

CAS Public Information Notice

Indonesia

Country Assistance Strategy

On November 25, 2003 the World Bank's Board of Executive Directors discussed the Bank Group's Country Assistance Strategy (CAS) for Indonesia covering the period 2004-2007.

i. **Country Context.** Indonesia continues its transition from an autocratic, centralized state to a democratic, decentralized one. It has successfully regained macroeconomic and political stability, but economic growth remains below 4 percent, poverty reduction remains a challenge, and governance concerns continue to cloud its achievements. Public debt has declined from 100 percent of GDP to 72 percent, inflation is now below 7 percent, and income poverty has fallen from 27 percent in 1999 to 16 percent today. However, 110 million people still live on less than \$2 a day, and remain vulnerable to falling back into severe poverty. Indonesia continues to underperform its neighbors in access to quality health, education and other basic services, as reflected in the MDG indicators. Weak governance institutions are keeping investors away and undermining service provision, especially to the poor. Indonesia has undertaken reforms that could lead to a more effective and accountable government, and a restoration of growth. But sound implementation is now needed to turn the promise into reality.

ii. **The Government's Reform Program.** Following its decision not to renew the IMF program after 2003,¹ the Government prepared a comprehensive package of policy reforms through the end of 2004. This "letter of intent to the Indonesian people" provides an agenda of time-bound actions, covering macroeconomic management, financial sector reform, and policies to help raise investment and reduce poverty. The package is ambitious – especially for an election year -- but represents an important effort to spur the momentum of reforms, and serves as a mechanism to monitor the Government's progress on the basis of its own stated benchmarks. With steady progress on this reform package, and an effective PRSP,² growth over the CAS period is expected to reach 5 percent by 2006, enabling poverty to decline to 11 percent by 2007.

iii. **The Bank Group Strategy.** Further progress in reducing poverty is prevented by two major factors—low investment, and weak service provision—which in turn are caused primarily by problems of governance. The Bank Group's entire efforts -- in the form of analytical and advisory services, lending, IFC and MIGA activities, and donor coordination -- will be to help address these problems.

- ***Improving the Climate for High Quality Investment.*** Bank Group support will be directed to address five key areas that are essential to raise the rate of investment from its current level of 20 percent of GDP: deepening macroeconomic stability, building a stronger financial sector, fostering a competitive private sector, building Indonesia's infrastructure, and creating income opportunities for poor households and farmers.
- ***Making Service Delivery Responsive to the Needs of the Poor.*** Weak service delivery is undermining Indonesia's goal of improving the quality of life of its citizens and the

¹The IMF will engage in post-program monitoring beginning in 2004.

²As a blend country, Indonesia's PRSP preparation is not directly linked to IDA access and was therefore not a pre-requisite for Bank CAS preparation. Indonesia's I-PRSP was circulated to the Board in March 2003, and its full PRSP is due to be completed in mid-2004.

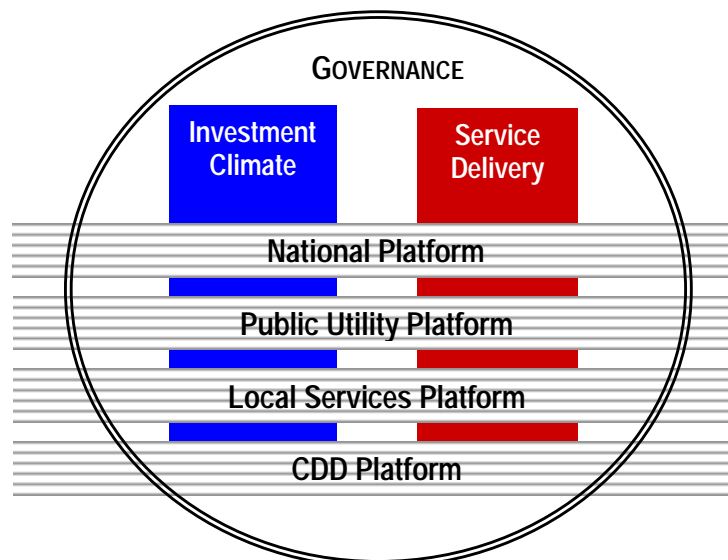
attainment of its MDGs. Bank Group support will thus be devoted to help revamp the management and accountability systems for service delivery to make providers more directly accountable to their clients. Focus will be given to implementing the principles of the World Development Report 2004, especially in health and education, but also in agricultural research, extension and irrigation, and in public services in general.

