

Good Governance and Development: A Time For Action

by

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Twenty years ago this month I arrived in Indonesia as the American Ambassador. Little did I know at the time that I would become so attached to this wonderful country, and so deeply moved by the kindness, passion, and courage of your people. I am privileged to have enjoyed warm and deep friendships with many of you, friendships which have left a profound mark on my professional and my personal life.

It is great to see many of those old friends in the audience tonight, and perhaps it is not surprising that the words that best capture my feelings today are in Bahasa: "pulang kampung." I am thrilled to be back home in Indonesia once again.

I would also like to express my heart-felt thanks to the two sponsors who have worked so hard to make this event possible. Tempo needs no introduction to this group, led by brilliant and brave people, including my old friends Bambang Harymurti, Gunawan Muhammad, and Fikri Jufri, it has stood at the forefront of Indonesia's struggle for freedom of expression for a generation. Bambang's recent victory in the Supreme Court safeguards values that are so important to the people of this country, and it is an honor to be here to help celebrate 35 years of remarkable perseverance and achievements. CSIS has played an active in Indonesia's intellectual journey over the past three decades. It has maintained the very highest standards of intellectual integrity, even when this was costly.

Indeed, change in Indonesia over the past 20 years has been breathtaking. Your population has grown from 166 million when I first arrived as Ambassador, to 212 million today. In the last 20 years, Indonesians have seen their average incomes double, and the percentage of people living in extreme poverty, that is, people surviving on a dollar a day or less, has dropped dramatically, from 28 percent 20 years ago, to about 5 percent, although we must recognize that still represents 11 million people, far too many.

These gains are impressive by any standards. They are all the more impressive when you consider the economic crisis that swept this country 8 years ago. The financial collapse of the late 1990s was a crushing setback to the Indonesian economy. In one year alone, from 1997 to 1998, GDP declined by 13 percent. By conservative estimates, the collapse cost Indonesia some \$40 billion. At the time, many people believed Indonesia would take a long time to recover. Some even questioned whether it would survive as a unified country. Instead, Indonesia got back on its feet with a strong economic recovery, and, indeed, experienced a truly extraordinary and peaceful democratic transition.

While significant problems persist and the economy still has far to go to fulfill its real promise, the past few years have shown Indonesia's ability to rise above enormous challenges. You have passed a key milestone in democratic development, that is, two consecutive free and fair presidential elections. As Bambang and Jusuf both noted, when I left here at the end of my term as Ambassador, I made an appeal for greater political openness in this country and expressed my belief that not only did the country need it, but it was ready for it, and that changes in that regard, though they took some time to come, have been dramatic. The press which used to operate under severe censorship is now free, bringing all the blessings and the challenges that come with such openness,

and I have my sympathy for colleagues in the Indonesian government. Sometimes it is tough, but it makes your job ultimately better.

The Parliament which used to be a subservient arm of the Executive is now a vigorous forum for debate, and an important check on Executive power. And just as important has been the emergence of a strong civil society that encompasses national religious organizations, the pesantren (traditional Islamic Boarding school) school system, a press that was vibrant even under censorship, and a deeply rooted spirit of cooperation that is captured by the Javanese expression gotong royong.

Yet there are enormous challenges ahead. Investment remains low. Indeed, it has fallen from 30 percent of GDP, to 20 percent since the crisis, far lower than your fast-growing Asian neighbors. More jobs are needed, particularly for young people, one-third of whom are unemployed. And the quality of education, health care, and infrastructure is poor. Of course, you do not need any reminders that nature is often unkind to Indonesia. You are located in a region that is regularly hit by earthquakes, volcanic eruptions, and typhoons, but the tsunami that struck Aceh and Nias a year ago December, counts as one of the worst natural disasters in 100 years. The challenge from recovering from that enormous disaster adds a huge burden to an already daunting development challenge.

President Yudhoyono and his team have shown a strong political will to confront these challenges, but they face the difficult task of moving from commitment to results, and making a real difference in the lives of millions of Indonesians.

In the 10 months since I joined the World Bank, I have traveled to developing countries in Sub-Saharan Africa, in South Asia, in East Asia, and in Latin America. I have met with people from all walks of life. Across remarkably different continents I have heard the same thing: people want opportunities, they want a better future for their children. But without a government that can deliver on its promises, without a government that listens and treats its citizens fairly, those hopes and dreams cannot be realized. To put it more plainly: people need government that works.

In the last half-century we have developed a better understanding of what helps governments function effectively and achieve economic progress. In the development community, we have a phrase for it. We call it good governance. It is essentially the combination of transparent and accountable institutions, strong skills and competence, and a fundamental willingness to do the right thing. Those are the things that enable a government to deliver services to its people efficiently.

An independent judiciary, a free press, and a vibrant civil society are important components of good governance. They balance the power of governments, and they hold them accountable for delivering better services, creating jobs, and improving living standards. Some countries can achieve growth for many years without all of those factors. Indeed, Indonesia's history in the 1970s and 1980s is an illustration of that. But the devastating economic crisis that followed here shows how fragile growth can be when institutions that keep governments accountable, transparent, and responsible, are systematically weakened.

