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FAST TRACK BRIEF

IFC in Indonesia

An Independent Country Impact Review

IEG's Country Impact Review (CIR) evaluates IFC's strategies and operations, and their outcome drivers in Indonesia, during fiscal year (FY) 1990-2006. The review covers the period before, during (FY 1998-2000) and after the most recent economic crisis. The CIR was prepared in parallel with the IEG Country Assistance Evaluation (CAE) of the World Bank's operations during FY 1998-2005,—both are intended to inform the next World Bank Group Country Assistance Strategy (CAS) for Indonesia.

The CIR's main messages are:

- While IFC's strategic priorities in Indonesia have been aligned with the country's private sector development needs, it has made little progress in supporting a larger private sector role in infrastructure and in helping deepen the financial markets. Increased private sector participation and IFC support for infrastructure development and for deepening the financial markets will depend on further government reforms. The CIR calls for a stronger IFC role in infrastructure and capital market development, including by strategically and operationally partnering with the World Bank and other MDBs to help dovetail sector reforms and investments.
- IFC needs to strengthen the environmental supervision of its Indonesian projects. The current compliance rate on environmental aspects is significantly below the institutional average and should be improved.

The highlights of the report include:

Indonesia's investment levels after the crisis for infrastructure are well below pre-crisis levels and are limiting economic growth.

During the crisis of 1997-98, Indonesia suffered the deepest economic downturn in Asia and took the longest time to recover. After the crisis, Indonesia's annual Gross Fixed Capital Formation (GFCF) averaged only 20.4 percent of GDP, compared to an annual average of 27.6 percent during 1990-97. Both private sector and public sector components of GFCF fell. The private sector GFCF fell from an annual average of 20.0 percent of GDP before the crisis to an annual average of 15.3 percent after the crisis. Public sector GFCF fell from an annual average of 7.6 percent of GDP before the crisis to an annual average of just 5.6 percent after the crisis. Two recent World Bank reports found that Indonesia has underinvested in infrastructure since the onset of the crisis and needs to increase such investments by the equivalent of at least two percentage points of GDP annually to avoid an infrastructure crisis, which could cripple economic growth. The incomplete financial sector reform and the associated underdevelopment of the long-term local-currency debt market are contributing factors to the insufficient infrastructure investment.

About IEG-IFC

IFC's Independent Evaluation Group (IEG-IFC) independently evaluates IFC's investment and advisory services operations and reports its findings to IFC's management and Board of Directors. IEG-IFC is a resource for helping staff understand what IFC has learned and how IFC can do better business in the future.

About *Fast Track Briefs*

Fast Track Briefs help inform the World Bank Group (WBG) managers and staff about new evaluation findings and recommendations. The views expressed here are those of IEG and should not be attributed to the WBG or its affiliated organizations. The findings here do not support any general inferences beyond the scope of the evaluation, including any inferences about the WBG's past, current or prospective overall performance.

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IFC's strategic investment priorities during the review period were mostly relevant. However, in the areas of infrastructure development and financial market deepening more work is needed.

IFC was successful in supporting projects in the tradable goods sector, in broadening IFC's client base to include second tier companies and local sponsors, and in avoiding projects associated with politically connected sponsors. However, IFC had very few infrastructure projects and had no project to develop the local bond market over the review period because of incomplete reforms in these sectors. After the crisis, IFC focused on SME development and supporting agribusiness projects with linkages to the rural economy and small and medium enterprises (SMEs). In our view, these post-crisis priorities are appropriate given the country's needs and objectives.

The number and levels of IFC investments dropped during the crisis.