- **The Core Issue of Governance.** Advances in governance will be needed to address both CAS objectives. Four areas will be given priority: (i) making development planning more responsive to constituents; (ii) improving public financial management; (iii) strengthening the accountability of local governments under a more coherent decentralization framework; and (iv) enhancing the public credibility, impartiality and accessibility of the justice sector. Selectivity in the Bank’s activities will be determined less by sectoral priorities than by the opportunity to make progress in these areas. Corruption poses a special problem in Indonesia, and the country team aims to integrate governance and corruption issues through the entire Indonesia program, shaping how projects are selected, designed, implemented and monitored.

v. **Business Platforms—How the World Bank will Deliver.** Indonesia’s massive decentralization calls for a new approach to the delivery of development assistance. The Bank will leverage the projects it finances with analytical work, policy advice, technical assistance, strategic partnerships and capacity building to systematically increase standards of governance at each level of government the Bank engages. Four business platforms are envisioned:

- The Community Driven Development Platform: about 25 percent of all lending (about \$200 million per year) would be allocated to scale up this successful program.
- The Local Services Platform: about 40 percent of lending would be allocated to help create accountability at the district and provincial levels.
- The Public Utility Platform: about 15 percent of lending would help support investments in good corporate governance and efficiency in water supply and energy.
- The National Lending Platform: about 20 percent of lending would be allocated to address central problems.

The CAS Framework



vi. **Scale of World Bank Activities.** Through these platforms the Bank proposes a Base case with lending in the range of \$450 - \$850 million, including \$230 million in IDA resources. The Base case assumes continued, but incremental, progress on the Economic Policy Package. Evidence of decisive momentum in implementing the reform package could lead to an “enhanced” Base case, in which the Bank would offer an adjustment loan in late 2004. The actual amount of Base case lending would also depend on the number of districts and utilities that qualify through their governance reforms for Bank assistance. The CAS also includes a High case of up to \$1.4 billion, and a Low case of less than \$300 million. The High case triggers have all been selected from the Government’s Economic Policy Package as those most important to achieving target outcomes in the three CAS areas and putting the country on a path to stronger growth and better living standards.

vii. **Program Delivery—Portfolio Management, Analytical and Advisory Services (AAA), and Partnerships.** Despite challenges of portfolio management across a large country with significant corruption risks, portfolio performance has improved with commitments at risk down from 39 percent (FY02) to 12 percent (FY03), and disbursements remaining above 20 percent. Portfolio risks will be managed by building external monitoring mechanisms into project designs, requiring anti-corruption strategies for each project and using the platform approach to maximize the effectiveness of supervision. The platforms will also bring more coherence to capacity building activities with the World Bank Institute taking a strong role. The AAA program is being thematically developed around the CAS objectives to stay focused on results. Finally, partnerships will play a large role in the success of the platforms, through support for critical analytical, M & E, and capacity building contributions, and in support of specific sectoral reform programs through grant financing, TA and analytical inputs.

viii. **International Finance Corporation (IFC) and Multilateral Investment Guarantee Association (MIGA) Programs.** IFC’s activities, including the new SME Facility (PENSA), are directed to help the private sector and contribute to sustained economic growth and poverty alleviation, by focusing on: (i) strengthening of banks; (ii) deepening the financial sector; (iii) supporting export-oriented companies, mainly in the agribusiness sector; (iv) supporting infrastructure investments in power and telecommunications; and (v) supporting SMEs. MIGA is proposing to support privatization through the provision of political risk guarantees to foreign investors, to provide support to the investment promotion agency, and to undertake a comprehensive benchmarking study of Indonesia.

ix. **Managing Risks.** The program is designed to mitigate risks that could limit the effectiveness of Bank support. These risks include, a lack of political will to address governance issues, macroeconomic shocks arising from domestic or international factors, including a financial sector crisis; political and security instability threatening a loss of confidence, disruption in Bank activities, and a potential risk to Bank staff; stalled decentralization undermining the effectiveness of local governments; challenges to the Bank’s reputation and credibility stemming from continued public concerns about corruption and the impact of donor assistance. Risk management measures are described for each risk area.