



**Australian Government**

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**AusAID**

**AUSTRALIAN AGENCY FOR INTERNATIONAL  
DEVELOPMENT**

**INDONESIA COUNTRY PROGRAM STRATEGY**

**FROM 2003**

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ABBREVIATIONS AND ACRONYMS

<b>ACIAR</b>	Australian Centre for International Agricultural Research
<b>ADB</b>	Asian Development Bank
<b>AMS</b>	Activity Monitoring System
<b>AusAID</b>	Australian Agency for International Development
<b>Bappenas</b>	National Economic Planning Board
<b>CGI</b>	Consultative Group on Indonesia
<b>CSO</b>	Civil Society Organisation
<b>GDP</b>	Gross Domestic Product
<b>GNI</b>	Gross National Income
<b>GNP</b>	Gross National Product
<b>GoI</b>	Government of Indonesia
<b>IBRA</b>	Indonesian Bank Restructuring Agency
<b>IDP</b>	Internally Displaced Person
<b>IMF</b>	International Monetary Fund
<b>LOI</b>	Letter of Intent
<b>MIS</b>	Management Information System
<b>NFP</b>	National Forestry Program
<b>NGO</b>	Non-Government Organisation
<b>ODA</b>	Official Development Assistance
<b>PPP</b>	Purchasing Power Parity
<b>SME</b>	Small and Medium Enterprise
<b>SMERU</b>	Social Monitoring and Early Response Unit
<b>SUSENAS</b>	National Socio-Economic Survey
<b>TNI</b>	Indonesia National Military
<b>UN</b>	United Nations
<b>UNDP</b>	United Nations Development Program
<b>UNICEF</b>	United Nations Children's' Fund
<b>VCP</b>	Virtual Colombo Plan

## **EXECUTIVE SUMMARY**

### **Background**

Australia's national interest is best served by having a unified, prosperous and democratically strong Indonesia as a neighbour. This will be a major challenge as Indonesia strives to emerge from a severe economic crisis and continue its difficult transition to a decentralised, democratic and prosperous society. This transition will span many years. Its success will depend significantly on reducing the poverty and vulnerability that currently affects more than half of Indonesia's 210 million citizens.

Indonesia's devastating 1997-99 economic and political crisis exposed fundamental weaknesses in its financial system and institutions of law and government and dramatically altered Indonesia's development prospects. The installation of the Megawati Government in July 2001 coincided with a transition from crisis management to a focus on the institutional and structural obstacles to sustained economic growth and poverty reduction.

It remains to be seen whether the Megawati government--or its successor--can re-establish economic, political and social reform momentum towards a more democratic state capable of sustained strong economic growth.

The available evidence suggests that the leadership will move ahead in a measured way, avoiding potentially destabilising pressures that may arise from aggressive reform on many fronts. The most likely scenario is a prolonged period of economic growth of around 3-4% a year, with uneven and somewhat erratic progress towards a vibrant democracy. As a result Indonesia will have difficulty absorbing the more than two million people projected to enter the labour market each year for the next decade. Moreover, 100 million people will still be in poverty or vulnerable to poverty a decade from now.

Poverty affects at least half of the entire Indonesian population. Poverty in Indonesia is not just a matter of inadequate incomes and expenditures on food and other daily necessities: many of the poor and near poor lack access to basic education, health services and adequate nutrition. The incidence of poverty in Indonesia varies considerably among and within provinces, but three-quarters of Indonesia's poor live in rural areas.

Prolonged weak growth not only will fail to significantly reduce the incidence of poverty but it may also give rise to social and political unrest. For long-term political and social stability, it is imperative that Indonesia avoids economic stagnation.

### **The Proposed Strategy**

In accordance with Australia's national interest in ensuring a stable and prosperous Indonesia, and in light of the threat posed to this by large numbers of Indonesian poor, the long-term goal of Australia's development cooperation program with Indonesia over the next decade will be to assist that country to reduce poverty and achieve sustainable development.

The analysis indicates that to achieve this goal Australia will need to target its efforts on four inter-related strategic objectives:

- **Improve economic management** through support for critical measures for accelerated structural reform including assistance for revenue enhancement, financial sector restructuring and supervision, and debt management.
- **Support the transition to democracy** by strengthening democratic institutions and practices, through assistance for legal and judicial reform, the institutions of human rights and public accountability, electoral and parliamentary processes and institutions, and civil society.
- **Enhance security and stability** through support for law enforcement and counter-terrorism capacity building, conflict and disaster prevention and humanitarian assistance for vulnerable groups.
- **Increase the accessibility and quality of basic social services** through policy engagement at the national level and support for planning and implementation at the district level, and support for community-based approaches.

These objectives are consistent with the national development priorities identified by the Government of Indonesia in its current planning document, *Propenas 2000 – 2004*.

A key element of the strategy over the medium term is to reduce the program's current geographic spread and significantly improve its poverty focus. A broad program target of eight of Indonesia's poorest provinces has been identified. Within this broader target, three or four focus provinces will be selected for intensive direct poverty reduction efforts in a number of contiguous districts.

Monitoring program performance will be an integral part of program risk management arrangements. The increased uncertainty about the future course of political, social and economic development in Indonesia places a premium on enhanced risk management.

- There are three broad categories of risk to be managed:
  - *external risks*, including global economic slowdown and financial contagion;
  - *country risks*, including political and social unrest, weak governance, economic and financial crises and lack of reform progress; and
  - *project-specific risks*, including poor project preparation and design, weak implementation arrangements, lack of effective demand for projects, poorly defined target groups or beneficiaries and weak institutional linkages.

Management of country risks will include redeployment of resources to sectors that are performing well, or to geographic areas or agencies and organisations at the national or local level that demonstrate a strong commitment to reform and that have objectives consistent with those of the program.

# **1 THE DEVELOPMENT CONTEXT**

## **1.1 THE TRANSITION TO DEMOCRACY**

### **Early Progress**

In June 1999, Indonesia held its first free and open elections since the 1950s. Post election negotiations resulted in the appointment of Abdurrahman Wahid as President and Megawati Sukarnoputri as Vice-President. The initial governing coalition proved to be incapable of giving direction to reform efforts and was characterised by indecision and weak leadership. A situation of near paralysis developed during this period as politics dominated Government business. President Wahid tenure was brought to an end with his impeachment by Parliament in July 2001. The Government of President Megawati Sukarnoputri was installed and a new ‘Rainbow Cabinet’ with representatives from various political parties appointed. President Megawati’s government has brought increased stability to Indonesia.

Constitutional amendments passed during the August 2002 session of the People’s Consultative Assembly represent a fundamental change to Indonesia’s political system. The amendments provide for direct elections of the president and vice president and a fully elected legislature.

