

REPORT ON THE ELEVENTH CONSULTATIVE GROUP MEETING ON INDONESIA

Introduction

1. An ADB delegation participated in the captioned meeting (Meeting) held on 7-8 November 2001 in Jakarta. The Meeting was chaired by Jemal-ud-din Kassum, Vice President, World Bank. The Government delegation was led by the Coordinating Minister for Economic Affairs (Dorodjatun Kuntjoro-Jakti) and included the Coordinating Minister for Social Welfare (Jusuf Kalla), the Coordinating Minister for Political, Social and Security Affairs (Susilo Bambang Yudhoyono), Minister of Finance (Boediono), Minister for Justice and Human Rights Affairs (Yusril Ihza Mahendra), Minister of Forestry and Plantations (M. Prakosa), Minister for Resettlement and Regional Infrastructure (Soenarno), Minister of Agriculture (Bungaran Saragih), Chairman of Bappenas (Kwik Kian Gie), and Governor of Bank Indonesia (Sjahril Sabirin) among others. The ADB delegation (delegation) was led by J.B. Eichenberger, Vice President (East), and included J.P.M. van Heeswijk, Director, Indonesia Resident Mission, Ayumi Konishi; Manager, East Asia Division, Programs Department (East); and David Green, Deputy Director, Indonesia Resident Mission.

2. Representatives of the Government of Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Republic of Korea, the Netherlands, New Zealand, Norway, Portugal (joining for the first time), Spain, Sweden, Switzerland, United Kingdom, and the United States attended the Meeting. Representatives of European Commission, European Investment Bank, International Finance Cooperation (IFC), International Monetary Fund (IMF), Islamic Development Bank, Kuwait Fund for Arab Economic Development, Nordic Investment Bank, United Nations Development Program (UNDP), and the United Nations Children's Emergency Fund (UNICEF) also attended.

1. Representatives of civil society groups attended the Meeting and presented several statements on their development priorities and concerns. These statements stressed particularly the link between poor governance and poor development, the difficulties of the present public debt burden, and the need to actively combat corruption.

2. The Meeting reviewed the economic and social developments since the last CGI Meeting held on 17-18 October 2000 in Tokyo and the Interim Meeting held on 23-24 April 2001 in Jakarta. Prior to the CGI, on 6 November 2001, the Partnership for Governance Reform held a meeting to review the work ongoing by this donor-supported organization.¹ Subsequent to the CGI, on 9 November a meeting was hosted by the IFC on private sector development. The CGI focused very much on the implementation of structural reforms. In addition, poverty reduction and the ongoing decentralization program were major agenda items. A sectoral focus was maintained by sessions on education, SMEs, and forestry. Governance was dealt with in many of the discussions, but particularly in a session on reforming the justice sector. The Meeting ended with indicative commitments of assistance by Indonesia's development partners for 2002. A summary record of each session is contained below and the ADB's statements and interventions attached.

¹ The ADB is a founding member of the Partnership along with the UNDP and the World Bank.

Session I: Opening the CGI

3. The Opening Statements by Jemal-ud-din Kasum, Vice President, World Bank and Dorodjatun Kuntjoro-Jakti, the Coordinating Minister for Economic Affairs, stressed similar topics: the deteriorating world economic conditions; limited fiscal freedom of the Government; and the heightened importance of unblocking structural reforms, such as the passage of anti-money laundering legislation and programs of privatization and asset sales.

Session II: Encouraging Economic Stability, Fiscal Sustainability and SME Development

4. These issues were echoed in the second session. The Government, in particular Finance Minister Boediono, warned that there was going to be a revenue shortfall this year as a result of the failure of privatization activities and lack of disbursement of program loans. The Minister reiterated the Government's commitment towards privatization and structural reform but was frank about the challenge of making progress in the next few months. The Central Bank Governor Sjahril Sabirin noted the current difficulties of controlling inflation during a period of international uncertainty and depreciating local currency. The IMF representative's statement urged strong measures to redress the fiscal uncertainties, particularly through greater revenue raising efforts in order to avoid the need to curtail further Government spending in the waning days of 2001. The Government reiterated its commitment to such actions as anti-money laundering legislation, supportive investment policy, and non-tax revenue measures. The importance of these structural reforms was acknowledged, particularly to provide scope for private investment to support an economy with the potential for long-term poverty reduction.

5. The ADB's statement noted that the difficult world economic situation carried increased risks for Indonesia given the fragile face of economic growth, but that this underscored the importance of reforms to encourage investment. The NGO statement stressed the links between corruption and poor use of official assistance, insisting on the need for debt reduction that would reflect an alleged lack of concern for good governance in the past by both creditors and borrowers. The Japanese Government's statement on behalf of the international community on SMEs noted the importance of better policy coordination and certain policy actions including specifically limiting any moves to interfere with the procedures of financial institutions for credit provision to SMEs.

