure due to the low rate of registration.
• The Land Administration Project, cofinanced by the Bank and AusAID, has been under implementation since September 1994, mainly to accelerate land registration.
• Land can only be owned by Indonesian nationals; others get short (10-30 year) extendable leases.
• Land markets are heavily regulated (with about 2,000 land-related laws and regulations identified to date) and not very efficient.

Key Issues
• Low rate of land registration. Only 13 percent in East and West Java.
• Distorted land markets due to (a) insecure tenure, (b) unfair land acquisition mechanisms — location permits — that favor large developers/investors, and (c) underpricing of public land sold to investors for housing, industry, and tourism.
• Traditional communal lands/indigenous land rights are, in practice, not respected and are included in forest and mining concessions without consultation/compensation.
• Intransparent land use/spatial planning. The process of land use/spatial planning is not transparent, despite provisions of a 1994 law.
• Institutional inefficiencies and insufficient human resources in the National Land Agency.

Government Position
• All natural resources, including land, are a national asset and must be used for public benefit.
• Rising land price is mainly a result of speculation, and should be controlled by government regulations.
• Register all nonforest land within 25 years.
• Forest land will remain under GOI administration and no legal status will be given to indigenous communal land (at the most, limited use rights under community forest agreements with MoFr).
World Bank Position

- **Accelerate land registration** to provide the basis for functioning land markets.
- **Review land management policies**, in particular the location permit, exploring more equitable land acquisition options.
- **Implement the Law for Spatial Planning**, to increase transparency in land use planning. Legally recognize/protect indigenous communal land rights.
Key Issues

Legal Development

Background
Legal development in Indonesia has taken a back seat to the Government’s efforts to maintain economic growth. The legal system remains fragmented and outdated, consisting of customary law, remnants of colonial law, and more recent legislation. In recent years, a strong consensus on the need for extensive and responsive legal and institutional reform has emerged from society and the business community, in particular. As a response, GOI, for the first time ever, included a separate chapter dedicated to describing its legal reform policy in the 1994-98 Five-Year Development Plan (REPELITA VI). Under REPELITA VI, GOI would:

(a) develop a modern legal system and framework;
(b) improve the administration of justice;
(c) strengthen application and enforcement of laws;
(d) develop community-oriented legal aid services and extension programs; and
(e) strengthen legal infrastructure.

Key Issues
A successful legal reform program must:

(a) address institutional deficiencies of the current legal framework
   • develop technical skills and capabilities;
   • strengthen professional and ethical standards;
   • promote independence of the judiciary; review salary structure for judges.
   • improve dissemination of laws;
   • develop an appropriate legal framework through the modernization of civil and commercial codes dating from the 1800s, avoiding piecemeal reforms; and

(b) enhance confidence in the legal system and provision of justice
   • improve access to justice and equity;
   • enforce laws and contracts in a transparent manner;
   • curtail administrative discretion in the implementation of laws and regulations;
   • improve society’s trust of the legal/judiciary system.

Government Programs
Legal reform efforts are currently underway through the combined efforts of:

(a) BAPPENAS (National Planning Agency)
(b) EKKU-Wasbang (Coordinating Minister for Economics, Finance and Development Supervision, assisted by USAID), and
(c) BPHN (National Law Development Agency of the Department of Justice).

World Bank Assistance
An IDF grant is supporting GOI’s efforts to complete a thorough diagnostic assessment of the legal system and institutions, aimed at:

(a) preparing a strategy for human resource development in the legal field;
(b) assessing the capabilities of legal institutions and identifying more opportunities for community participation in legal development; and
(c) assessing the functioning of the judicial system and other means of dispute resolution, including measures to enhance the awareness of legal rights and responsibilities among the citizenry.
• The Land Mobilization Project provides GOI with technical assistance to improve land registration regulations and study customary land registration.