Despite impressive progress with institutional reform since 1999, problems remain. Action is required on many fronts including clearer definition of the respective roles and powers of the Executive and Legislature, legal and judicial reforms and corruption. Reform programs also need to deal with administrative reform, including archaic management systems, inadequate budgets and other problems that contribute to the lack of effectiveness of Indonesia’s institutions.

### **The Threat of Political Violence**

The vast majority of Indonesians are committed to peaceful political change and to ensuring the integrity of Indonesia as a nation state. Nonetheless, the new freedoms ushered in after the fall of the Soeharto Government have brought to the surface long-suppressed ethnic divisions, deterioration in law and order and an increase in politically motivated violence. The secessionist movements in Aceh and Papua are one of the most visible forms of opposition; the other is communal violence of the kind that has occurred in the Maluku, Central Kalimantan and South Sulawesi. Other potential hotspots, such as North Sulawesi, East Kalimantan and South Kalimantan, could erupt into violence and further risk the stability of Indonesia.

Tensions have mounted as local aspirations for self-rule are met by the determination of the central government and military to maintain Indonesia’s territorial integrity. The passage of special autonomy laws for Aceh and Papua in 2002 offered a good prospect to dissipate some of the pressures for independence, but progress on implementation has been slow. The presidential decree dividing Papua into three provinces has complicated the situation there.

As well as the tragic loss of life, the bombings in Bali on 12 October 2002 confirmed that terrorism presents a significant threat to Indonesia’s sovereign democracy. In response, the Government of Indonesia announced an eight-point approach to combating terrorism and has

moved to implement a range of these initiatives. Effectively combating terrorism is a significant task that will require adequate resources over a long period of time.

Progress by the national government in asserting civilian control over its military and security forces is an important barometer for the democratic transition. This control is also needed if human rights abuses that have exacerbated tensions in troubled regions are to be avoided. In the event that civilian control is not reasserted, and human rights abuses continue, even generous autonomy arrangements are unlikely to stem the pressures for independence. In these circumstances, the Government would likely face a long and costly struggle with permanently rebellious local populations. Preserving national unity will become a major preoccupation and likely to retard progress towards democracy.

### **The Shift to Decentralised Government**

After decades of highly centralised government, decentralisation is widely seen as a political imperative for Indonesia, to respond to strong pressures within the country for greater local participation and representation in the economic and political life of the country. The decentralisation laws are bringing fundamental and far-reaching changes to the way in which Indonesia is governed. Laws 22 and 25 of 1999 devolve most functions of government to Indonesia's districts and cities. The key exceptions are national defence, international relations, justice, police, monetary policy, national planning, religion and finance. These laws also provide for an increase in the regional share of general government spending. When decentralisation is fully implemented, the regions will spend some 8% to 9% of GDP, or well over 40% of general government spending – more than double what they spent prior to the decentralisation program.

So far, the results of decentralization are mixed: financial transfers from the centre to districts are being effected; essential services continue to be delivered and in some districts there are indications that the budget allocations for these have increased; there is more open, public debate about key issues confronting Indonesian society; local governments are becoming more active and legislatures have begun to take a greater interest in overseeing executive branches of local governments. The central government is beginning to make the transition also from service delivery to setting minimum standards and monitoring. However, there is limited capacity in many district governments with consequent problems in the allocation and management of public funds. The absence of regulatory frameworks is creating opportunities for the ad hoc, unregulated imposition of local taxes and levies, over-exploitation of the environment and the imbalance in the resourcing of essential services. Support is required at both national and district levels to ensure that the hopes and aspirations embodied in the decentralization process do become a reality. The decentralisation of government is one of the greatest areas of uncertainty over the medium term.

## **1.2 GOVERNANCE AND CIVIL SOCIETY**

### **Improving Governance and Combating Corruption**

Indonesia remains an extremely difficult country in which to conduct business, largely because of systemic corruption and a lack of legal certainty. There is a vigorous national debate underway on how to control corruption. The Government's stated commitments to reform have been vulnerable to pressures from strong political and vested interests. Strong resistance from entrenched interests in the bureaucracy, the legal system and enforcement

agencies has delayed reforms or undermined their implementation. It is proving difficult for the authorities to show clear and significant progress. Recent attempts at combating corruption by prosecuting the highest ranks of government have yet to produce significant results, thereby increasing society's distrust of government and the legal system.

Problems with the rule of law centre on an inadequate legal framework compounded by lack of enforcement and extensive bribe taking and giving within the enforcement agencies of Indonesia – primarily the judiciary, the police and the public prosecutors. The origin of endemic corruption in enforcement agencies is the long period under Soeharto in which there was minimal public accountability and transparency. Low salaries, poor training and inadequate budgets significantly compound the problems.

There is no clearly articulated strategy for administrative reform and there may be little prospect for major reforms until after the 2004 elections. Successful administrative reform will require, *inter alia*, stronger civil society organisations that can exercise advocacy and oversight functions.

### **Development of Civil Society**

During the Soeharto era, the activities of NGOs and other citizen groups were tightly controlled and monitored. Since the fall of the Soeharto Government, however, there has been a proliferation of private organisations intent on improving oversight of political processes, government, the legal system and business activities, to mention but a few. There is a lively and free press with thousands of new journalists, and hundreds of new magazines, newspapers and radio stations, an increasingly vocal and active civil society and a growing free trade union movement. There is now more open domestic debate about the major issues that confront the country, including for example, corruption, debt, and participation of civil society in public policy formulation. The free press is active in commenting on the political process and the courts. The Parliament now plays a more meaningful role in shaping the laws and policies of the country. With decentralisation, local governments have become increasingly active and legislatures have begun to take a greater interest in overseeing executive branches of local government. Decentralisation, democratisation and increased media freedom are all helping improve Government responsiveness to society's needs, albeit slowly and from a low base.

### **The Problem of Gender Inequality**

As a consequence of persistent biases, women have not benefited as much as men from the development that has taken place in the past three decades. Maternal mortality rates in Indonesia among the highest in Asia. Illiteracy among females is higher than for males, although the gap has narrowed considerably. Access to basic education is nearly gender balanced, but problems persist at the senior secondary and tertiary levels. Despite increasingly equal access to education, there are significant biases in the labour market. Women are primarily found in low-skill, low-paid employment. They are over-represented among the unemployed and underemployed, are often not well informed about their workplace rights, and these rights are not well enforced. Only 7% of the senior administrators and managers are women. Women make up 34% of the civil service, but only 4% are in the highest two echelons. There has been no significant improvement in elevating women to positions of public office. In fact, the number of women in Parliament has actually declined. Parliament has only 10% women, and only 2% of village heads are women.



Part of the problem is the institutionalisation of gender inequalities. Although the Constitution gives equal rights to women, successive state policy documents have defined separate roles for men and women: men as heads of households and women as mothers and caretakers. These stereotypes are increasingly at odds with conditions in society. According to the 2000 Population Census, for example, women now head more than 14% of households in Indonesia. Poverty interventions have typically not recognised these demographic realities. Women have been discriminated against in gaining access to resources such as capital, property, credit and information. Citizenship laws do not allow women to pass nationality on to their children. The legal position of women is weak in the workplace, in inheritance, in trade and with respect to rape, adultery and violence. Tax laws treat women as minors.