Session III: Strengthening Governance and Fighting Corruption in Forestry and the Justice Sector

6. The grouping of forestry and the justice sector together reflected a strong feeling on the part of the international community, expressed at last year's CGI, that the major problems involved in protecting forest resources, were those of poor governance, particularly the inability to enforce existing laws concerning natural resource management. Emphasizing the problems, the paper read by the European Union for the international community could report no progress in the forestry sector—illegal logging and non-sustainable forest management systems continue basically unabated. As generally acknowledged, the public interest is not served by the lack of ability to enforce existing rules and regulation. There was a considerable commonality of expression

among the statements of the international community, the Government and the NGOs on the problems, strategy, and need for action.

7. In its report on the need for reform in the justice sector, the Government acknowledged particularly the need to encourage greater civil participation. The Government noted the weaknesses of the legal and judicial system, especially in law enforcement—weaknesses that threaten the overall potential for long-term economic recovery. The Coordinating Minister for Political, Social and Security Affairs and the Minister of Justice stressed the need to strengthen existing legislation and improve judicial accountability. The delegate for the Netherlands, speaking for the international community, noted appreciation of the Government's understanding of the problems. But citing surveys by the Partnership for Governance Reform, noted the general perception that corruption is widespread. Many in the donor community noted considerable frustration with the slow pace of reform and the existing situation—arguing that the situation imperiled development and political stability. The international community emphasized that failure to move aggressively to reform the justice sector would put at risk the potential for realizing developmental and other national objectives. The ADB noted its support for governance reforms generally, especially its commitment to support improvements in corporate governance and support for the Partnership.

Session IV: Investing in the Poor through Decentralization and in Basic Education

8. The Coordinating Minister for People's Welfare delineated a long history of actions directed towards poverty reduction yet admitted difficulties in moving forward given the present condition of the country. Poverty reduction will require more resources, especially in health and education, and the better provision of these services. The Coordinating Minister also stressed that to meaningfully affect the condition of the poor will require efforts to increase wages and income opportunities.

9. It is in the context of the need to focus on poverty that decentralization and basic education were discussed by the CGI. The Government noted particularly the need to ensure that local governments maintain a supportive business environment. To ensure quality education services in a decentralized environment, the Government will undertake a number of steps including the setting of minimum service standards. The donor community statement, read by the GTZ delegate, on decentralization focussed on a number of aspects, including the need (i) over time to ensure equity among the regions with respect to resource availability and the incidence of poverty, (ii) to coordinate policy to ensure consistency across the regions and establish minimum service standards, and (iii) to see that mechanisms of supervision and control are effectively used.

10. The ADB provided the donor statement on education, emphasizing the importance of basic education especially to the children of poor families. To provide quality education a number of concrete actions are required including: (i) developing in a participatory manner a national strategy; (ii) clarifying the role of the national government including minimum service standards; and (iii) instituting mechanisms to encourage local participation in schools, including dissemination of information on the quality of service actually provided and the flow of funds. The commonality of vision between the international community and the Government was the basis for the conclusion that the working group established to support the CGI should continue its work to coordinate donor assistance and change in the sector.

Session V: Implications for the Poverty Agenda

11. Session V was added specifically to emphasize the overall focus on poverty reduction that was the theme of the CG. The Coordinating Minister for Economic Affairs noted the importance of developing a national strategy for reducing poverty. Recognizing the cross cutting demands of reducing poverty, President Megawati is soon expected to issue a decree requiring the two Coordinating Ministers for People's Welfare and Economic Affairs to coordinate anti-poverty efforts. It was explained that work of the former-Agency for Coordinating Poverty Reduction was to be carried through by this joint effort. The international community's report read by the UK delegate emphasized particularly that a national strategy to reduce poverty needed to be developed in a participatory fashion. The strategy needed to view poverty from a broad perspective not a narrow one of anti-poverty projects. The strategy had to provide for follow-up work that would mainstream poverty reduction efforts throughout the Government, particularly in the budgetary process.

Session VI: Aid Effectiveness

12. The Chairman of Bappenas, Kwik Kian Gie, strongly expressed his concern that assistance often simply means debt without the increased capacity to repay the debt. Indonesia's debt may be unsustainable and Minister Kwik further worried that a dependency syndrome has set deep into Indonesia where corruption inhibits aid effectiveness and encourages debt-financed operations. Acknowledgement of the difficulty and pervasiveness of eradicating corruption should be foremost in the design and channeling of assistance. The international community's statement, read by the World Bank, also stressed the impact of corruption on aid effectiveness and suggested mechanisms for project implementation to reduce the scope for misappropriation and wrongful allocation of funds. Endemic corruption must be addressed and one approach can be the institution of strong fiduciary standards at the national and local levels. The ADB intervention, as well as those of the other delegations, emphasized the need to improve project administration and to address systemic corruption.

13. The NGO statement stressed their perception that neither the international community nor the Government are serious about issues including human rights, the accountability of the military, and the extent of corruption now and in the past. The NGOs hold the Government and the international community collectively responsible for the misuse of aid and the existing debt problems. In summary the Chairman noted the concern that the debt burden not become unmanageable through a failure of policy and missed opportunities to maximize the concessional element in new lending and to avail of possibilities for easing the debt burden through the offices of the Paris Club.