• Analytical work on commercial law done by the Bank in 1990 led to a USAID-sponsored technical assistance program.
Key Issues

Improving the Financial System

Background

- Indonesia’s financial system is market oriented and operates in the context of an open capital account; it remains undercapitalized and has large bad debts, particularly in the state banks.
- Rapid financial sector growth followed the massive financial deregulation of the late 1980s. Bad debts rose sharply, particularly in the state banks, when financial tightening occurred early in the 1990s. About 10 percent of bank assets (17 percent for state banks) are classified, mostly loans to well-connected citizens.
- The Government has improved supervision and prudential regulation in the 1990s and reduced bad debts in four of the state banks by about US$1.3 billion. The Bank has supported this program. With state banks’ lending restricted by poor portfolios and low capital, private banks have captured the majority of lending volume.
- Real interest rates are high, reflecting exchange rate and country risk. The differential between on- and off-shore US$ deposits is about 1 1/2 percentage points; deposit rates in local currency are about 8 percentage points above on-shore US$ deposits.
- The capital market’s development is in line with Indonesia’s per capita income. The main constraints to growth are not regulatory but high inflation, high risk premiums, poor financial accounting, and an inexperienced rating agency.
- There is no domestic government debt, owing to the longstanding balanced budget rule. The central bank issues debt which it uses to conduct open market operations.
- The new public pension scheme could help capital market development, but its treatment of contributors and its investment rules remain opaque.

Key Issue

- To improve the soundness of the financial system so that it can mobilize more saving and allocate those funds more effectively.

Government Position

- The Central Bank Governor and the Minister of Finance appear to believe that everything is under control and that progress—albeit slow—is being made in resolving the most important structural issues.

World Bank Position:

- Government is taking undue risks with a sector that would be among the first stressed in the event of economic crisis, owing to the country’s open capital account. To reduce risks, there is a need for:
  - President Soeharto’s active support to collect more bad debts, particularly those of the state banks.
  - the Central Bank’s stronger enforcement of its regulations regarding legal lending limits and capital adequacy;
- a shift in priorities for the use of public money towards closing bad banks rather than bailing them out;
- collection of more bad debts before bail-out is permitted; and
- increased capital requirements for nonforeign exchange banks.

- For capital market development, risk could be reduced by significantly lowering inflation; a stronger pension system should assist in raising local savings.
Key Issues

**Macroeconomic Stability**

**Background**
- The risk of macroeconomic instability is increasing. Consumption/construction-led boom has overheated the economy (rise in imports of 20 percent and inflation of 9 percent in 1995/96).
- The current account deficit doubled (to about 3.5 percent of GDP). Despite rising foreign direct investment, external borrowing was needed to finance deficit, adding to Indonesia's already large foreign debt.
- In the next few years, foreign investment projects are likely to generate large imports and private debt (assuming even a 80/20 debt-equity ratio), given the large volume of approved projects.

**Key Issues**
- To reduce the risk of sudden capital flight if foreign lenders and domestic depositors consider Indonesia's external position unsustainable. This would provoke a foreign exchange crisis, given Indonesia's modest international reserves and still weak banking system.
- The Government needs to reduce risk and make room for the new foreign investment by (a) tightening fiscal policy, and (b) reducing its own external debt.
- Prudent management of the external debt, especially the fast-growing private component.

**Government Position**
- The President's budget speech made overheating a major issue. However, he assigned monetary policy to cool overheating, and presented a looser budget than in 1995/96.
- The Government relates much of the import growth to foreign investment. Government considers the consumption/construction boom to be slowing and projects a sharp fall in import growth.

**World Bank Position**
- The Bank followed up President Soeharto's request to President Wolfensohn to help reduce overheating with package of recommendations to raise the fiscal surplus from 0.5 percent to 2.5 percent of GDP, and use it for debt prepayment. The IMF has made similar recommendations. This package put would Indonesia in line with Thailand and Malaysia's surpluses, and reduce the risk of loss of confidence.
- The higher fiscal surplus can be achieved by a combination of expenditure restraint and revenue enhancement, through such measures as: (a) reducing spending for telecommunications and power generation, (b) limiting the rate of growth in civil service wage and salary payments, (c) reducing debt service payments by prepaying high-interest debt from privatization proceeds, (d) increasing petroleum prices, electricity tariffs and forestry charges, and (e) raising property taxes and improving assessments.
- Keep monetary policy tight to increase international reserves. Strengthen monetary policy through further widening of Bank Indonesia's exchange rate intervention band.
Key Issues

Trade and Foreign Investment Policy

Background

- Indonesia has a fairly open trade and foreign investment regime, but recent ad hoc decisions have called into question this policy direction.

- Presidential Ruling (PP) 20 of May 1994 allowed investment in most industries without export requirements or a local partner. Other industries are open to joint ventures with a local partner; divestiture is required, but only as agreed to by the parties. De facto, a local partner is needed to maneuver through the bureaucracy. Press, strategic industries, and wholesaling/retailing are the main closed sectors, although retail franchises exist.