In recent years, the Government has attempted to give more prominence to the problem of gender inequality. National development goals now include gender equality as an objective and a number of specific programs have been launched, including a review of the bias in legal statutes. The mandate of the State Ministry of Women's Empowerment has been expanded. But budgetary support and institutional capacities for furthering these objectives are limited.

### **1.3 ECONOMIC RECOVERY AND STRUCTURAL REFORM**

The financial crisis of 1997 and subsequent political upheavals brought the era of rapid economic gains to an end. GDP contracted by some 13% in 1998. The combination of the economic decline and currency devaluation meant that GDP declined from US\$270 billion in 1996 to US\$95 billion in 1998. The Indonesian economy began to recover in 2000, registering growth of almost 5%. However, growth slowed to about 3.5 % in 2001, reflecting slower world growth as well as internal structural impediments. Despite increased competitiveness from the depreciation of the Rupiah from early 2000 until mid-2001, non-oil export growth weakened in 2001. Weaker domestic demand and a slowdown in imports partly offset slower export growth.

Before the 1997-99 crisis, Indonesia had very little domestic public debt and only a moderate level of external public debt. Today, the Government is burdened with debt equivalent to around 70% of GDP (down from 100% in 2000) and debt service payments equivalent to around 35% of fiscal revenues. In the next few years, large amounts of the US\$75 billion of government domestic debt will reach maturity. While some of this debt could be retired, the bulk of it will have to be refinanced. To do so in an orderly manner that does not jeopardise macroeconomic stability will require the existence of an effective bond market.

Indonesia's high level of debt is a potential source of financial instability. The very large service payments place significant strains on the Government's ability to maintain spending on basic services and development, (the development budget has been cut for four years in a row). Maintaining the fiscal consolidation strategy and a budget deficit target of less than 2 % of GDP will require a significant effort to raise non-oil tax and other revenues. Asset sales by IBRA and privatisation may fall short of budget targets in the face of domestic opposition to particular transactions. A major effort to raise tax revenues will be required. Improved revenues will depend on extensive administrative reforms, reductions in tax exemptions and a concerted effort to broaden the tax base.

The Megawati Government has achieved significant progress on reforms. A period of macroeconomic stability has resulted in the debt to GDP ratio being reduced, interest and

inflation rates have also fallen and a stronger market confidence in the rupiah. Indonesia credit rating has also improved. The Government has also demonstrated an ability to respond quickly to shocks as it did in introducing a number of measures after the October 12 Bali attack. Other examples of progress include the passage of a law on the anti-corruption commission, the sale of Bank Danamon, and announcements of further bank sales. The Parliament passed an anti-money laundering law that will assist in the tracking and freezing of criminal and terrorist funds. Legislation for a consolidated supervisory regulator and financial safety net is being drafted. Developments in trade policy are less encouraging, the government is taking a more protectionist stance and has recently introduced a range of tariff and non-tariff measures.

Indonesia's current IMF program is an Extended Fund Facility (EFF), which is scheduled to end in December 2003. Being in good standing in an IMF program that involves regular monitoring is a pre-condition for Paris Club-supported debt re-scheduling, it can be a condition of support by development banks and can influence investor confidence. There has been considerable debate from politicians and civil society about whether or not Indonesia should enter another agreement with the IMF, much of which has been very critical of the Fund. Whether or not Indonesia enters into a new IMF program, firm economic management and a credible reform program will be critical to Indonesia's future prosperity.

Despite the progress in structural reform, there has been serious erosion in private investor confidence. Prior to the crisis, fixed investment had been running at around 30% of GDP. Since the onset of the crisis, this ratio had declined to about 17% of GDP in 2000, a level of investment that is not sufficient to support sustained strong growth. The decline in investment stems from loss of confidence among both domestic and foreign investors. Investment funds have been shifted to other emerging markets that are perceived to be much less risky. Unlike other crisis-affected countries, the large net outflow of foreign private capital, which began shortly after the onset of the crisis, continues, though has slowed markedly as the economy has stabilised. Foreign investors have noted security problems affecting mining and oil and gas companies, such as ExxonMobil in Aceh, political interference in the asset sales process of IBRA, and an uncertain judicial environment as shown in the Manulife case.<sup>1</sup> Indonesia has also experienced substantial domestic capital flight since 1997, primarily by Indonesian Chinese business interests. The amounts are believed to be in the billions of dollars. While there has been some indication of a return of the capital in small amounts, it remains to be seen whether this signifies a return in confidence among Indonesia's Chinese business people and whether investment inflows from abroad will recover.

Economic recovery depends primarily on renewed private investment. Indonesia is facing a situation of declining competitiveness as a result of declining investment in key infrastructure, particularly in the power sector. The Government's heavy debt burden will limit the use of fiscal policy to create additional domestic demand in support of stronger economic growth. The private sector must therefore be the engine of growth in the Indonesian economy. A recovery in investor confidence and aggregate investment spending of 25% to 30% of GDP on a sustained basis will be essential for GDP growth of 5% a year or more.

Concerted efforts will be required to remove to restore investor confidence and establish a vibrant private sector. The basic prescriptions for a strong and productive private sector are well known. They centre on having secure property rights, impartial enforcement of contracts

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<sup>1</sup> The Manulife case involved officials from the police and judiciary conniving in attempted extortion against a foreign-owned subsidiary during the sale of government assets.

and internationally accepted codes of commercial conduct. The legal and judicial system must operate in an impartial manner in support of these basic principles. It will also be critical for the Government to effect in a timely and transparent manner the transfer back to the private sector of substantial assets now held by the public sector, accelerate corporate restructuring, improve corporate governance, adopt policies that will foster competition, and develop the small and medium enterprise sector. Progress on this wide-ranging agenda will be essential for a recovery in domestic and foreign investor confidence and improved prospects for sustained strong growth.

A period of protracted slow growth in the range of 2.5 - 3% a year would place considerable strains on the revenue side of the budget. In these circumstances there would be continued under-funding of development investment and expenditures. The country would not be able to reduce the burden of debt and would be very vulnerable to bouts of financial instability. Furthermore, a prolonged period of such low growth also implies almost no growth in per capita incomes. Such a scenario has serious implications for stability, especially in Java, and therefore represents an important issue for the Government of Indonesia and a key strategic issue for Australia and the region.

