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### Indonesia: Country Assistance Strategy

#### Indonesia in Transition

1. Indonesia is now under transition in various areas, including political, economic, and social dimensions. Firstly, in the political and social sphere, Indonesia is in the process of moving towards a democratic society. Secondly, in the economic area, while Indonesia made some progress on the recovery from crisis, in order to materialize sustainable growth, Indonesia has still to tackle important policy issues such as financial and corporate restructuring and fiscal sustainability. Thirdly, as cross-cutting issues related to political, economical and social spheres, Indonesia needs a successful implementation of its ambitious decentralization program.

2. Facing these many difficult challenges during the transition period, the current democratic government has made tremendous efforts and achieved considerable results in a short period. We highly appreciate these achievements. On the other hand, we cannot deny the fact that there are uncertainties and risks for the future of Indonesia.

#### Bank's Continuing Engagement is Important

3. The stability of Indonesia is important for securing the stability of East Asia and the world. The international community is required to support reform efforts by a democratic Indonesian government in the medium to long-term perspective, putting political, economical and social stability as the top priority. A democratically chosen Indonesian government faces a large policy agenda, including macro-economic stability structural reform, poverty reduction, and mid-to-long-term development. As Paragraph 25 points out, although the challenges are enormous, "there is also a real possibility that from this process of muddling through will emerge enough momentum around subset of reforms that it will be possible to lay foundation for a more sustained development effort. Indeed the challenge for Indonesia's development partners will be to encourage and to help bring about this latter outcome."(emphasis added.) The Bank has played an important role in Indonesian development process, not the least as Chairman of Consultative Group for Indonesia. The Bank's role continues to be extremely important for tackling future issues.

As one of the major long-term development partners, the Bank should maintain its broad and deep engagement and continue to support Indonesia's policy reform in an active manner. In this regard, we welcome this opportunity to discuss the CAS for Indonesia in which the Bank formulates its strategy to support Indonesia to manage considerable risks coming from large uncertainties and achieve sustainable economic recovery and balanced mid-term development.

### Broad-Based Growth is Key

4. The CAS sets the Bank's three priority areas to achieve the overarching goal of poverty reduction as follows:

- Sustaining economic recovery and promoting broad-based growth;
- Building national institutions for accountable government;
- Delivering better public services for the poor.

We agree that these three priority areas are important. We, however, think that the highest priority should be given to "Sustaining economic recovery and promoting broad-based growth" because growth is a necessary condition for poverty reduction; and institution building, which is inherently related to political, economic, social and cultural dimensions, cannot be accomplished within a short period of time. Given the large debt burden, it is important to maintain fiscal sustainability and assure graduation from the Paris Club rescheduling at the end of March 2002. The reform in the other two priority areas has to be carried out steadily with a medium-term perspective, and resorting to impatient solutions. In connection with this, we welcome the Bank's willingness to support capacity building of local governments for decentralization, based on its comparative advantage.

### Specific Comments

5. The CAS shows Base case, High case and Crisis case scenarios. We want to make 7 comments.

We agree with Paragraph 25 which states that the challenge for Indonesia's development partners will be to encourage and help bring about enough momentum around reforms that will lead to more sustained reform efforts.

Given the uncertainty in Indonesia, the Bank has to respond to changing circumstances flexibly.

Lending level under the Base case scenario is less than one third of the pre-crisis level. Considering the poverty situation in Indonesia, this low level of the Bank's support is not sufficient. The Bank, as a major long-term development partner, has to be flexible and should consider adjustment loans, if necessary, to avoid "disassociate[ing] itself as the country moves through its historic democratic transition (Paragraph 58)."

Although the Indonesian economy has hit bottom, poverty is still deep. As the CAS mentioned in Paragraph 24, the role of IDA lending is important either in the base case or the high case, we should consider increasing IDA lending for Indonesia if needed.

Regarding the Bank's exposure, the Bank's net disbursement turns negative in FY 2002 and thereafter. As previously pointed out, Indonesia's poverty situation requires the Bank's continuing support and we do not believe it is appropriate that the Bank rapidly change its net disbursement toward the negative. Furthermore, considering that repayment to bilateral creditors restarts in April 2002 following completion of bilateral rescheduling in March 2002, we doubt whether the Bank's rapid negative net disbursement is sustainable.

Structural conditionality has to be realistic and prioritized based on the Indonesian political, economic, and social situation. Especially when we set result-oriented and numerical targets, it has to be controllable by Indonesian authorities. We should avoid, as far as possible, choosing benchmarks that are not under control of the authorities, even though active efforts for pursuing those issues are important. If these uncontrollable items are set as benchmarks and authorities cannot meet those benchmarks despite their efforts, we should take into consideration these circumstances. In this respect, triggers for the high case scenario includes IBRA cash recovery and receipts from privatization plans. Although these figures are projected in the FY01 budget, we urge the Bank to take into account the above-mentioned considerations when it reviews these benchmarks.

Paragraph 76 states that "the Bank would cease all new lending until base case conditions have been restored," when Indonesia faces a crisis resulting from internal reasons. We believe that the Bank, as a major long-term development partner, should not act like a by-stander, when Indonesia faces a crisis, irrespective of its cause. The Bank's flexible response, such as considering loans that directly support the poor, should be considered. Regarding the response to a crisis caused by external reasons, paragraph 76 also states, "the Bank's response this time around would be limited by Indonesia's high debt burden, as well as IBRD's high exposure in Indonesia." We believe that the Bank, as well as the Fund, should play an active role in an international crisis. As a development financial institution, the Bank should strengthen its support exactly when a member country has difficulty raising money in the market. The Bank should support the member as far as possible, especially when a member suffers from external causes despite its efforts at reform. Private banks are sometimes criticized as "lending an umbrella when the sun shines, but asking to return it when it rains." The Bank, as a development institution, should not act like this. In a crisis situation, the Bank should play a counter-cyclical role and it should be the solution, not the problem, in a crisis.

#### Exposure is Not Everything

6. Paragraph 90 touches upon IBRD's Exposure guideline. We would like to point out that "Share of Export Guideline" or "Debt Service Guideline" themselves do not necessarily decide IBRD lending ceiling. The 1993 Bank paper(JAC93-27) states that It is important to note that the guidelines are not applied rigidly and take into account the particular

circumstances of the borrower. (Paragraph 2) "There is no presumption that guideline triggers will translate into automatic reductions in Bank lending" (Paragraph 5) Paragraph 18 compares "Debt Service Guideline" with "Portfolio Share Guideline" and "Share of Exports Guideline", and makes it clear that "Debt Service Guideline" should be applied most flexibly. ( the debt-service indicators most flexibly, since there is no simple link with country creditworthiness and in the short to medium run, the composition of PPGD(Public and Publicly Guaranteed Debt) is largely fixed. )

#### Language in CAS and Market Confidence

7. The CAS emphasizes the financial risk (Paragraph 90) and country risk (Paragraph 91) on the Bank's exposure in Indonesia. We cannot deny the fact that risk exists and we believe in general that the CAS should be candid. However, we have concerns that this pessimistic view will undermine the already fragile market confidence. We would like to ask to tame some language in the CAS so that disclosure will not negatively affect market confidence.