Session VII: Pledging Session

14. The Meeting ended with a total pledge of funds to support budgetary activities in 2002 of \$3.14 billion. This suggests adequate support for the anticipated requirement of \$3.0-3.5 billion in external financing. The pledges noted the concomitant need for action on the part of the Government, in particular: (i) to begin the process to develop a national strategy to reduce poverty, (ii) to effect structural reforms to strengthen the financial and legal systems, and (iii) a continued focus on macroeconomic stability. There was wide unanimity among the delegates that there was a need to demonstrate commitment on the part of the Government towards reform through concrete, measured

actions. A number of delegations pledged further funds for off-budget items such as the support of civil society activities. The ADB statement indicated a program commitment that would likely disburse \$1.15 billion in 2002 as a combination of existing program and project loans and anticipated new program loans. The ADB statement noted carefully that this level of assistance was contingent upon the resolution of problems delaying the disbursement of existing program loans and actions such as successful follow-up to the Poverty Partnership Agreement signed in April 2001 and the easing of project implementation issues.

15. The Chairman noted the likelihood of a 12th CGI to be held in the later part of 2002.

11TH CONSULTATIVE GROUP MEETING FOR INDONESIA

STATEMENT BY VICE PRESIDENT (EAST), ASIAN DEVELOPMENT BANK ON STRUCTURAL REFORMS

We are meeting at a difficult time. Recent events have compounded the already enormous complexities of Indonesia's quest for stability, equitable growth, and durable poverty reduction. Today's major challenges – new and existing, internal and external – are testing the new Government's welcome resolve to take the difficult decisions that are urgently needed to meet these aspirations. The circumstances provide an even narrower range of tolerance for missteps or delay, even as they call upon the international community to show the fullest possible support.

The recent agreement with the IMF on a framework for macroeconomic stability and the passage of a budget for 2002 that meets the spirit of this framework is a clear positive signal. However, the considerable delay in obtaining previously programmed support from the IMF and the MDBs reflects the multiple difficulties in implementing key structural reforms. Important pieces of legislation, for example, have been prepared and submitted, but only a handful of priority legislation has actually been enacted this year. In other cases, key administrative actions have not been taken as both hoped and expected. As a result, vitally needed reforms, whose effectiveness will take time in any case, have been delayed.

These delays have not only postponed release of substantial external assistance, including from ADB, and impeded mobilization of funds for priority development investments. Delayed structural reform is also constraining recovery and will adversely affect long-term growth and poverty reduction.

Lack of material progress in power sector restructuring, for example, jeopardizes both the public and the private investments necessary to meet current and projected needs, including for the poor. In transport, the rehabilitation of road networks is proceeding slowly. In the case of the regions, and generally for all infrastructure under their responsibility, the adequacy of funds allocated for development and the ability of international funding agencies to support local development are major constraints.

Similar problems are evident in provision of social infrastructure—especially health and education—in view of the devolution of responsibilities to regional governments under decentralization. This is especially problematic for the poor in financially weak regions who are most vulnerable to deficient basic social services. Greater attention must turn to regional budgets, in part to assess whether support from the national level is necessary to ensure that neither critical programs, nor the vulnerable poor, do not suffer. The Government will also need to speed up policy reform and capacity building actions to support regions in providing acceptable minimum services standards.

On the positive side, some progress is being made in key areas. The new Investment Policy, for example, should greatly facilitate foreign and domestic private investment. This announcement is to be followed by a unified national law on investment incorporating market oriented principles of investment policy and basic guarantees for investors. Early enactment of this law would pay huge dividends for years to come and should be regarded as a priority. It is necessary to ensure that the national effort envisaged by the new investment policy is supported by appropriate complementary actions by regional governments. Complementary

actions to increase competition in the domestic economy and further liberalize trade also needed.

In the financial sector, banking system problems have received much attention. Yet despite substantial Government assistance, many banks remain seriously vulnerable. Moreover major issues in the non-bank financial sector—including pension systems and the insurance industry—remain to be addressed. Effective planning for the proposed introduction of an integrated approach to financial sector supervision and regulation is urgently needed and fundamental governance concerns continue to affect the financial and corporate sectors. The proposed law on antimoney laundering, which is central to strengthening anti-corruption efforts is still pending. It deserves strong Executive Branch advocacy leading to swift legislative enactment.

We have attempted to highlight those structural issues where in our view concerted and accelerated action is most needed. Deeper and broader support and cooperation from all branches and levels of government is essential, as is ensuring a process that is fully transparent and inclusive of the private sector and civil society.

Let me stress in closing, Mr. Chairman, that we do not underestimate the persistence, and effort, and courage that these steps will require. We at the ADB, and the rest of Indonesia's international partners, appreciate the enormous challenges faced by the new government. We have spoken directly about the policy imperatives going forward in a spirit of support and high aspirations for the government at a time of both great pressure and great opportunity. The Asian Development Bank has been, and will remain, a reliable partner. And we join the international community and our Government of Indonesia colleagues here today against that background.

The prize remains what it has been. A return to robust and sustainable growth. The equitable spread of wider opportunities for all. And greater realization of the enormous potential of this vast and richly endowed country. Let us, together, remain acutely focussed on the prize.