#### **1.4 PROTECTING THE ENVIRONMENT**

Progress in addressing the major environmental issues in Indonesia has been uneven, with the least progress being made in forestry. In 1999, the Government undertook to formulate a National Forestry Program (NFP) and to take action on eight specific issues: measures against illegal loggers and sawmills; forest resource assessment as a basis for formulating the NFP; a moratorium on all natural forest conversion pending agreement on the NFP; downsizing and restructuring the wood industry; closure of wood-based businesses that are heavily indebted; linking the reforestation program with wood-processing facilities; recalculating the real value of timber; and use of decentralisation as an opportunity to enhance sustainable forest management. Progress on this agenda has been very slow and uneven and gives little cause for optimism about future prospects for sustainable forest use.

There has been little progress in bringing the large-scale deforestation of the past 20 years under control. New surveys suggest that during 1985-97 for example, the rate of deforestation was 1.7 million hectares a year, compared with earlier estimates of 0.6 to 1.3 million hectares per year. Commercial development, especially oil palm plantations, not shifting cultivators, was the main reason for the accelerated rate of deforestation. Despite repeated commitments, successive governments have made little progress in bringing production forests under sustainable management. Forest practices by concessionaires fail to meet acceptable standards for sustainable management of production forests. Illegal log and pulpwood production was estimated at three times the official figure in 1998, with much of the production coming from protection forests and national parks, as well as production forests. IBRA is the single largest holder of forestry assets in Indonesia. IBRA has initiated sales of unstructured debts in its portfolio, including debts held by forestry and plantation companies. These debt sales have occurred at heavily discounted prices, undermining the Ministry of Forestry's ongoing efforts to downsize and restructure Indonesia's forest sector industries.

Indonesia is one of the most biologically diverse countries in the world. Habitat loss is the main threat to this diversity. Much of the loss of forest cover has occurred in the lowlands that are suitable for plantation and large-scale agriculture. These are the most biologically rich

forests. Areas that do remain are often not large enough to sustain viable populations of many species.

Yet another area of concern is the poor management of Indonesia's water resources. An increasingly important issue is ensuring access to sufficient amounts of water of adequate quality to satisfy growing demands. The bulk of this growth is coming from urban industrial users that currently account for a little more than 10% of total demand. For many years, the emphasis was on providing sufficient water to meet agriculture's needs and the goal of food self-sufficiency. In more recent years, an increasing number of rivers have begun to experience water deficit problems during the dry season. Increased urban industrial demand will impose difficult choices in the management of water resources in Java and other heavily populated locations. These problems are compounded by the deteriorating quality of water in many locations as a result of inadequate sanitation, and agricultural and industrial pollution. The problems of deforestation are leading to degradation of watersheds, increased runoff and erosion.

The move to decentralised government has added a new level of uncertainty to environmental management in Indonesia. Resource-rich provinces are demanding greater control over resource-based revenues, and local populations are demanding access to resources they had long been denied. The decentralisation program creates both risks and opportunities with respect to forestry, biodiversity protection and mining. It offers the opportunity to move toward more local participation in resource allocation decisions, greater accountability by regional governments, and a refocusing of central agencies on policy and oversight. Decentralisation also carries a considerable risk of accelerating environmental degradation in the near term and perhaps beyond. The factors behind this risk include local natural resource agencies that lack authority and funds to protect and manage effectively the local resource base, official corruption and further breakdown of law and order.

## **1.5 PROSPECTS FOR INDONESIA OVER THE MEDIUM AND LONGER TERM**

Indonesia has made a start on the transition to a more democratic state, but progress with political, economic and social reform has been slow and uneven. As a result, there is considerable uncertainty about the prospects for the country over the medium and longer term. In assessing these prospects, three sets of issues have been considered: (i) prospects for a successful transition to democracy; (ii) progress on policy reform, governance and institutional capacities; and (iii) prospects for economic recovery and sustained long-term growth. These issues represent the critical elements of successful and sustainable poverty reduction and national stability.

### **Governance and the transition to democracy**

Many of the institutional reforms needed for the transition to a more democratic system have been put in place in the past few years. Many new institutions have also been or are being created. The key questions are whether these institutions will be well staffed with trained people, will have adequate budgetary support, and will be able to operate in an environment that is increasingly free of corruption. It remains to be seen whether the Government can address these basic issues in a concerted and timely fashion, and whether it will continue to have the political support to do so.

Two scenarios have been identified for governance and political transition over the medium to longer term:

- *Semi-democracy scenario.* The most likely outcome over the medium to longer term. It represents a continuation of the current political system with incremental reforms in some areas, combined with continuation of existing economic, political and security problems.
- *Democratic consolidation scenario* in which there would be a relatively smooth transition to democratic government. This scenario would require significant simultaneous progress in economic reform and recovery, governance and legal reform and resolution of security problems. A transition to a strong democratic system of this kind is unlikely in the medium-term because of the magnitude of the challenges that currently confront Indonesia. Emergence of a vibrant democratic system is possible over the long-term provided there is significant progress with governance, economic reform and consolidation of civil society.

### **Economic recovery and sustained long-term growth**

Against a background of considerable uncertainty, there are a number of significant downside risks associated with the global economic outlook, including the current account imbalance in the United States, the dim prospects for the Japanese economy, and the global economic uncertainty. The World Bank projects that world GDP growth, after slowing from 3.8% in 2000 to around 1.3% in 2001, and increasing only slightly to 1.7% in 2002, will climb to 2.1% in 2003. The economic recovery in East Asia that began in late 2001, continued to strengthen in the first half of 2002 but has slowed and uncertainties have increased, with, for example, continued security incidents and new issues such as Severe Acute Respiratory Syndrome (SARS). However, the slow down in East Asia is expected to be limited, with strong growth in China creating a strong market for intra-regional exports. Nevertheless, the global economy remains fragile and investment spending is insufficient to bolster growth that is being underpinned presently by consumption. Private investment flows to developing countries have fallen sharply<sup>2</sup>.

***Alternate growth scenarios for Indonesia.*** Against this global setting, Table 1 sets out three plausible scenarios for Indonesia's GDP growth in the short- and longer-term. The most likely scenario is growth of over 3% for the near term followed by a prolonged period of growth at around 4% a year. Given the uncertainty surrounding the likely pace and extent of future reform, and the vulnerability of Indonesia to further financial crises, there is a risk that the growth performance of the country could falter. In these circumstances, there will be very little improvement in average incomes of large segments of society, with worrying consequent strategic implications for stability in Indonesia.

The likelihood of sustained annual GDP growth of 5% or more in the decade ahead seems remote unless the investment environment is enhanced. Apart from requiring substantially higher levels of investment on a continuing basis, concerted action on a wide range of institutional and structural issues is also needed, including for example, bank and corporate restructuring, legal and administrative reforms, significant reductions in corruption, improved governance and successful implementation of the decentralisation program. These are difficult and complex issues that will take time to resolve. There is little evidence to support the view that Indonesia can immediately and significantly accelerate the pace of reform sufficient for sustained high growth. Domestic demand can be expected to continue to play large role in

<sup>2</sup> World Bank, *Global Economic Prospects and the Developing Countries 2003*. Washington DC, 2002.

supporting sustained strong growth. There are tight limits on the scope for using fiscal policy to stimulate domestic demand without endangering macroeconomic stability. Serious questions remain about the pace and timing of a recovery in private investment spending. Moreover, the strong negative international market sentiment towards Indonesia is not expected to change in the short term, and could even increase in the event of increased domestic tensions or failure to make progress with economic reform.