- The May 1995 deregulation package cut the average tariff to 15 percent (similar to Malaysia), and set up a schedule to reach a 7 percent average tariff by 2003. This package followed up APEC’s Bogor Declaration (1994) of “open” regionalism that President Soeharto and his team pushed through. The January deregulation package cut average tariffs by another 1 percent.

- Recent decisions (e.g., a favorable tax/tariff regime for joint venture between one of the President’s sons and Kia of Korea to produce a “national car,” a tariff surcharge to protect a petrochemical plant in which another son is involved) have gone against the now “rules-based” approach.

Key Issues

- The unfinished trade agenda consists of nontariff barriers in agricultural trade, export restrictions on primary commodities, and high protection for cars and strategic industries.

- Infrastructure concessions to joint foreign/local ventures have shown a high degree of favoritism, nontransparency, and uncompetitiveness.

Government Position

- Nontariff barriers in agriculture are part of the state trading company’s (Bulog’s) management of agricultural trade; barriers to trade in soybeans, meat, and dairy products will be lifted under GATT/WTO Uruguay Round agreements.

- Export restrictions promote higher value added industries (e.g. plywood instead of logs), regulate domestic supplies, conserve natural resources, and raise export quality.

- Development requires a “national car” and strategic industries (for example, planes and ships).

World Bank Position

- Carry out the scheduled tariff cuts with no back-tracking; the rules-based approach is a sound framework for ensuring efficient investment.

- Eliminate nontariff barriers in wheat, sugar, rice, and soybean products (and deregulate local production) to improve efficiency and cut the cost of food, helping the poor.

- Eliminate export restrictions, improving efficiency and benefiting agricultural producers off Java. The most important case is forestry, where the setup generates huge profits for the favored cartel of plywood producers. Replace the ban on log exports and the cartelization of plywood exports with (a) a higher fee per cut log to compensate for the reduction in national wealth, and (b) competitive auctions of concessions under a performance bond to improve sustainability of forestry (forestry-based exports are already slowing in volume terms).
Key Issues

External Debt

Background

• Total external debt: estimated at more than $100 billion, with public debt $62 billion at end-1995.
  Debt service-to-export ratio: 31 percent. The Bank's Debt Tables classify Indonesia as “moderately” indebted. Fifty percent of medium and long-term debt, including multilateral debt, is linked to the yen.

• Indonesia’s S&P rating is BBB; Moody’s is Baa3. Indonesian borrowers can access 5-7 year commercial loans at 100-300 basis points over LIBOR, depending on the borrower.

• Almost all public external debt is owed by the central Government. External borrowing for public enterprises typically is done by the Government and on-lent to the enterprise; guarantees are few. (Recent exceptions: guarantees to state banks and the national airline, and gas facilities that are guaranteed by export receipts.)

• The Commercial Offshore Loan Team (COLT, or BKPN in Indonesian) has restrained offshore borrowing since its formation in October 1991, public borrowing more effectively than private borrowing. In addition, prudential regulations limit the offshore borrowing of commercial banks.

• Indonesia prepaid about $1.5 billion of high interest IBRD and ADB debt in 1994-95, using offshore privatization proceeds.

• Indonesia’s open capital account has allowed foreign investors play a large role in the capital market and hold bank accounts; this role is understated in the external debt estimates.

Key Issues

• Reduce public debt with public sector surpluses and privatization revenues.

• Ensure productive use of borrowing by public enterprises and quasi-public projects.

• Avoid excessive guarantees

Government Position

• The Finance Ministry is against guarantees of private debt, since Indonesia has established a track record of sound macroeconomic policy and debt repayment over the last 25 years. Guarantees would call into question that record and be difficult to manage, in terms of who receives the guarantees and maintenance of incentives for project performance.

• Government wants to renew COLT, especially to handle public borrowing and contain borrowing for mega-projects that are import intensive and may not be internationally competitive.

World Bank Position

• Government should increase fiscal surpluses and reduce external debt, as promised in the President’s budget speech; it should continue to use privatization revenues to reduce debt. This would reduce risk and create room for the private sector.

