

Chairperson's Summary: Committee on Development Effectiveness

IFC in Indonesia: 1990–2006 An Independent Country Impact Review

(Meeting of January 23, 2008)

1. On January 23, 2008, the Informal Subcommittee of the Committee on Development Effectiveness (CODE) considered the IEG reports on *The World Bank in Indonesia, 1999-2006: Country Assistance Evaluation*,¹ and *IFC in Indonesia: 1990 – 2006. An Independent Country Impact Review (CIR)* together with the draft IFC Management Response.
2. **Indonesia Country Impact Review (CIR).** The CIR evaluated the effectiveness of IFC's strategic approach and operations in Indonesia between fiscal years (FY) 1990 and 2006. The CIR described the shift in IFC's operations before, during and after the Asian financial crisis. IEG found that IFC's strategic priorities have been aligned with the country's strategy for private sector development. Among the areas supported, IEG noted that more work is needed in supporting a larger private sector role in infrastructure, and in boosting the financial markets. IEG also emphasized the need to strengthen the environmental, social, health, and safety (ESHS) compliance of projects, which have had lower satisfactory performance in Indonesia than the overall IFC average. Some other recommendations were: (i) strategically partner with the World Bank and other multilateral development banks (MDBs) to introduce sector reforms and investments to promote the role of private sector in infrastructure and to develop a long-term local currency debt market; (ii) scale-up and diversify its agribusiness operations, working more closely with small and medium enterprises (SMEs), farmers and communities; and (iii) scale up support for SMEs in underserved regions through regional SME-oriented commercial banks.
3. **IFC Management Response.** IFC management agreed with the thrust of the findings and recommendations, which were being incorporated into its operations. In the areas of infrastructure and the financial sector, Management elaborated on its ongoing activities and its work with the World Bank. Management commented on its work in supporting the linkages and supply chains in the agriculture sector and plans to expand value chain approaches in International Development Association (IDA) countries in the East Asia region. It assured that greater attention would be given to SME development in remote areas, but also remarked on the need for the government to improve policies to enable greater IFC involvement. To improve ESHS compliance rate, Management said supervision is being increased, and with the decentralization of IFC operations, IFC would strengthen its client contacts and monitoring.
4. **Comments from the Government.** A statement on behalf of the Indonesian authorities was circulated for the meeting. The government welcomed the CIR, which they considered constructive. For IFC's role, the Government encouraged efforts to increase the private sector role in infrastructure, including in the transportation sector. It noted the need to improve the link between IFC Advisory Services and investment operations. Scaling-up and diversification of support to agribusiness was welcomed, taking into consideration the importance of ensuring food security.
5. **Main Conclusions and Next Steps.** CODE members welcomed the opportunity to consider the CAE and the CIR together, which provided a comprehensive review of the Bank and IFC activities. With regards to IFC operations, issues of ESHS compliance and link between IFC

Advisory Services and investment were raised. A few members stressed that the Bank and the IFC needed to address the constraints in infrastructure, which was noted by the two World Bank Group institutions.

6. The need to strengthen ESHS compliance was emphasized. A member stated that IFC ought to better understand the reasons for weak compliance in this area and Management should outline the steps being taken to address them. *IFC management believed that the main reason for the lower ESHS compliance was the Asian financial crisis when a large number of companies experience financial distress. While IFC helped to restructure many clients, a few involved litigations. In the process, IFC supervision was affected and there was impact on ESHS compliance. It was also noted that IFC is strengthening the overall oversight of ESHS with the revised policies for environment and social development, better understanding of ESHS issues in the financial sector, and more proactive supervision including for Category B projects.* The member insisted that according to IEG the problem of compliance is not confined to projects active at the time of the Asian crisis but it includes the entire study period in addition to the most recent years, a fact which IEG confirmed.

7. **Link Between IFC Advisory Services and Investment Operations.** A member sought more information on the need to link advisory services and investment operations and actions being taken to address the matter. *IFC management responded that while advisory services and investment operations were not well-coordinated in the past, the situation has changed more recently. It elaborated on the role of the Country Manager in delivering a coordinated and aligned package of advisory services and investment. Likewise, in the area of infrastructure and the private sector, IFC management emphasized the attention given to coordination with the World Bank.*

8. **Crisis Management.** A member asked whether IFC has systems in place in anticipation of a crisis, based on lessons learned in Indonesia and other countries. *IFC said that since the Asian and Russian crises, it has established a more formal portfolio management system where the credit risk ratings of projects are assessed every quarter. This provides early signals about a deteriorating situation. In addition, IFC said that if there are macroeconomic issues in a country, its portfolio is subjected to a periodic stress-test to determine the potential impact of a crisis and to consider mitigating actions.*

Jiayi Zou, Chairperson, CODE