Table 1: Alternative Real GDP Growth Scenarios, 2000-2010 (% p.a.)

Scenario	Actual	Short-term			Long-term
	2000	2001	2002	2003	2004-2010
Stagnation scenario	4.9	3.4	3.7	3.5	2.5
Weak growth scenario	4.9	3.4	3.7	4.0	4.0
Sustained recovery scenario	4.9	3.4	3.7	5.0	5.5

Source: IMF figures

### Summary of Prospects for Indonesia

The analysis suggests two possible scenarios for the decade ahead. These are summarised in Table 2. The international financial institutions, donors, and domestic supporters of reform have generally called for rapid change on many fronts in order to make a successful transition to a stable democracy with sustained strong growth. There is little evidence from recent years to suggest that the political elite of Indonesia is prepared to push ahead rapidly in this manner. What evidence there is suggests that the current leadership will move in a measured way, rather than risk potentially destabilising pressures that may arise from aggressive reform on many fronts. With the 2004 elections in sight, it is increasingly clear that President Megawati, concerned about re-election, is opting for a slow and deliberate pace of change, with an emphasis on avoiding major political problems arising. Significant progress on democratic reform and improved governance will only be possible after the elections and will depend on their outcome. Slow and inconsistent implementation may continue beyond these elections. A decade of slow progress would very likely undermine public confidence in, and support for, government policies and would lead to increased cynicism about the prospects for a transition to a strong democracy. The most likely scenario (Scenario I) is a prolonged period of economic growth of around 4% a year, with uneven and somewhat erratic progress towards democracy. Transition to a strong and vibrant democracy (Scenario II) is likely to be a protracted process with no certainty that this will be the ultimate outcome. These two scenarios are not mutually exclusive. Indonesia may experience different combinations of political transition and economic performance over the decade ahead.

Table 2: Summary of Two Scenarios for Indonesia

Scenario	Probability (%)			Form of Governance	Economic Performance
	Short-term	Medium-term	Long-term		
Scenario I	100	80	60	Semi-democracy	Weak economic growth over extended periods; GDP growth averages 4% p.a.
Scenario II	0	5	20	Democratic consolidation	Periods of sustained strong growth interspersed with periods of weakness. GDP growth averages 5% p.a.

## 1.6 EXTERNAL FINANCING REQUIREMENTS

Indonesia will require substantial amounts of external assistance for the decade ahead in support of macroeconomic stability, structural and governance reforms, poverty reduction and other development needs. However, like the budget deficit, total financing requested from the CGI is declining, from US \$5.5 – 6.0 billion in 2000 to US \$2.4 – 2.8 billion in 2003. As Table 3 indicates, the World Bank estimated the total external financing requirements of the central government at about US\$9 billion for FY2003. Future financing requirements will be strongly influenced by Indonesia's debt management strategy.

Table 3: External Financing Needs of Central Government  
FY2003 (US\$ billions)

	Amount
<b>Requirements</b>	
Budget deficit	3.8
Amortisation of external public debt	4.9
Total	<b>8.7</b>
<b>Sources</b>	
Domestic finance	
Privatisation receipts	0.9
Asset recovery	2.0
Others	-0.4
External financing	
Non-CGI sources (including debt rescheduling)	3.6
CGI financing	2.6
<b>TOTAL</b>	<b>8.7</b>

Source: World Bank, *Indonesia: Mainstreaming Stability, Deepening Reforms*.

## 2 REDUCING POVERTY AND VULNERABILITY

### 2.1 DEFINITION OF POVERTY

This strategy defines the poor as those who suffer a level of deprivation such that they are unable to meet minimum standards of wellbeing. Critical aspects of wellbeing include adequate resources for attaining the basic necessities of food, water, shelter, and clothing; access to acceptable levels of health and education services; accountability from governing institutions; high levels of participation in decision making; and freedom from excessive vulnerability to adverse shocks.

### 2.2 PROGRESS IN REDUCING POVERTY

In the three decades prior to the financial crisis of 1997, Indonesia made exceptional progress in reducing the incidence of poverty. From an impoverished country at the end of the 1960s, Indonesia rose to the ranks of a middle-income country in two decades. Some two-thirds of the population were in absolute poverty in the early 1970s; by the mid-1990s the incidence of absolute poverty as measured by consumption had declined to about 8 % of the population. Between 1975 and 1995 life expectancy increased from 47.9 years to 63.7 years, infant mortality (per 1000 live births) decreased from 118 to 51, net primary school enrolment increased from 75.6 % to 95 % and net secondary school enrolment increased from 13 % to 55 %.<sup>3</sup> The maternal mortality rate was reduced from around 800 in 1980-87 to 373 by 1995. There were also considerable improvements in the status of women: male-female gaps narrowed at all levels of education and women's earnings increased as a proportion of earned family income.

Table 5: Estimates for Indonesia's Poverty Rate  
(Headcount index: percent of population)

	1996	1999	2000
<b>National poverty line</b>			
Urban	7.2	16.3	7.3
Rural	20.5	34.1	20.7
Indonesia	15.7	27.1	15.2
<b>International poverty line at 1993 PPP prices</b>			
US\$1 a day	7.8	12.0	7.8
US\$2 a day	50.5	65.1	57.9

Source: World Bank.

Despite the progress in poverty reduction over the past three decades, many Indonesians remain very vulnerable to poverty. Poverty in Indonesia is not just a matter of inadequate incomes and expenditures on food and other daily necessities. Many of the poor and near poor lack access to basic education, medical services and adequate nutrition. Some 25 million people are illiterate; almost 50 million suffer from health problems and a similar number lack access to health facilities. Many poor communities have inadequate or non-existent basic

<sup>3</sup> WB, 1/9/98 East Asia: The Road to Recovery



infrastructure, including safe water, adequate sanitation, transport and roads, and electricity. Significant biases against females persist in employment and participation in public life. In other cases, people are excluded from social community life or are discriminated against for other reasons. The combination of conflict and natural disasters has displaced millions and driven many into poverty or made them exceptionally vulnerable to poverty. When all these dimensions are taken into account, poverty is an issue that affects at least half of the entire population in Indonesia.