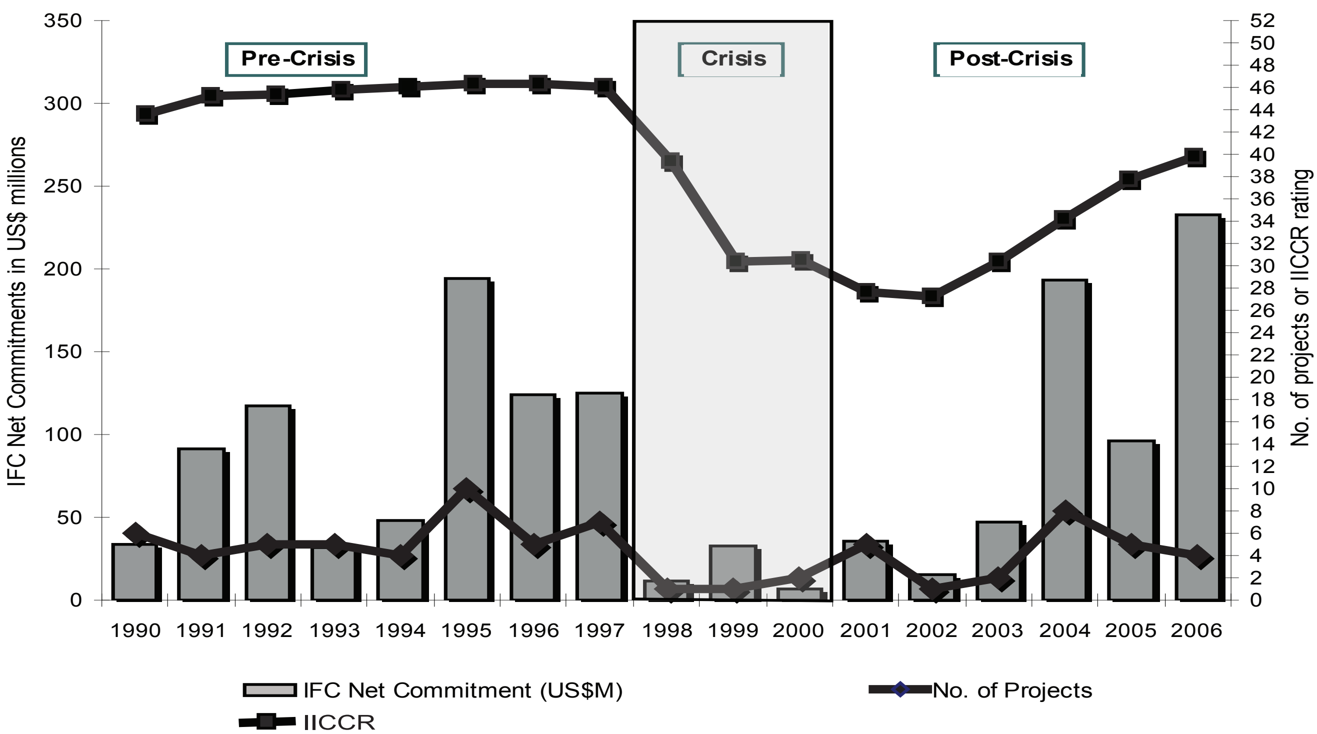
IFC's investment operations fell during the crisis and took several years to recover (see figure 1), mainly because of the lack of reforms. The crisis also contributed to below-average development outcome and loan investment success rates of IFC's mature investment projects. However, equity investment outcomes in Indonesia are similar to the IFC-wide average. The similarity can in part be attributed to the relatively high proportion of low-risk (or high quality) project sponsors. The environmental compliance rate of the Indonesia project portfolio is significantly below the IFC-wide average at the end of the review period. This requires IFC environmental supervision to improve.

Going forward

Major areas of country needs are aligned with IFC's strategic priorities in:

- Infrastructure development, particularly in the provision of electricity;
- Development of a long-term local-currency bond market;
- Development of environmentally and socially sustainable extractive and forestry industries;
- Enhancing the rural development impacts of agribusiness operations; and
- Supporting the development of small and medium enterprises.

Figure 1: IFC's investment commitments in Indonesia post-crisis took several years to recover to their pre-crisis level



Note: IFC net commitments (original commitments less cancellations) are shown by approval fiscal year. Institutional Investor Country Credit Rating scores are by calendar year

Source: International Finance Corporation

CONCLUSIONS AND RECOMMENDATIONS

The main recommendations of the CIR are for IFC to:

- Work with the World Bank and other mulitlateral development banks (MDBs) to help the Government of Indonesia to introduce reforms in the infrastructure and in bond market development to facilitate greater private sector involvement;;
- Scale-up operations to support small and medium enterprises (SMEs) and agribusiness projects with strong linkages to the rural economy and SMEs; and
- Strengthen environmental supervision of IFC projects to improve their compliance with IFC's environmental requirements..

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