Thank you

11TH CONSULTATIVE GROUP MEETING ON INDONESIA

INTERVENTION BY ASIAN DEVELOPMENT BANK: STRENGTHENING GOVERNANCE AND FIGHTING CORRUPTION

In addition to our efforts to support the Partnership for Governance Reform, which we discussed briefly yesterday, ADB focuses in Indonesia on three areas for governance reform: decentralization, anti-corruption and corporate governance. The quality of public governance, especially the performance of people in government, is key to achieving sustainable development and meaningful poverty reduction. The quality of corporate governance is similarly vital to the performance of the private sector and its capacity to generate long-term economic value and equitable opportunities for society as a whole.

The importance of legal and judicial reform has rightly been emphasized. The Forestry sector provides a good example. Unsustainable harvesting of forests is well known to be a major problem in Indonesia today. But, without a functioning judicial system it is difficult, if not impossible, to come to terms with the illegal logging and move to a position of sustainable management. We should add that similar, and similarly severe, governance problems exist in other sectors such as marine and coastal resources, and watershed management. The bottom line is that functioning judicial system is thus an imperative for the sustainable use of natural resources on which future generations will depend, whether that use is by the public or the private sector.

We welcome the significant progress made over the past year on corporate governance within Indonesia. There is greater support for improved standards, and awareness of the benefits that can result from their implementation. Nevertheless, there remains wide scope for broader adoption of recognized standards and the unfinished agenda for further corporate governance reform in Indonesia remains substantial and challenging. A particular opportunity to consolidate legal reforms relating to corporate governance is now available with plans to review and change at the same time the Company Law, the Capital Market Law, the Company Registration Law. The hope is that business and society in general will support the government, and provide inputs on suggested improvements.

In the area of corporate governance, as in so many others, much depends on a strengthened legal and judicial system. One very clear example is the need for effective bankruptcy proceedings. It is a fact that Indonesia's recovery from the effects of the 1997 Crisis has been severely hampered by the lack of a functioning judicial system that can support necessary restructuring and redistribution of assets through efficient and equitable bankruptcy proceedings.

Establishment of a bankruptcy law and commercial court is a start, but bankruptcy proceedings cannot yet be said to be functioning as required. Remaining reform needs include strengthened capacity of the bankruptcy court, improving the integrity of court rulings, and effective execution of court decisions. ADB is willing to provide more support in these areas—but it will require a commensurate commitment from the Government.

As regards Anti-Corruption, most donors have anti-corruption activities among their priorities, including building awareness. However, the need for major additional progress is considerable. Eradication of corruption, collusion and nepotism requires a well-designed

transparent and accountable public infrastructure of regulations, institutions, management and control systems. Progress in these areas must be regarded as a top priority.

Ultimately, we all agree on the need for fundamental changes in the performance of the executive branch of government—to improve vital functions such as budgeting, accounting, internal audit, procurement, public reporting, staffing and personnel management. These functions cannot be reformed overnight, but there must be clear, visible and coordinated efforts towards change. Currently ADB is providing support in several of these areas. We hope that further progress will provide us the opportunity to do more.

11TH CONSULTATIVE GROUP MEETING ON INDONESIA

STATEMENT OF THE INTERNATIONAL COMMUNITY ON BASIC EDUCATION BY THE REPRESENTATIVE OF THE ASIAN DEVELOPMENT BANK

A focus on education has been added back into the Consultative Group for Indonesia (CGI) Meeting this year, the first time since 1997. We applaud this action, particularly in the context of the overall theme of the this CGI, "Working Together to Reduce Poverty." As with the provision of health services, education is a key area where public action can lead to long-term reduction in the incidence of poverty. Often, the only resources available to children of poor families to materially improve their condition in life will be the skills provided in public schools. In this there is a clear, common position by both the Government and the international community on the importance of investing in the poor by improving the provision and accessibility of education services, especially basic education. This is also in line with the EFA goals to which Indonesia and the international community have committed themselves.

Indonesia has succeeded in getting children, even those of poor families, to enter school. However, it has not succeeded in keeping them in school and in ensuring that, especially children from poor families, benefit from school attendance. About one million children never attend school and another million drop out every year before completing the six-year primary cycle. As you would expect, those that do not attend or drop out tend to come from poor families. Their non-attendance and premature departure virtually ensures low level employment and low earning capacity as adults, thus perpetuating the poverty cycle. What accounts for a lack of continued participation by so many children in school? In many cases family poverty combines with inequitable provision of services to reduce the incentives to maintain attendance. For example, a large number of rural schools suffer with regard to teacher deployment and attendance and availability of school materials.

It is important to note, that there is a wide spread commonality of vision with respect to the problems of the sector, strategy, and actions that should be employed in education between the Government and the international community. Just because education has not been explicitly included in the CGI's deliberations in every year has not meant there has been a lack of substantive dialogue. Similarly, the end of this CGI session will not mean an end of discussion on education issues. But we do mean to put this CGI meeting to the best possible use in furthering education issues.

The paper we have tabled sets forth the international community's summary of our discussion to date, focusing on the most critical issues, identifying practical steps to meet credible targets. I will mention only a few of these issues, leaving the paper as a working document—we invite comments and your participation in the continuing post-CGI dialogue.