### **What are the characteristics of Poverty?**

On Java and Bali, poverty is typically associated with urban unemployment or with rural families with few assets (land, education and skills) who rely primarily on uncertain and poorly paid wage labour for their incomes. In Eastern Indonesia, the proportion of the agricultural labour force working as wage employees is quite low. The majority of these rural households own agricultural land. It is the poor quality of the land, together with low productivity technologies, limited educational attainment and limited access to basic services such as health and water supply and sanitation infrastructure, which are the main causes of poverty in these provinces. Poor infrastructure such as roads and lack of access to input and product markets compound the problems in this region. Resource poor areas are particularly vulnerable to the risks associated with climatic variation and to soil erosion, mining of soil fertility and reduced bio-diversity. Poverty in rain-fed and upland zones forces communities to exploit natural resources for short-term gain. The combination of growing populations and declining crop yields results in lower incomes, worsening poverty and food insecurity.

The incidence of poverty is heavily concentrated among those with little or no formal schooling. Pradhan *et al* have reported that households in which the head is illiterate or has only primary education account for 87% of all households below the national poverty line in 1999 – a slight decline from the 93% in 1996.<sup>4</sup> Improving access of the poor to basic education and improving the quality of their education is of great importance for a successful reduction in the incidence of poverty. The quality of basic education in Indonesia is low. International results in reading and mathematical ability suggest that Indonesia compares very unfavourably with neighbouring countries. Indonesia also allocates a much lower share of GDP to public education than many other countries. During 1994-97, for example, Indonesia allocated about 3% of GDP to public outlays on education, compared with an average of almost 5% of GDP in the case of lower middle-income countries. The poor quality of education is due in large part to the fact that Indonesia is simply not spending enough money on education.

Lack of access to affordable health services is also a major contributing factor to poverty. During 1990-98, Indonesia allocated 1.6% of GDP to public and private health services, compared with the 4.5% allocated by low-income countries as a whole in the same period, and the 4.7% of GDP by lower middle-income countries. Traditionally, private spending on health care has been somewhat higher than public spending in Indonesia. It would appear that since the crisis this gap may be growing, perhaps as a result of budget cuts and declines in the accessibility and quality of public health services. Government services appear to be facing more competition from private providers and growing recourse to self-treatment.

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<sup>4</sup> Pradhan, Memo, Asep Suryahadi, Sudarno Sumarto and Lant Pritchett, *Measurement of Poverty in Indonesia: 1996, 1999, and Beyond*. Jakarta, SMERU Working Paper, June 2000. Table 6.

## **Who and Where are the Poor?**

Three-quarters of the poor live in rural areas. About one-fifth of the rural population is classified as living below the national poverty line, compared with about 7% in urban areas. Poverty is concentrated in particular sectors of the economy, especially agriculture and small-scale trade. Approximately 60% of the poor live in households for which the agricultural sector is the main source of income.

There is considerable variation in the incidence of poverty among and within provinces. The highest incidences of poverty are recorded in the provinces of Maluku, North Maluku, East Nusa Tenggara and Papua. These provinces have incidences of poverty that are more than ten times that of Jakarta and five times that of Bali. The next highest incidences of poverty in 1999 were recorded in West Nusa Tenggara, Southeast Sulawesi and East Java. Although the incidence of poverty is somewhat lower in Java/Bali, population densities are such that these provinces account for about 60% of the poor and near poor in Indonesia.

There are also marked differences in urban poverty rates. Some 12% to 20% of the urban population is below the poverty line in South Sumatra, Central Java, East Java, West Nusa Tenggara and East Nusa Tenggara for example, compared with 5% to 7% in Aceh, West Sumatra, Jambi, Bengkulu, Bali, and Central Kalimantan.

## **The Degree of Inequality**

The degree of income inequality in Indonesia is not as severe as in many other developing countries. With a Gini coefficient of 31.7, income inequality in Indonesia is lower than in all other major developing countries in East Asia except Korea (31.6), and is substantially lower than many Latin American countries.<sup>5</sup> The relatively low level of inequality in Indonesia, if it continues, can ease the task of poverty reduction to some extent. International experience has shown that economic growth has a greater impact on reducing poverty when income inequality is lower.

## **Impact of the Financial and Economic Crisis**

The surge in the incidence of poverty that occurred during the financial crisis appears to have been concentrated in urban areas, which took the brunt of the downward adjustment in incomes and employment. In addition to financial services, industries like construction and trade were affected. Despite concerns at the time, the overall unemployment rate rose by only one percentage point to about 5%. There was also little change in the overall labour market participation rate. It is likely that unskilled workers in the affected sectors would have been most vulnerable to the downward adjustment in service industries. Many of these unskilled workers appear to have moved back into agriculture, with the inevitable result that real agricultural wages fell. The decline in real agricultural wages, in combination with high inflation, at least in 1998-1999, probably contributed to the temporary increase in the incidence of poverty in this period. A large part of the surge in poverty during 1997-1999 took place in Java and Bali.

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<sup>5</sup> Gini coefficients for selected neighbouring countries in East Asia are as follows: Vietnam (36.1), China (40.3), Thailand (41.1), Philippines (46.2) and Malaysia (49.2). Inequality is even greater in Brazil (59.1) and Mexico (51.9). The Gini coefficient measures the degree of inequality in the distribution of income in a given society. The higher the Gini coefficient, the greater is the degree of inequality.

A mitigating factor in the degree of poverty experienced has been the growth of the informal economy, which official GDP figures do not take into account. Data on the nature and size of the informal economy is problematic, with relevant government agencies disagreeing as to its exact composition, but typical informal economy production units tend to be small-scale and have a very rudimentary organisational structure, with virtually no distinction between capital and labour as factors of production. Activities typically undertaken through the informal economy include small scale retail trade; catering; land transport; personal and household services; food-processing; small scale manufacturing; textiles and garments; and non-metallic minerals industries. Some estimates attribute 50% of economic output to the informal economy.

A number of measures taken by the Government helped moderate the impact of the crisis on the incidence of poverty. Chief among these was the provision of cheap rice, which helped maintain acceptable levels of food intake among many millions of families. The Government also adopted measures to protect educational participation and quality at the primary and secondary levels throughout Indonesia. It would appear that these programs have been partially successful: enrolments have been maintained and schools have continued to operate in poor areas. These programs are being continued.

Although the Government has sought to protect spending on basic services that can help the poor, budgetary pressures have resulted in a drop in spending in these areas. Given the already very low levels of spending noted above, this is a worrying development. According to the World Bank,<sup>6</sup> spending in real terms on health and education services declined by about 30% during 1996/97 and 1998/99, although there was a rebound of some 16% in 1999/2000. The issue is whether access to these services by the poor has been adversely affected since the onset of the crisis. Contrary to earlier expectations, there is some evidence that the impact of the crisis was not as severe as many had predicted at the time. A recent study by Cameron finds little evidence that the crisis had a dramatic negative effect on children.<sup>7</sup> School attendance rates have rebounded to higher than pre-crisis levels. Fewer children are now working. Child health status indicators appear to show a relatively stable pattern of child health.