• Government should clearly distinguish between private and public debt. It should exercise great care in extending guarantees. Any guarantees of debt for concessions should be provided up front. The status of debt of the partially privatized enterprises needs clarification.
• COLT should be strengthened for the public sector firms but reduced for the private sector firms, except those with contingent public liabilities. COLT is a blunt instrument, but it is perhaps even more necessary today, now that more public enterprises, including partially privatized firms, are being allowed to borrow offshore more independently.
Key Issues

Privatization

Background

• In 1995, the public enterprise (PE) sector comprised about 180 firms across all sectors, accounting for 15 percent of GDP; with assets (book) of about US$140 billion and employment of 1.14 million (1.4 percent of the labor force).

• While privatization has been on the agenda since 1989, meaningful actions have been taken only over the last two years through partial divestiture of state-owned firms in the telecommunications (P.T. Telkoms and P.T. Intelsat) and tin mining (P.T. Tambang Timah) sectors, and private/public joint operating schemes for the development of basic telecom services.

Key Issues

• PEs are performing poorly; average financial returns are barely half those of private companies.

• The privatization process is widely perceived as nontransparent, with continuing rumors of favoritism and post-contract negotiations, notably in the IPO of PT Telkom.

• Selection criteria for divestiture to date have emphasized revenues and speed rather than competition and efficiency.

• Ad hoc arrangements for preparation and implementation prevent full realization of the potential benefits of privatization.

• The President seems to aim for a faster privatization program than what the administration considers feasible to deliver, in part out of concern that vested interests may extract rents.

Government Position

• Announced plans to privatize five companies - PT Krakatau Steel, Bank Negara Indonesia, PT Jasa Marga (toll roads), and PLN (electricity).

• Has decided on a general formula for IPOs of 25 percent divestiture of Government shares (international offering) and 10 percent dilution (domestic offering), with revenues from international offering earmarked for public debt reduction.

• Has asked for Bank Group advice in implementing the privatization program.

World Bank Position

• Has strongly advocated privatization as an instrument not only for debt reduction but also for improved efficiency and competitiveness.

• Responded to the President’s request for technical assistance by collaborating with MOF in:
  - making suitable institutional arrangements for an accelerated privatization program;
  - establishing clear and transparent procedures for using privatization advisors/underwriters and for defining technical aspects of sales;
  - identifying key sector/corporate issues that need to be addressed for successful privatization of identified candidate companies;
  - developing a broader list of potential candidates for privatization with recommendations for addressing pertinent constraints.
• After an initial hiatus, a constructive working relationship has been established with MOF. The first phase of the technical assistance has been completed with submission of technical papers on the various key issues. An IDF grant is being processed to provide MOF with requisite in-house expertise and training.

• IFC's Corporate Finance Services Group has been in discussion with state-owned companies, including PLN and the Hotel Indonesia Group, regarding provision of advisory services, and with the Ministry of Transport and Communication on privatization of four ports and Garuda Airlines.
Key Issues

Private Provision of Infrastructure

Background

- Investments of about $45 billion (about 6 percent of GDP) in infrastructure are needed during 1995/98 to sustain rising living standards and enhance Indonesia's international competitiveness. Private financing is expected to account for over one third of investment requirements.
- Public enterprises have held monopoly positions in virtually all infrastructure sectors until recently. They have expanded infrastructure at one of the world’s most rapid rates in 1970-90, but are unlikely to meet future demand and service quality requirements.
- Infrastructure provision in Indonesia is generally characterized by high-cost contracts, capacity imbalances, inadequate maintenance, and service deficiencies.

Key Issues

- Mobilization of private financing in most infrastructure subsectors has been slow and costly due to negotiated deal-by-deal approaches and pass-through of cost overruns.
- With the exception of telecom, the Government has not yet established a clear market structure and effective regulatory oversight in infrastructure. The Government's decision to maintain uniform infrastructure service prices throughout Indonesia effectively rules out cost-based pricing and complicates unbundling and divestiture of public utilities.
- Infrastructure tariffs — except in telecom — are not sufficient to generate attractive rates of return or even to cover costs. This poses a problem for private sector entry.

Government Position

- Committed to private sector entry into infrastructure provision. Has lead role within APEC for public-private sector dialogue in infrastructure;
- Displays high tolerance for rent extraction and for regulatory and legal ambiguity;
- Now looking into possibilities for mitigating private investor uncertainty and risk except for sovereign guarantees for private infrastructure deals.
- Has established high-level Steering Committee to promote cross-sectoral arrangements for private concessions to provide infrastructure services.

