Board Meeting of March 9, 1999
Statement by Valeriano F. García and Iván Rivera

Indonesia: Country Assistance Strategy – Progress Report (R99-18)

We welcome this timely and comprehensive CAS-Progress Report, in particular the open discussion of what went wrong in the implementation of the Bank strategy and the ensuing lessons. We are also grateful for the timely presentation of the CAN as well as for its candid and objective way of addressing Indonesia’s most pressing issues. We lament, however the unwanted incident with the press.

We now turn to some comments and questions on the proposed Report.

First, on macroeconomic matters, on para. 25 we do not think the crisis was mainly a problem on the microeconomic realm. There was clearly inappropriate macroeconomic management, but this was not easily detected with the standard “flow” macro indices routinely used to diagnose macroeconomic problems in the pre-crisis era, such as GDP growth, current account balance, fiscal equilibrium flows, etc. It is clear that the problem was a serious stock problem of private short-term debt accumulation. This problem was deepened by the improper initial response to the crisis through stop and go actions on bank resolution and project cancellation and opaque exchange rate policies.

Second, the report is not clear on how advanced is Indonesia in first generation structural reforms. In particular it is not clear how much progress has been made in trade liberalization and the promotion of competition. We would like to know if all targeted NTBs have been eliminated and if the DFI regime has been completely liberalized. We also understand there is substantial amount of public enterprise activities and about 50,000 state owned cooperatives. What are the plans for privatization? Are privatization and re-privatization included in the anti-corruption action plan? What are the plans for further trade and investment liberalization?
Third, we are worried with the slow progress in bank and corporate restructuring; in particular because this is at the crux of any future sustained recovery. In the regulatory area there is a need to go beyond prudential policies to protect the macro environment and to focus specifically on speeding up the process of bank resolution and regulations on lending to related parties, among others. Given that the cost of bank/corporate restructuring is extremely high (30% of GDP), we would like to know if proper screening has been performed for the restructuring exercise. We also would like to know how the cost of financial and corporate restructuring is going to be financed? How these extra expenditures are going to be accommodated in a public budget, which has to finance targeted subsidies and has set a floor to social spending?

Fourth, we are concerned with medium term fiscal sustainability. The proposed fiscal expansion is supposed to be financed by external financial assistance. The slow progress in structural reforms places at risk this source of deficit financing. It is also worrisome in this regard that Indonesia is approaching the Bank’s country concentration limits.

Fifth, we understand that recent developments have made evident that governance and political issues are at the crux of the slow progress in the recovery of the Indonesian economy as is clearly identified in the risks section of the report. We wonder why staff has not been more explicit in suggesting ways of mitigating these risks in the proposed strategy.

To close let us remind staff that crisis times present a unique window of opportunity to advance the reform programs, as has been demonstrated by the recent experience in other parts of the world and also in the East Asia region. We encourage staff to take a more pro-active stance in addressing Indonesia’s most pressing challenges. We are sure that the people and the Government of Indonesia will welcome this effort.