### **2.3 PROSPECTS FOR POVERTY REDUCTION**

There is extensive empirical evidence that shows that countries experiencing strong economic growth have also achieved significant reductions in the incidence of poverty, especially when the growth has been combined with sound economic and governance policies. Slow growing economies with a poor policy environment have been unsuccessful in reducing the incidence of poverty. Table 6 illustrates the likely incidence of poverty (as measured by the number of people who are living on less than US\$2 a day per capita) under each of the three scenarios outlined in Table 1.

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<sup>6</sup> World Bank, *Indonesia: The Imperative for Reform*. p.4.5.

<sup>7</sup> Lisa A. Cameron, *The Impact of the Indonesian Financial Crisis on Children: An Analysis Using the 100 Villages Data*. Bulletin of Indonesian Studies, Vol. 37, (1), 2001, pp.7-41.

Table 6: Illustrative Projections of Poverty Rates, 2000-2010

Growth scenario	GDP Growth rate		Population Below \$2 per day per capita			Population Below \$2 per day per capita		
	(% p.a.)		(%)			(millions)		
	2001-2005	2006-2010	2000	2005	2010	2000	2005	2010
Stagnation	2.9	2.5	58	54	50	120	118	115
Weak growth	3.7	4.0	58	50	42	120	109	97
Sustained recovery	4.5	5.5	58	48	39	120	105	90

With the slower growth projected for the next decade, the recent slowdown in poverty reduction will persist. In this scenario the incidence of poverty could drop to around 42% of the population by 2010. This would produce a decline of only 20 million in the number of people living on less than US\$2 a day per capita. Some 100 million people would continue to live in poverty. In the case of Indonesia, protracted weak economic growth of around 4% a year will have profound implications for employment creation and poverty reduction. Prolonged weak growth will not reduce the incidence of poverty and may give rise to social and political unrest, especially among young people entering the labour force with inadequate education and skills. The current labour force is estimated at about 105 million. It has grown at 2.8% a year during the 1990s and is expected to grow by about 2% a year over the next decade. More than 20 million people will enter the labour force this decade. The Indonesian economy will be hard placed to create productive employment for these people while, at the same time, creating better opportunities for the millions of people already in the labour force who are among the poor or near poor. Growth at 4% a year can overcome the worst of these problems, but it is unlikely that there will be any significant reduction in the incidence of poverty.

Growth at 5% a year or more will be essential for a serious reduction in the 120 million people currently in absolute poverty or vulnerable to poverty. At a sustained long-term growth rate of 5% a year, the proportion of the population below US\$2 a day per capita could decline to around 39% by 2010. This would mean that the number of people in this category would decline steadily from about 120 million in 2000 to 90 million in 2010.

For long-run political and social stability, it is imperative that Indonesia avoids economic stagnation. In the event that growth is stuck at around 2.5% a year, there would be little progress in reducing the number of people living below US\$2 a day per capita. The proportion of the population in this category could drop to about 50% - about the 1996 level. Moreover, the total number of people in this situation would remain stuck at almost 120 million. With little visible progress in poverty reduction, the risk of instability would undoubtedly rise, thereby undermining confidence in democratic government and perhaps opening the door to a period of more authoritarian rule.

### Where will the Poor be Located?

Under the stagnation scenario with its low levels of aggregate investment, the brunt of the economic slowdown could be concentrated in Java and those Outer Island provinces that have weak resource bases and limited human capital. Resource rich provinces in Sumatra, East Kalimantan and Papua, which account for about 40% of GDP, may enjoy higher growth

driven by resource exploitation. By way of illustration, national economic growth of 2.5% a year might come from growth of 4% a year in the resource rich provinces and 1.5% a year in Java and the other provinces. With a population growth rate of a little over 1% year, this would mean economic stagnation or worse for many of the almost 140 million people in the latter provinces; moreover, with some 70 million people in the labour force in these provinces and the prospect of another 15 million new entrants in the decade ahead, the prospects for productive employment would be poor indeed. In these circumstances, the risk of political and social unrest would be high.

This is a disturbing potential trend that will have deep social, political and policy implications for Indonesia. It suggests that inter-regional disparities in wealth and poverty will persist and may even be exacerbated in those cases where local governments are weak and fail to develop effective strategies for poverty reduction. It remains to be seen whether the rural poor will move in larger numbers to urban areas in search of work and access to better basic services, or whether they will remain in rural areas in low productivity employment. Much will depend on the growth performance of the country and whether new growth poles emerge in some regions. Under the weak growth scenario, it is unlikely that there will be significant changes in the location of the poor over the next decade at least. With slower population growth and economic growth, it is possible that the rate of growth in the urban population will slow from the average of 4.4% a year experienced during the 1990s. An urban population growth rate of 3% to 4% a year for the decade ahead would result in an urbanisation rate of about 50% by 2010 (compared with about 42% in 2000). If the proportions of urban and rural poor remained unchanged over the decade ahead, some 65 to 70 million of the 110 million rural people in 2010 would be among the poor and near poor.

### **The impact of decentralisation on poverty**

The impact of the decentralisation process on the poor and near poor is difficult to determine at this early stage in the process. Progress on poverty reduction will be influenced by a number of considerations. One is the level of development spending by local governments on basic services, including health and education. There is already concern that the level of development spending is too low and that salaries and other recurrent expenses are absorbing high proportions of local government budgets. The issue is compounded by the lack of minimum service standards that can be used at the local level to maintain a basic level of services to the poor. The current revenue equalisation formula of the central government does not adequately consider expenditure needs for minimal service provision. Poorer regions could be short-changed and left with insufficient funds to meet the basic service needs of their constituents. Systems are not yet in place for monitoring expenditures on key services now that a large part of government spending has been decentralised.

Another concern is whether local governments will be responsive to the needs of the poor and those vulnerable to poverty. For example, the top-down decision-making that has characterised the management of the forestry industry for decades has exacerbated poverty among many rural households who have been denied access to their customary natural resource assets. Communities that believe they have claims for compensation or return of land use rights against the Government or logging or plantation companies are becoming more vocal. How will local governments respond to these types of concerns?

## Corruption and poverty reduction

There are also concerns that corruption, collusion and nepotism, which has been a major obstacle to the reduction of poverty, will become commonplace among local governments. Corruption slows economic growth and increases the gap between the haves and the have-nots. By skewing the incentive structure, it deprives the poor of income-generating opportunities or favours capital-intensive over labour-intensive technologies. Well-connected people in the public and private sectors may siphon off funds from poverty programs. Recent work by the IMF underscores again the importance of anticorruption measures and good governance as a means of reducing poverty.<sup>8</sup> Their analysis suggests that a 1% increase in the rate of corruption reduces the income growth of the poorest (bottom 20 percent) by almost 8% per annum.

## Communal violence and natural disasters contributing to vulnerability

Yet another dimension of poverty and vulnerability is the impact of conflict and natural disasters on populations throughout Indonesia. The International Red Cross has recently estimated that around 1.4 million people are displaced and sheltered in different locations throughout Indonesia as a result of conflict and natural disasters. Low economic growth is likely to exacerbate the prospects of communal conflict. Indonesia will continue to be vulnerable to earthquakes, drought, flooding, forest fires and other natural disasters that can leave thousands of people destitute.

