Board Meeting of July 10, 1997
Statement by Jan Piercy

Indonesia: Country Assistance Strategy

1. At the outset I would like to thank Dennis de Tray and the Bank and IFC staff for their hard work and candid discussions with us on the Indonesia CAS. In addition, I think that it is important to commend Indonesia for the progress it has made in reducing poverty and fostering steady economic growth. We also strongly support the goal of continued economic growth with a focus on equity. This CAS, however, is a disappointment. It alludes to issues rather than frankly addressing them; it highlights problems but presents no clear follow-up on Bank engagement; and it provides no clear policy framework or rationale for the Bank's lending program in the next three years. We are left with no clear idea of the trade-offs and choices facing the Bank and Indonesia.

2. Given the progress we have seen in CASs over the last few years, we have come to expect a frank assessment of the government’s and the Bank’s performance and an indication of measures needed to address remaining challenges. In our discussion with staff, they explained that such a forthright discussion was not possible given the inevitable release/leaking of the CAS. CASs for a number of other countries, however, have managed to candidly present problems. The Board must be able to rely on the CAS for a clear and candid discussion of the issues at hand.

3. For example, the economic distortions created by the government’s role in certain sectors of the economy and the problems of corruption are well-known in Indonesia and is openly discussed in the global press. The CAS, however, makes no clear statement of the Bank’s position or program for engaging the government. This is inconsistent with the recent report of the Bank’s Corruption Action Working Group, which notes that the Bank must “address corruption and its economic effects more explicitly in CAS’s, in ESW, in the design of projects, and in research.” The CAS does talk about the need for transparency, but not how the Bank is addressing this issue in Indonesia. We believe the Bank needs to become more engaged in the good governance dialogue with Indonesia. Two areas which could benefit from Bank intervention are the issues of continued deregulation and the need to address off-budget expenditures.

4. The CAS presents a number of areas for further work and improvement in Indonesia: in the health sector; in improving quality and expanding access to education; in financial sector...
reforms; in public sector management and legal reform; and in natural resources management. Staff inform us that the Bank’s highest priority in Indonesia is human development, which we strongly support. Unfortunately, there is no clear lending program to support these areas of reform, and addressing them through non-lending services is not discussed. We must therefore assume that these areas are being addressed through a quiet policy dialogue. While this may be appropriate in certain cases, the Board also needs to know what the specific problems are and how the Bank is or is not engaged in priority sectors. (In water, for example, we were told that the Bank is not involved because the government has not yet undertaken necessary policy reforms.)

5. The CAS does a good job of integrating environmental concerns with economic analysis, but we understand that the bank has not had much success in its engagement with the GOI on natural resources management and forestry issues. This is highlighted as an area of great concern by a number of donors, who also seek Bank leadership. We know from experience that economic sustainability requires an effective and active natural resources management policy. If the Bank is having difficulty in this area, we need to know what these difficulties are and the conditions for deepening bank engagement. In our opinion, sectoral and regional environmental assessments and analysis could provide a useful means of engaging the government in dialogue and ensure that proposed developments do not have unintended negative impacts on forests and the environment.

6. We do not see the link between the policy challenges the CAS outlines and the Bank’s proposed lending program. For example, we understand that Indonesia no longer needs to borrow from the Bank for the energy sector and can raise these funds itself. Instead, the Bank has a focus on human development. However, the proposed lending program indicates that 49.8 percent of the lending in FY98 is in the power and energy sector (with 26.7% and 28.7% in FY99 and 2000 respectively). At the same time, lending for population, health and nutrition amounts to less than five percent of planned lending in each of these years, and lending for the environment is limited to several large loans in FY99. Our lending program, in sum, does not match the Bank’s own analysis of the needs it should be addressing.

7. The same can be said of interventions in the financial area and public sector management, which are vital to improving investments and private sector development. In a related area, we find it curious that once again, there is no use of guarantees, which we are trying to mainstream, by one of the Bank’s largest borrowers. We would welcome a comment from management on this in light of ongoing efforts to use guarantees as a major instrument for encouraging private sector development, particularly in infrastructure.

8. Labor issues also present an area of unrest and controversy in Indonesia. We would expect this to be addressed as part of the dialogue on governance, public sector management and education. We expect the Bank to consider and better integrate core labor issues into the Bank’s analysis and project development activities.

9. Finally, we are pleased to see the greater role played by the resident mission in Jakarta, and hope that this will lead to an improved dialogue with the Government on these areas of concern. I must repeat, however, our opposition to the devolution of procurement
responsibilities to the resident missions. This is incompatible with fulfilling the Bank's procurement standards and hardly advances efforts to combat corruption.

10. This document does not make a strong case for a fifty percent increase in financing to Indonesia over the next few years. The rationale, benchmarks and evaluation of options are lacking.

11. In closing, I do not think this was the right time to produce a CAS. The document opens by noting upcoming government changes and the intention to review the strategy with the new government over the next year. No wonder the CAS is unable to clearly lay out a strategy for engagement over the next three years. It may have been better to simply provide a progress report to the Board at this time and plan a review next year which could better reflect the Bank's and Government's strategy.