World Bank Position

- Developed frameworks for private participation in all infrastructure sectors and assisted selectively in preparing concession contracts and evaluation of bids.
- Has played a decisive role in the process of awarding concessions to five international consortia under joint operating schemes, with PT Telkom as a passive partner. Transparent rules were adhered to and the award was competitive. The international investor community has given Indonesia high marks in this case.
- Made specific recommendations on cross-sectoral regulations for awarding infrastructure concessions.
- The Government hosted a high-level Bank conference on the "Frontiers of the Public-Private Interface in East Asian Infrastructure" in September 1996 in Jakarta. Among the issues discussed were: why are so few deals finalized; why are transaction costs high; what are the real prospects for private infrastructure financing; what steps are needed to revive the momentum.
Key Issues

Strategic Industries and Competitiveness/Comparative Advantage Debate

Background:

- Minister Habibie’s “technologist” view is that his strategic industries will improve competitiveness through technology upgrading. “Promoting high value added manufacturing and high technology industries won’t bring high growth in the short run...but in the long run national interest will be well served because national development will no longer be determined by the international division of labor.”

- IPTN, the most notable strategic industry, has produced a passenger plane used in Indonesia and sold a broad (often in counter trade but perhaps not used), flew a prototype turbo prop in August, and plans a jet. President Soeharto just established a firm to raise funds for the jet.

- Other major strategic industries include shipbuilding, which is heavily protected, and Krakatau Steel, which was protected and still enjoys subsidized gas inputs, but which is now slated for privatization.

- Minister Habibie also is pressing for nuclear power, on technological transfer as well as cost grounds; numerous industrial countries are trying to sell it.

- Although the “technologists” claim that the strategic industries are profitable, the ten strategic firms account for half of the losses in Indonesia’s state enterprises. True losses are probably much larger since many of the sales are counter-trade, and with Minister Habibie handling military procurement, losses can be covered up easily.

Issue: How Best to Promote Technology Development in an Open Economy?

- Should growth be based solely on comparative advantage that changes over time in line with growth in capital and human resources and in foreign investment? Or should there be leapfrogging into high tech using a technology cadre? (India may be an example of the results of leapfrogging; India has nuclear weapons and rockets, but many more illiterates and much poorer performance than Indonesia.)

Government Position: Divided but Habibie’s Influence is increasing.

- President Soeharto’s good relations with Minister Habibie go back many years; the President treats him as favorite son and has backed the IPTN planes to the hilt. He probably thinks that Minister Habibie will protect his children.

- Minister Habibie’s arguments appeal to the President, nationalists, and a number of “technologist” proteges throughout the Government. The latter are typically engineers without much faith in the market, who generally favor an interventionist strategy.

- The army is generally anti-Habibie, in part because of his control over procurement, but Habibie supporters and nationalists have recently gained ground in the army.

- The economics team is anti-Habibie (confusingly, the economists are known as “technocrats”). They favor an open economy and the comparative advantage approach.

- The economics team enjoyed the Finance Minister's refusal to increase the money budgeted for Minister Habibie’s purchase of the East German navy but the President ordered the money to be paid out of the reforestation fund (a suit against this is in the courts) and closed three publications that supported the Finance Minister.
World Bank Position

- The Bank supports the economists. (the *East Asia Miracle* box “Indonesia’s Turbulent Leap into High Technology” was negative on the strategic industries, and was perhaps the most-read piece ever done by the Bank).
- The strategic industries have wasted substantial capital and human resources. They have had minimal technological spillover into the rest of the economy; they and all the personnel they have trained remain a closed circle.
- The protection afforded the strategic industries has been costly to the rest of the economy, for example, it hits the Eastern Islands by raising inter-Indonesia shipping and airline costs substantially.
- The Bank supports high tech, provided it is privately funded. If it is publicly funded, the costs should be accounted for in the budget, including any subsidies, instead of a nontransparent protection.

Note

- The “technologist-technocrat” debate is highly charged, even the use of certain words.
- The President supports the planes strongly. Little can probably be gained by raising the issue again, except to say that the Bank is worried about the costs and nontransparency of the project.
- Nuclear power is still an issue, and the Bank’s worries over costs and environmental issues could be raised. Even Japan is reconsidering nuclear power after its recent accident. Great care will be needed in the Indonesia context to ensure that the purchased technology is not outmoded and that its location on densely populated, earthquake-prone Java is safe.
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