Clear Strategy for Education Reforms. There is need for a clearly articulated strategy for reforms in basic education in the context of a democratic, multicultural and ethnic society. This should be understood, shared and supported by all key stakeholders. Reflecting the on-going decentralization, this strategy must be developed through a broad program of participatory efforts. These efforts must involve stakeholders in local communities—parents, teachers, government officials, and education administrators—to improve the quality of basic education. The government needs to initiate this process to develop the big picture in a post-crisis era where all programs and activities will fit in. We expect to develop with the Government a plan for such a national strategy for education by 31 January 2002 and complete the plan in time for the next CGI in 2002.

New Role for the Central Government. Basic education is now a service provided by the local government—many of the actions needed to enhance the sector will demand changes at the local level. However, the Central Government will remain a key player. In particular, it will be the responsibility of the Central Government to ensure minimum service standards (MSS). Minimum service standards need to be clearly spelled out and ways and means identified to make these operationally meaningful. Standards are needed for school facilities, curriculum, staffing, learning materials, learning processes, and institutionalizing community/civil society involvement. We believe the Government is close to providing preliminary standards—these need to be assessed in a participatory fashion. We hope to work with the Government, to ensure that by March 2002, a detailed process of review, comment, revision, and issuance of minimum service standards will be completed in consultation with the provincial and district authorities.

Supporting this, and to meet the other needs of the sector, we urge the Government to work to clarify the respective roles of central, provincial and district authorities—initiating a procedure of suggestion and consultation with the goal of providing within six months a framework of responsibility assignments. Within this time frame the Central Government could begin to reexamine and redesign its own business processes and tools to implement the program, with the goal of completing its plan by the next CGI Meeting.

Targeting Equity and Access. It will be the local community that can determine the quality of schooling and the broader incentives that face families over educating their children. To stimulate awareness, a process of monitoring and disseminating comparable statistics on drop-out rates and other measures of access needs to be initiated after regional consultations that can be made part of local discussion on education administration and budgeting. One aspect of this is to clarify the extent to which fees and other charges, both legal and illegal inhibit the access to the system by the poor. We call upon the Government to develop such a monitoring system by March 2002, to review this with concerned localities, and institute the system so that information on performance can be utilized in the 2003 budgetary review process.

Equalizing Education Financing. Beyond involving the community, there are also for the Central Government to better target resource allocation to provinces and districts with higher incidence of poverty and pockets of economically, socially, and culturally disadvantaged children. Following the issuance of Laws 22 and 25, funds are being transferred from the central budget to districts via block grant (DAU), and then to schools through predetermined allocation procedures. This has simplified pre-existing funding mechanisms. However, the hard question of how to ensure that districts poor in resources have adequate funding for education must be faced. Moreover, funding is not simply a matter of paying teachers and keeping school maintained, there are the longer-term needs for investment financing. These issues are not particular to education; they are common to all sectors involved in the ongoing decentralization. We call for a review of the fund flow—to ensure that adequate funding is provided to poorer districts, that funds are being utilized, that investment needs can be accommodated. To support the discussion, the Central Government should commit to reviewing actual expenditures by local government with respect both current and investment needs in time for the next budgetary review.

Involving the Community. Most of the actions discussed demand involvement of the local community. Decentralization heightens this need and creates the opportunities to streamline and rationalize the basic education management structure. Decentralization offers the potential for

- systematic involvement of citizens in decisions on education policy goals, programs, financing and monitoring of services and school's performance.
- empowerment of service providers with incentives, skills, supervision, material support, and the discretionary authority needed to offer high quality services; and
- transparency throughout the system as the public, through school boards and school committees are provided information, more control over education resources and the bargaining power to demand better quality services.

In order to realize the opportunities, we urge the Government to establish or cause to establish school boards and district committees, as now called for by many representatives of the civil societies by March 2002 so as to allow for these groups to become involved in the operations of the schools in the next budgetary round.

Plan for Capacity Building. Perhaps the greatest obstacle to a smooth transition from a centralized to decentralized education management is the need for strengthening institutional management and administrative capacity at all levels. Decentralized services require adequate institutional arrangements within local government administrations, district planning agencies (BAPPEDA), local parliaments (DPRDs), and school boards and committees. Furthermore, within the broader national policy of institutionalizing school and community based management, effective involvement of the civil society and communities remains vital to create demand for basic education services and for transparent planning and management of education services. Working closely with the international community the Government will develop a comprehensive HRD plan for capacity building by the end of 2002.

Concluding Remarks. We appreciate the opportunity to discuss the problems and challenges of the education sector within the context of the Consultative Group for Indonesia. I want to reiterate that the international community feels that there is a broad consensus on what needs to be achieved, particularly for education to meet its potential for long-term sustainable poverty reduction. And together with the government we will monitor the progress of the above targets set for next year. The donor community is ready to continue our cooperation to establish provision of quality basic education program to all children.

11TH CONSULTATIVE GROUP MEETING ON INDONESIA
INTERVENTIONS BY ASIAN DEVELOPMENT BANK
ON POVERTY

Where are we today? The most recent snapshot suggests that following the shock of the East Asian crisis, we have almost moved back to 1996 in terms of the overall incidence of poverty. This is relatively good news. But although some moderately favorable ground has been traveled, this still means close to 50 percent of the population is poor or near poor. The imperative of enduring poverty reduction remains Indonesia's most deeply-rooted challenge.