What the Asian crisis of some 8 years ago shows, and nowhere more clearly than here in Indonesia, is that corruption is often at the very root of why governments do not work. Today one of the biggest threats to development in many countries, including I think here, is corruption. It weakens fundamental systems, it distorts markets, and it encourages people to apply their skills and energies in nonproductive ways. In the end, governments and citizens will pay a price, a price in lower incomes, in lower investment, and in more volatile economic fluctuations. That is a lesson Indonesia learned the hard way. Corruption contributed significantly to the economic collapse of

1997-1998. It now looms as a major obstacle to achieving the development successes that I believe this country is capable of, and which the Indonesian people deserve.

Corruption not only undermines the ability of governments to function properly, it also stifles the growth of the private sector. We hear it from investors, domestic and foreign, investors who worry that where corruption is rampant, contracts are unenforceable, competition is skewed, and the costs of doing business becomes stifling. When investors see that, they take their money somewhere else.

To give you an idea, in Indonesia, a survey of firms said that 56 percent of them, a majority, were willing to pay more taxes, in fact, half were willing to pay up to 5 percent of their revenues, if corruption could be eliminated. When businessmen offer to pay more taxes to solve a problem, you know it is a real problem.

Corruption thrives in countries where private investors face cumbersome procedures and excessive regulations. When extra licenses are needed to start a business, when extra signatures are required to import goods, that creates opportunities for abuse of authority and for corruption.

One of the most interesting and useful products of the World Bank Group is something we started a few years ago called the Doing Business report which looks at the investment climate in 155 different countries around the world and ranks them in various categories according to ease of doing business. That kind of analysis is already, I think, having a useful impact here in Indonesia. When the new government learned in 2004 that it took 151 days to launch a business here, three times the average for the world, your President announced that this would be reduced to 30 days. Our estimates show that the time to start a business has already fallen to below 80 days, and we are hopeful the government will reach its target. That would be a wonderful success story.

But the government faces many challenges ahead. It costs Indonesian entrepreneurs the equivalent of one year's income to register a business, and more than three-and-a-half times their annual income to obtain all the necessary licenses and permits.

But perhaps the most important challenge lies in the enforcement of contracts. On this front, Indonesia ranks amongst the lowest in the world, 145 out of 155. In fact, investors' lack of trust in the legal system is one of the problems that have brought investment levels down to half of those of your fast-growing neighbors.

Indonesia has already begun to confront some of these difficult challenges. President Yudhoyono has launched a tough anti-corruption drive that is holding public officials accountable across all levels of government.

New institutions like the Anti-Corruption Commission, the Anti-Corruption Court, the Judicial Commission and Timastipikor are up and running and producing results. And institutions like the Supreme Audit Commission and the Attorney General's Office are showing newfound strength.

Even more important are the measures taken to reduce opportunities and incentives for corruption, led by an impressive economic team. [When Pak Boediono was finance minister, he began a comprehensive plan of reforms on revenue management, treasury systems and tax and customs reforms. Today, Sri Mulyani is boldly taking them forward.]

I am pleased that the World Bank Group has been providing help in this area, and I am meeting with the government on this visit to see how we can do more.

We know that when governments don't work, the development assistance we provide to governments doesn't work either.

It means that children are denied the education they need - mothers are denied the health care they deserve - and countries are denied the institutions needed to deliver real results.

But when governments do work-when they confront corruption and improve their rule of law-they can raise their national incomes by as much as four times in the long run.

The World Bank first acknowledged corruption as a major impediment to development only ten years ago. But since then, it has been leading the development community in coming to grips with this very serious, but long-ignored problem.

We have pioneered research to better understand the root causes of corruption. We are learning from the experiences of countries worldwide and integrating anticorruption measures into our operations, our research, and our dialogue with partner countries, but we, too, need to do more. Fighting corruption is a long-term commitment, and results will not come overnight.

What we can work for is steady progress toward building transparent and accountable institutions. That is why fighting corruption requires a long-term strategy that systematically and progressively attacks the problem, and that is why any strategy for solving the problem requires the commitment and participation of governments, private citizens, and private businesses alike.

There has been some attention in the newspapers recently to a number of actions that we have taken to suspend lending in existing projects where corruption concerns have emerged. That has to be an important part of any World Bank strategy for dealing with the problem, but it is only a part, and not even the most important part. Suspending loans on problem projects by itself does not deliver results for the poor. Much more is needed.

Today we are stepping up our governance and anticorruption efforts along three different fronts, and let me describe them. First is the country approach. We are working to significantly expand our anticorruption work at the country level so that our partner countries receive the support they need in carrying out reforms. This will include investing in professional expertise to address corruption, and backing our teams in the field with governance specialists. I will be asking my staff in high-risk countries to develop a strategy to mobilize all World Bank instruments, loans, grants, research, technical assistance, and private-sector investment, to strengthen and fight corruption. We will increase our investments in such key areas as judicial reform, civil service reform, the media, and freedom of information and decentralization of public service delivery.

