Statement by Todd Crawford
Date of Meeting: January 30, 2001

Indonesia Country Assistance Strategy

1. We commend staff on their frank assessment of the risks and uncertain prospects for Indonesia's macroeconomic stability. The candor and quality of this document set a benchmark for future Country assistance Strategies. In the case of Indonesia, conditionality should be quantifiable and oriented toward achieving a manageable public debt burden, and we strongly agree with the Strategy's "up-front conditions", focused on fiscal sustainability, for lending scenarios. Thus we welcome the fact that the excellent analysis in this CAS will be made public. We would be pleased for the Indonesian authorities to take ownership over a mixture of policies that they feel are right for Indonesia, as long as that mixture is consistent with well-controlled debt, sustainable growth and poverty reduction.

2. We want to continue to support Indonesia in its political and economic transition, but, to be frank, Indonesia's consistently poor results in implementation of its IMF-led reform program have led us to the conclusion that we will not support significant new lending to Indonesia unless we see major progress in mitigating risks, particularly through accelerated privatization of assets, banks, and other state-owned enterprises (SOEs). The authorities have not taken advantage of the return to growth to press ahead with needed reforms. We are concerned at how close Indonesia is to the "crisis scenario" described in the CAS.

3. Without a doubt, Indonesia's achievement of low inflation and a return to positive growth in 1999-2000 deserves applause. But it is no cause for complacency: the 100% of GDP public debt burden is fraught with risks. Expectations of uncontrolled public debt and another economic contraction could easily become immediately self-fulfilling. As the CAS says, "major policy slippage, including inadequate progress on bank and corporate restructuring," could knock the IMF program off-track, leading to the "crisis scenario".

4. It is alarming that major slippages have already emerged -- the Indonesian authorities missed a key IMF commitment to fully privatize two intervened banks by end-December. We insist that the base-case scenario must go hand in hand with an on-track IMF program. It is also worth noting that the next annual phase of Indonesia's Paris Club Agreement, scheduled to go into effect in the spring, is contingent on the IMF's program remaining on track.
5. We share the concerns about threats to fiscal sustainability, outlined in the CAS -- in particular:

- **IBRA asset sales and SOE privatization.** We are concerned that the Indonesian authorities do not appear to have a credible strategy for meeting their own 2001 revenue target for IBRA asset sales and SOE privatization. We agree with staff that accelerated sales should be set in the context of a reasonable set of principles guiding transparency of asset restructuring and sales -- such as independent review and public disclosure of restructuring terms.

- **Privatization of banks.** Despite repeated commitments, Indonesia has failed to sell a controlling stake in a single bank to private investors. We are particularly concerned about the health of the huge state-owned Bank Mandiri.

- **Decentralization** has the potential for enormous benefits, but also carries threats to fiscal discipline.

We share the concerns set out in Mr. Passacantando’s statement regarding the need to maintain and adequately finance a World Bank presence in the financial sector in Indonesia.

6. Our concerns are heightened by other recent actions. For example, Bank Indonesia’s tightening of regulations on foreign exchange trading is a definite step in the wrong direction.

7. Governance is indeed the weak link. The task of governance reform and combating widespread corruption is huge, the actions taken small, and commitment seemingly weak. Indonesia is near the bottom in surveys on rule of law, corruption, and business environment, all of which seriously impede equitable growth. We support the Strategy’s time-bound benchmarks for Indonesia to produce a governance strategy, reform the legal and judicial systems, reform the civil service, and improve procurement and financial management. We strongly urge Indonesia to work with its IFI partners to achieve real reform in this area.

8. The closing of the Social Safety Net Adjustment Loan presents an opportunity to distill lessons learned on governance and participation of civil society, which are critical for the success of Indonesia’s poverty programs. These lessons will be very useful in developing new poverty-oriented projects which are indicative in the program under the high case scenario.

9. We understand that Indonesia and MIGA may be close to reaching agreement on the power project claim. If this is true, we welcome it and if not, we urge resolution as soon as possible. Resolution of such cases will certainly help restore investor confidence.

10. Specific issues that are important to the success of the Bank’s program and of particular concern to the U.S. include:

- **Fiduciary controls and budget transparency:** We appreciate the attention paid in the CAS to
core fiduciary controls -- audit, procurement and financial management. The procurement system in Indonesia needs to move towards a market-driven system based on internationally accepted principles. We agree that the decentralization program raises new risks of corruption, and it remains unclear what minimum standard of national fiduciary controls the Bank intends to promote (in the base case). This is particularly important given the intention for significant sub-national lending. We do not want to see fiduciary policies harmonized, across regions, to the lowest common denominator.

- We are pleased that the critical fiduciary diagnostic work for procurement (CPAR) is now available. We have just received the diagnostic work for financial management -- the Country Financial Accountability Assessment (CFAA). We are pleased that the CFAA candidly discusses current deficiencies in public sector auditing and recommends improvements in a time-bound action plan. In the future, we believe key analyses such as the CPAR and CFAA should be widely circulated before the CAS discussion.

- More broadly, the Indonesian authorities need to improve fiscal transparency, which will allow for a better understanding of the overall composition and accountability of public spending and highlight the relative neglect of anti-poverty and development expenditures. In this regard, we urge the government to honor its commitment to audit and report all sources of finance, including off-budget military revenue. Action on this front will continue to be a key determinant of U.S. support in the IFIs.

- Anti-money laundering actions: A focus on money laundering issues is increasingly important for all countries. Money laundering has the potential to derail economic growth, stunt the development of capital markets, and weaken the rule of law. To begin to alleviate such concerns, we strongly encourage Indonesia to put in place appropriate anti-money laundering regimes as a necessary step to achieving greater economic prosperity. We understand that Indonesia has draft anti-money laundering legislation and would be interested in an update on its status.

- Labor: We appreciate the discussion on labor issues, which we asked for as part of the Bank's IDA-12 commitments, and the CAS greatly benefits from the inclusion of labor groups in the consultation process. It is important that there be effective coordination on policy advice among the different international institutions, including the ILO, which has a strong presence in Indonesia. We stress the importance of developing an effective legal and institutional framework of labor relations that ensures the expeditious and equitable resolution of individual and collective labor disputes. The enactment of proposed labor legislation would be an important step in this regard; oversight and implementation are equally important.

11. We appreciate the extent to which this CAS addresses the concerns and shortcomings we and other Board members outlined at the discussion of the CAS Progress Report in 1999. It prioritizes necessary reforms and incorporates their progress into the CAS matrix. It integrates the lessons of the OED CAN into the CAS design and lending program, including proposed instruments, use of prior conditions, monitoring mechanisms and a comprehensive
AAA program to inform and appropriate structure operations. It incorporates a progressive approach to participation of civil society in the planning and monitoring of Bank programs, including specific reference in the CAS to stated priorities of civil society and the areas of disagreement by the Bank. And it incorporates important cross-cutting sectors such as environment and labor into the overall policy dialogue.