Moreover, this news is almost 18 months old—it comes from survey data collected in February 2000. We don't know yet what the latest shocks have meant for Indonesia, but we need to know. ADB is working with the Government to develop leading indicators of poverty to achieve this. Perhaps at the next CGI meeting we will be able to share with you the results of the work.

The obstacles to substantial and durable poverty reduction are many. Decentralization provides a vehicle for more targeted and specific poverty reduction efforts, but local resources are unevenly distributed and the processes and mechanisms are still evolving. A commitment to engagement in the international market remains essential; but it is alone not sufficient to guarantee growth, and the need for efficient and competitive domestic privately driven markets has never been clearer. External assistance has never been the sole engine of enduring poverty reduction. But it can be a powerful catalyst in the presence of supportive domestic policy choices.

For ADB, this means working with the Government, civil society, and the private sector to ensure that poor people and poor regions have access to basic social services. It means helping to improve the functioning of local markets through SME development, and helping to provide adequate social and economic infrastructure.

Where conflict has been an issue, multilateral assistance can help focus and support public and community efforts towards reconciliation and reconstruction such as through small-scale infrastructure investments and livelihood activities. We hope to work with the Government to develop the program and project flexibility to enable us to respond to evolving conditions in all of these areas.

In the medium term, a coherent and locally relevant poverty reduction strategy is needed to make further inroads into reducing poverty. The draft poverty reduction strategy tabled at the October 2000 Consultative group meeting identified the three basic pillars for poverty reduction: promoting economic opportunities, empowering the poor, and enhancing social security. Wide participation of local government, civil society, and poor people is needed to build national ownership of stakeholders and, hence, ensure implementation.

Last April ADB signed a Poverty Reduction Partnership Agreement with Government that called for the development of such a broad-based strategy. At that time, the Government formed a Poverty Reduction Coordination Agency responsible for the coordination of the formulation of poverty reduction policies, plans, and delivery mechanisms at national and local level. Since that time, the Agency has developed some valuable inputs towards this goal in the form of a business strategy for bringing the dialogue to the regions, developed a toolkit to

enable local government and civil society to discuss poverty and development issues, and drafted a comprehensive discussion paper to initiate the debate.

The ADB looks forward to working with the joint offices of the Coordinating Ministers for Social Welfare and the Economy towards the same end and using the business plan, the toolkit, and the discussion paper as the starting point. Addressing poverty in a coherent fashion will require a coordinated effort on the part of the Government: poverty cannot be dealt with from a narrow standpoint; it is the ultimate developmental cross-cutting concern.

The ADB's overarching goal for its assistance in Indonesia is the sustainable reduction in poverty. It is the theme of this CGI. We hope that by the next CGI, the Government will be able to report meaningful action to this end.

11TH CONSULTATIVE GROUP MEETING ON INDONESIA

INTERVENTION BY ASIAN DEVELOPMENT BANK: AID EFFECTIVENESS

The effective use of aid is essential to promote growth and reduce poverty in Indonesia. The Asian Development Bank has been actively involved in the working group that met prior to this CG Meeting and we strongly endorse the statements presented in the name of the international community.

Improving aid effectiveness has become a central focus for ADB's operations in Indonesia. Partly this reflects the problems that we face: of the total approved loan pipeline of \$6.95 billion, 45 percent remains undisbursed. In many quantitative respects the ADB's Indonesian portfolio is among our poorer performers. Limited disbursement imposes financial costs on the Government, but also puts at risk project targets, and ultimately the benefits that should accrue to the Indonesian people.

The working group utilized the outcome of a recent joint Country Portfolio Performance Review (CPPR) undertaken by the Government and its two major multi-lateral lenders, the Asian Development Bank and the World Bank, prior to this CGI. This exercise focused on four common systemic issues where actions could be taken to improve aid effectiveness. The issues related to improving project management and streamlining the disbursement process especially in the context of decentralization.

One important aspect of this work was to develop the 'project readiness' concept. At scheduled start-up not all projects are ready for implementation and this can cause substantial problems, affecting particularly disbursement. For ADB and World Bank funded projects, the Government has agreed to certain project readiness criteria to be met before project start-up. These include targeted monitoring and evaluation indicators, the commitment of counterpart funds, completion of land acquisition and resettlement plans, actual land acquisition for the first year's implementation, and the establishment and staffing of Project Management Units and Project Implementing Units, among other actions.

Getting projects started well is one matter - keeping them on track is quite another. Unfortunately, the environment in which aid-financed projects are being implemented in Indonesia is characterized by collusive practices and pervasive corruption.

Indeed, slow disbursement of project loans is sometimes due to ADB taking a more proactive monitoring role to ensure that ADB-financed aid is used for the purposes of the loan and reaches the intended beneficiaries. Over last year, we have increased our Resident Mission staff precisely to bring more resources to bear in project administration. This may ironically result in a portfolio that appears to perform less well: as we investigate more and ask more questions we take more time to disburse funds. Over the long run we believe that this will result in more effective projects.