The World Bank Group's country strategy for Indonesia is in many ways leading the World Bank as a whole. It is one that particularly emphasizes governance. In partnership with the Indonesian government, we are committing \$900 million this year to strengthen governance with the goal of improving service delivery in education, health, and other essential services, and enhancing the investment climate. Our governance indicators already show that Indonesia is making headway in controlling corruption. It has moved up in rank from near the bottom, at 16 in 2002, to 40 today, in a list of about 200 countries. Bigger numbers are better. Clearly, that ranking remains too low, and much more needs to be done, but this progress suggests that progress is possible and is taking place. In countries like Indonesia where the government is committed to fighting corruption, our resources and expertise can make a difference.

Second, we are implementing a new system for minimizing the risk of corruption in World Bank

funded projects. Many of the elements of this new system were developed right here in Indonesia, and we are eager to bring them to other countries. We will deploy anticorruption teams in many Country Offices to work with local institutions like government audit units, and anticorruption commissions, to protect our projects and strengthen public procurement. We also are changing the way we design our projects so that they address the incentives and opportunities to fight corruption right from the start.

During this short visit, I have seen tsunami survivors in Aceh managing their own reconstruction projects, I have seen widows using microfinance to improve their families' lives, and I have talked to local villagers in Sulawesi who have been deciding which development projects to pursue. In all of these projects, the communities determine where the investments are made. They control the funds and monitor the results of the projects. The result has been more value for each rupiah spent, and demonstrable reductions in the levels of corruption.

We are developing anticorruption strategies for World Bank projects and we are publishing them on the Web so that our stakeholders can see what steps are being taken to ensure that resources are not diverted. Our Jakarta office, as I think I have said already, is one of the leaders in the World Bank Group in this effort, and I thank them. And we are empowering our Investigations Unit so that it can have the necessary staff, skills, and resources to detect fraud and follow-up on allegations of corruption in Bank financed projects, particularly on high-risk projects.

And third, we are committed to expanding our partnerships with a wide range of groups that have a stake in improving governance. One of the most important partners is the private sector worldwide. While there are individual firms that may take advantage of weak governance to alter the competitive playing field, the private sector as a whole stands to lose when corruption is pervasive and the rule of law is undermined. That loss in turn hurts society in lost growth and in lost job creation. We will work more closely with firms and individuals to identify misuse of funds in World Bank financed private-sector projects.

The multilateral development banks are another important partner, and the heads of those banks met several weeks ago and we agreed to develop a common approach to the problem. For the first time, I think, it was identified by all of us as a major obstacle to poverty reduction, and we are working on a common strategy to blacklist firms that engage in corruption on our projects, and to share information on these firms so that if you steal from one of us, you cannot go on to steal from the next. I believe it would be good if all development institutions would publicly blacklist firms and individuals that engage in bribery in projects, as the World Bank already does.

Corruption is not just a problem for developing countries to deal with. The developed countries have an enormous responsibility. Indeed, every corrupt transaction has, unfortunately, at least two parties, and often more, and very often the bribe givers are from developed countries. They need to do more to police that. And they also need to do more to prevent stolen cash from being moved to foreign bank accounts, and to hold private firms accountable if they export corruption to emerging economies.

Civil society everywhere is one of our most important partners. We will work with civil society groups because they are a key to holding governments accountable. Tomorrow I will be meeting with the heads of what I guess are the largest Muslim organizations in the world that represent millions of members across Indonesia. One of the subjects will be to explore how the World Bank can engage with these large and important civil society organizations to help ensure that aid dollars flow to the communities that they are intended to go to.

To conclude, enforcement alone will not cure corruption. How much we do and how much progress we make depends on the desire of both governments and civil society to create the right setting for sound, strong, sustainable development. The greatest changes come when people's ideas change, and in many countries, people are no longer as tolerant of corruption as they were in the past. A growing middle-class that is independent of government increasingly demands better performance from government. Expanding social safety nets can make even poor citizens less dependent on traditional powerful patrons. And the good news here in Indonesia is that the social and economic achievements of the last 40 years have created demand for government that works. The people of Indonesia recognize that with transparent and accountable governance they stand a better chance of reducing corruption, of improving their quality of life, and of securing a better future for their children.

I am told the newly elected Mayor of Depok, Nurmahumdi Ismail, echoed this sentiment when he said, "My dream is that my staff changes their orientation from thinking they are people of power, to thinking they are servants of the people."

Despite many challenges, I am deeply optimistic about this great country, and I would like to commit the full energy of the World Bank to assist you in these exciting times.

This morning I visited the grave of my good friend Nurcholis Majid, or Cak Nur as you all know him. His life, which ended prematurely just a few months ago, helps explain why I love this country so much, and why I am so hopeful about its future. He was a man of exceptional talent and profound humanity, grounded in a deep faith. When he briefly considered running for President 2 years ago, he laid out 10 principles for guiding government. The first two were promoting good governance, and upholding the supremacy of the law. I believe in these priorities not just for Indonesia, but as key principles for the World Bank Group's relations with all of our partners. These are principles we share with your current leadership and with your people, and we have every reason to be hopeful for the future. Thank you.