

LOAN COMMITTEE

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LC/M/86-39
November 21, 1986

Minutes of the Loan Committee to Consider
INDONESIA - Proposed Trade Policy Adjustment Loan
Held on November 17, 1986, in Conference Room E-1208

A. Present

Committee

Chairman: Mr. Stern
Finance: Mr. Hittmair
Legal: Mr. Goldberg
ERS: Mrs. Krueger
OPS: Mr. Husain
Region: Mr. Karaosmanoglu

Others

Messrs/Mmes:
Bhattacharya,
Clements,
Davar,
Doultsinos,
Dubey,
El Maaroufi,
Hamilton,
Kaji,
Katz,
Mead,
Ripley (IMF),
Roger,
Vorkink,
Yenal

DISTRIBUTION

COMMITTEE

Senior Vice President, Operations (Chairman)
Senior Vice President, Finance
Vice President & General Counsel
Vice President, Operations Policy
Regional Vice President concerned*
Vice President, Energy & Industry (for lending
in these sectors and SALs)
Vice President, Economics and Research (for non-
project lending)

OTHERS

Standard (see OMS 9.25 page 7)

*Copy to all other Regional Vice Presidents

B. Issues

1. The meeting was called to discuss the proposals in the Initiating Memorandum attached to Mr. Karaosmanoglu's memorandum of November 10, 1986, for a Trade Policy Adjustment Loan to Indonesia. The discussion focussed on the main issues raised in the Country Policy Department's memorandum of November 14, 1986.

C. Discussion

External Financing Gap

2. The Committee noted that the balance of payments projections showed a large external financing gap and were sensitive to assumptions regarding world oil prices. The meeting discussed how the external financing gap of \$3.7 billion projected for the next two years on the basis of oil at \$18 per barrel would be covered. The Region explained that, taking into account this proposed operation and other envisaged quick-disbursing loans from the Bank, a substantial amount of additional official financing, possibly as much as \$2.1 billion, was expected over the next two years without recourse to the IMF. The financing gap includes amortization payments to commercial banks of \$1.5 billion over the next two years. Therefore, Indonesia could borrow this amount without increasing net exposure. Together with official financing, this would come close to financing the gap without reserve use. However, if needed, Indonesia could draw down reserves by \$1 billion, while maintaining a comfortable import cover ratio. Should oil prices be significantly lower than projected, Indonesia would have to undertake further domestic adjustments and seek additional financing, including possibly from the IMF.

Trade and Related Policies

3. The meeting reviewed the Government's recent policy initiatives and areas for further reform. The Region noted that a preliminary assessment indicates that about four-fifths of non-oil imports are not subject to non-tariff restrictions. Of the rest (about \$2.4 billion of imports at 1985 levels), over one-third had been affected by the trade reform. This was a first but significant step in trade policy reform, which would complement the other adjustment measures taken by the Government. An estimate was being made of the significance of the remaining quantitative restrictions in terms of the percentage of domestic production benefitting from this protection. Concerns were expressed by the Committee about other distortions, in particular about regulations affecting domestic investment and public enterprises and export restrictions. The meeting concluded that the appraisal mission should look at the impact of the recent policy reforms on the overall incentive structure. Given the important linkages and interdependencies between domestic and trade policies, the importance of reducing barriers to domestic competition and enhancing the flexibility of the economy was stressed as an important area for follow-up.

Conditionality

4. The Committee enquired about the medium-term framework for policy reform, the nature and timing of further envisaged reforms, and the Government's commitment to them. The Region, while noting that the proposed loan was in support of policy actions already taken, identified several areas where further policy action could be expected. These included: further removal of QRs, reduction in number of tariffs above 60% and movement towards more uniform protection, an active exchange rate policy, further progress on eliminating investment licensing requirements and regulation, and appropriate fiscal and monetary policies as reflected in the next budget. Based on progress in these areas, the Region would consider proposing a further policy-based loan. The Chairman suggested that the President's Report should indicate the expected timing of the next loan, as an indication of the time frame in which further policy actions could be expected. In view of the untranching nature of the loan, the meeting also stressed that the Letter of Development Policy and the President's Report should clearly state the Government's future policy objectives, without necessarily providing a set timetable for further reforms.

Other Matters

5. In response to a question about the possibility of retroactive financing, it was agreed that this should be pursued only if there were clear and pressing reasons for it. Finally, the Committee noted that the technical assistance component should not be included in this loan but be processed separately, as it would have a much longer disbursement profile.

D. Conclusion

6. Subject to the above modifications, the Loan Committee agreed that the Region should proceed with the preparation of the Trade Policy Adjustment Loan as proposed in the Initiating Memorandum.