But individual projects can only do so much. The present acknowledged, widespread atmosphere supportive of collusive, corrupt behavior can only be changed through improvements in governance generally. Particularly, as we have discussed, there is need for improvements in legal and judicial reform. We hope that by the next CGI Meeting there will be clear signs of this, signs that will support needed improvements in aid effectiveness.

An important aspect of the present challenge is to solve long-standing problems in an evolving context of decentralization. As discussed over the last two days, decentralization offers considerable potential for greater local participation in decision-making. However there are obvious risks. Reducing risks, improving project implementation, will require concerted efforts. Two important reforms have been highlighted in the report of the international community: (i) ensuring that national fiduciary standards are applied and strengthened at the local level; and (ii) accelerating the pace of reform of public procurement and financial management systems. The ADB is strongly committed to supporting public efforts at capacity building and good governance at the local level and improving project administration. This is demonstrated by the support ADB has already provided in advancing reforms of the public procurement system. In 2002 a series of activities will be initiated, for example; to (i) strengthen procurement policies, legal framework and institutions; (ii) the capacity of the Ministry of Settlement and Regional Infrastructure in combating fraud; (iii) extend the reach of the Governance Partnership to support regionally based initiatives; and (iv) invest in capacity building of local officials. We hope that these efforts will combine with other initiatives to signal and effect change in governance in this country.

One final point should be made: as discussed, there needs to be a mechanism to provide for on-lending arrangements to support local level investment programs using foreign loans. Currently we are operating under interim arrangements that recognize the importance of foreign assisted support, but not the spirit of decentralization. Without effective means of channeling foreign assistance we may seriously limit the potential for growth, especially in poorer regions. The mechanism developed must recognize that regions have different capacity to repay and the on-lending terms must vary with respect to this. We have had a long-series of discussions with Government officials on this issue. If it is not addressed, we face the prospect that foreign assistance for such sectors as education, health, and local infrastructure would be at risk. This would drastically curtail the ability of the international community to support development and poverty alleviation.

11th CONSULTATIVE GROUP MEETING ON INDONESIA

INTERVENTION BY ASIAN DEVELOPMENT BANK: SUPPORTING SMALL AND MEDIUM ENTERPRISE DEVELOPMENT

ADB is closely involved in supporting SME development in Indonesia. The main example is the support provided for the Government's Industrial Competitiveness and Small and Medium Enterprise (ICSME) Program under a \$200 million program loan approved by ADB in March 2000. Implementation of this program is ongoing and is coordinated by two taskforces established by the Government: the Competition and Deregulation Task Force, and the SME Task Force (referred to in the SME Statement delivered earlier by Japan). These task forces are supported by ADB technical assistance.¹

Other ADB support has included input at a subregional level to develop a strategy for SME development in the East Asean Growth Area (EAGA) – specifically the islands of Sulawesi and Kalimantan in Indonesia. And work is under preparation for other project-specific support by ADB to further SME development in Indonesia. Among other matters, this includes assistance to develop a credit information bureau to enable lenders to better assess credit risk and thereby improve opportunities for SMEs to access credit as addressed in the SME Statement.

We support the SME Statement, but would like to elaborate on two matters.

First, while there are many very specific SME issues that need to be addressed, their ultimate success is inextricably linked to progress on larger structural and macro issues. Reducing corruption, improving the rule of law through a more effective court system, developing a predictable and impartially administered regulatory framework, reinforcing property rights, and improving corporate governance are all indispensable to more conducive environment for private investment, wealth creation, risk taking and opportunity. The return to lower interest rates – which will depend on appropriate monetary and fiscal policies, renewed lending by banks, development of capital markets and the nonbank financial institutions, are similarly vital to ensure availability of finance on market terms to support business activity, including by SMEs. A comprehensively supportive macro and structural environment, challenging even in the best of times, is a sine qua non for enduring SME development.

Second, I suspect we all agree on the need to adapt SME policies and programs to particular target groups. The specific needs of a small enterprise, for example, are likely to be different from those of a medium sized business. However, we do have some concern that the focus not be overly limited to micro enterprises, with little attention to growth-oriented small and medium enterprises. In part, this is understandable, given the large number of micro enterprises, but fewer medium enterprises. Our hope is that, going forward, re-ensure adequate concern for the circumstances of enterprises which can have much higher growth potential and stronger impact on poverty reduction through not only *more jobs*, but more importantly, *more productive jobs*.

¹ TA 3417-INO: *Promoting Small and Medium Enterprise Development*, for \$2.0 million and TA 3416-INO: *Promoting Deregulation and Competition*, for \$1.5 million. Both TAs were approved in conjunction with the ICSME program loan on 16 March 2000.

11TH CONSULTATIVE GROUP MEETING FOR INDONESIA
STATEMENT BY DELEGATE OF ASIAN DEVELOPMENT BANK
IN THE PLEDGING SESSION

During the past two days delegates have spoken at length of the greater uncertainties and new challenges for Indonesia arising both from the global economic slowdown and the still unfolding events on the global political stage. We have spoken of our high hopes for the success of the new government in addressing the myriad challenges it faces. We have spoken of our continued strong support for the reform commitments it made upon taking office not too long ago. And we have spoken, effectively with one voice, of our commitment to do all that we realistically can to help the people of Indonesia find and navigate a new course to greater economic stability, equitable and sustainable growth, and enduring poverty reduction. I believe it is fair to say that we conclude these meetings with a high degree of consensus around these core views.

But we also expressed, again with effectively one voice, a high and growing level of concern about the current complex of risks to our shared aspirations. We have expressed high and growing concern about the numerous examples of backward steps, unfinished work, and missed opportunities on the policy front to move the country firmly onto the path of progress. We have emphasized repeatedly a real sense of urgency about the need for this government to take clear and emphatic policy actions on a number of core issues. And we have essentially agreed that the costs of further delay have become unsustainably and unacceptably high.

There is near unanimity among us as to what that new heading must entail. A reinvigorated commitment to poverty reduction, including addressing the fiscal and administrative challenges arising from decentralization. Full and timely implementation of commitments now on the table. Determined and successful advocacy for key legislative actions now delayed. Concrete steps to improve public sector and corporate governance, and the integrity of the judicial system. Substantially accelerated divestiture of public assets and thoroughgoing financial sector modernization. Opening the doors to greater competition in both the public and private sectors.

The obstacles are substantial, to be sure, and the stakes are very high. But so is the degree of cohesion among Indonesia's friends and supporters in the international community about the core elements of the way forward. And most importantly, so too are the opportunities for the people of Indonesia.

As for ADB, our Country Strategy anticipates annual new commitment levels for the period 2002-2004 of between \$600 million and \$1.2 billion. We will strive for lending levels at the higher end of this range, as we have done in the past, assuming the necessary underlying support from the Government on the policy and administrative fronts. Actual new commitment and disbursement levels will continue to be driven by demonstrable progress in these critical areas. As part and parcel of this approach, we will intensify our joint monitoring with the Government of: portfolio and project performance; macroeconomic, structural, administrative, and legal reforms; the decentralization process; and, poverty indicators.

Portfolio performance has been undermined by delays in undertaking agreed policy and administrative changes, as well as project-specific problems such as deficient auditing and financial reporting. This has resulted in a high undisbursed loan balance, in the \$3.5 billion

range, out of which delayed program loan tranches amount to \$640 million. Such delays not only reduce disbursements for the ADB itself, but also reduce the availability of cofinancing and put new ADB assistance at risk. We urge our Indonesian colleagues to engage with us, as a matter of priority, to clear away these essentially avoidable obstacles.

In view of its impact on disbursements and its implications for good governance, the decentralization program must also be part of our intensified joint monitoring. In the short run we are committed to working with the government to resolve some of the problems that have emerged. These include: fund transfers from the center to the regions, delays in establishing on-lending mechanisms and cost sharing principles; capacity bottlenecks; and, project identification difficulties. On this last point ADB is planning to introduce, beginning next year, a geographic targeting of its operations to focus better on the poorest provinces with weakest financial capacities.

Our dialogue with the government and civil society on poverty reduction must be deepened, not least to deliver on our "Poverty Partnership" commitment to direct a minimum of 40 percent of new loan funds to targeted poverty reduction operations. We welcome yesterday's announcement by the Coordinating Minister of creation of a new Government committee to coordinate poverty reduction efforts.

In terms of new ADB commitments, we propose to target, as I said earlier, the upper end of the lending range, or \$1.2 billion. It must be emphasized again, however, that actual new commitments in 2002 will fall short of this figure if our policy reform and project design dialogue fails to progress adequately.

Projects proposed in 2002 are in the areas of financial governance; infrastructure development; small and medium enterprise development; rural development; urban development and urban poverty reduction; environmental protection, including coral reef rehabilitation; and support for decentralization including capacity building. Part of our funding will be on highly concessional terms from the Asian Development Fund, subject to the ADF's agreed performance-based allocation mechanism. And we will continue to seek supplemental funding through co-financing and private-public partnerships wherever possible. Finally, we envision a technical assistance grant program totaling around \$12 million, include support in areas of decentralization, good governance including anti-corruption efforts, poverty measurement, support for private sector participation in infrastructure and support for civil society.

Disbursements from ongoing and future loans in 2002 are anticipated around \$1.15 billion. Of this amount, it is important to emphasize that fully \$700 million would be accounted for by policy-based operations, where disbursements will continue to be a function of demonstrated progress on previously agreed policy and/or administrative actions.

In aggregate, we believe this constitutes a substantial and well-focused commitment to restoring economic growth and stability, and accelerating poverty reduction, in Indonesia. It is a commitment that we are pleased to make. And it is a commitment that reaffirms ADB's partnership with the people of Indonesia at a time of extraordinary challenge.

Others have spoken here of the current circumstances presenting Indonesia with a window of opportunity. In our view this is essentially correct. While there is no certainty as to the size of that window, there is also no question that it is not large and that it is getting smaller.

It is our highest hope that, one year from now, we will all – the international community and the people of Indonesia – find ourselves on the other side of that window.

Thank you.