## 2.4 STRATEGIES FOR POVERTY REDUCTION

The prospect of 100 million people remaining poor or vulnerable to poverty for the next decade reinforces the urgency of concerted action by the Government, with assistance from the donor community. A stronger growth performance will help, but as already discussed, the prospects for growth of 5% a year or more are not good. In these circumstances, in addition to undertaking the economic and financial reforms required to return to sustained strong growth, there is a clear need for increased emphasis on non-economic factors crucial to poverty reduction eg health, education and broader governance issues.

The Government has reaffirmed that poverty reduction is central to the development effort in Indonesia and is developing a strategy for poverty reduction. Its approach to poverty reduction has broadened in recent years. Increasing attention is being given to the links between environmental degradation and poverty, the need for anticorruption measures, ownership of assets by the poor, sound development management, and good governance with transparency, accountability, and people's participation. An essential part of the strategy will be interventions that address the very large spatial differences in poverty that are now evident and ensure that all Indonesians benefit from Indonesia's social and economic achievements. Poverty reduction programs will however need to be designed and implemented quite differently from the past highly centralised approaches used by the national government. Decentralisation offers an opportunity for the provinces and districts to formulate strategies that are responsive to local needs and possibilities. Such strategies will have to come from within the regions, since these are difficult to define at the central level.

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<sup>8</sup> Gupta, Sanjeev, Hamid Dawoodi, and Rosa Alonso-Terme. 1998. *Does Corruption Affect Income Inequality and Poverty?* Working Paper WP/98/76. International Monetary Fund, Washington DC.

Based on this analysis, poverty reduction will require a multi-pronged strategy from the GOI and donors:

***Building national institutions for accountable government.*** Of particular importance here will be legal and judicial reforms, civil service reforms, improved financial management, along with adoption of measures that improve the management of the nation's rapidly depleting natural resource base. Also important will be measures such as the strengthening of democratic institutions and practices that increase opportunities for the poor to participate in policy-making and implementation. Local government will need to foster mechanisms that give the poor a greater voice in decisions that affect them.

Indonesia's current five-year development plan, *Propenas 2000-2004*, recognises the realisation of the supremacy of law and good governance as one of five national development priorities. It also emphasises the importance of the development of participatory democracy and the empowerment of people to overcome poverty and inequality.

***Delivering better public services for the poor.*** Improved access to health, education and other basic services by the poor is not simply a matter of increased budgetary outlays. The far-reaching decentralisation of government functions means that programs in education, health care, agriculture and rural development and environmental management that are at the heart of poverty reduction strategies are now the responsibility of local governments. Actions will be required to strengthen capacities at the national and local levels to ensure effective delivery of public services to the poor. Given that the anticipated level of economic growth will, at best, result in only a slow decline in the incidence of poverty, it will be essential for local governments to adopt targeted interventions that take explicit account of the needs of the poor in their jurisdictions. Sustained improvements in health and educational status for the population as a whole, and the poor and near poor in particular, will require significant increases in spending on these services. The questions are whether local governments will set aside sufficient resources for these services and whether there will be sufficient targeting on the particular needs of the poor and near poor. In this connection, the development and application of minimum standards by the provinces or national government, and their subsequent adoption by local government, will be particularly important to protect services to the poor.

*Propenas 2000-2004* commits Indonesia to expanding and creating more equitable opportunities in education and improving quality of education. It also provides policy directions for improving the quality of health services.

***Measures that improve access to economic opportunities for the poor and the vulnerable.*** These programs will include empowering the poor and near poor through access to secure possession of land and natural resources. Improvements in the legal system related to titling and pledging of collateral and other institutional measures are needed to support increased lending to the poor, many of whom would be users of micro-finance programs. The latter appeared to function well throughout the economic crisis with continued high repayment rates. The further development of the micro-finance market in Indonesia might include the consolidation of the multitude of small programs now in existence throughout the country. There will also be a need for improved links between these micro-finance programs and the formal banking system.

Given the likely continued predominantly rural nature of poverty in Indonesia, there is a strong case for the GOI to place **renewed attention to agriculture and rural development** as an integral part of the nation's poverty reduction strategies. There is some evidence to suggest that, during the 1990s, less attention was paid to sustaining the earlier impressive improvements in agricultural productivity and rural development. Rural areas may also have been affected by reduced spending on rural infrastructure. The main elements of a renewed strategy for agriculture and rural development should centre on such basics as agricultural research, rural extension services, reduced post-harvest crop loss rates, improved rural infrastructure, improved productivity in the smallholder tree crop industry and expanded access to rural credit, including micro credit programs. The specifics of programs will depend on conditions in each province: for example, since over 70% of incomes in rice-growing areas is from non-rice sources, the emphasis in these areas must be on improved opportunities and support for diversification and off-farm activities.

**Mitigating conflict and reducing vulnerability to natural disasters.** Conflict is now seen as a chronic malaise affecting much of the country. Despite some recent positive achievements in Aceh and the Malukus, the prospect for a durable solution to remains uncertain and there is a possibility of nascent conflict erupting in other areas that have to date enjoyed relative calm. Indonesia is also highly prone to natural disasters, having regularly been affected by earthquakes, forest fires, floods and droughts. The combination of conflict and natural disasters has displaced millions, driven large numbers of people into poverty and significantly increased the number vulnerable to poverty. There is a need to develop capacity to be able anticipate the potential for conflict and plan for and manage the impact of conflict and natural disasters. Stability and rapid recovery are essential in reducing the numbers of people who are vulnerable to destitution as a result of human-made or natural disasters.

The Government of Indonesia recognises social conflict and the potential for national disintegration as one of its main problems. *Propenas 2000-2004* aims to overcome this problem through equitable development and implementation of democracy.

These areas are consistent with the Government of Indonesia's development planning. GoI is still in the process of developing its poverty reduction strategy paper. Australia will offer support in this process, which will help to ensure consistency between the PRSP and Australia's development cooperation program.



## **3 AUSTRALIA'S STRATEGY IN INDONESIA**

### **3.1 REVIEW OF CURRENT STRATEGY AND PROGRAM**

#### **Changing Circumstances have Reshaped the Strategy**

The development cooperation program has evolved substantially since 1998, influenced strongly by two developments: (i) the financial and political crisis that engulfed Indonesia from 1997; and (ii) the introduction of a new objective for Australia's aid program: to advance the national interest by assisting developing countries to reduce poverty and achieve sustainable development.

The FY1998-99 program aimed to respond to the impact of the financial crisis. The objective was to "...contribute to economic and social stability by assisting Indonesia to alleviate the social impacts of the economic crisis on the most vulnerable groups in society, and return to sustainable growth and development."<sup>9</sup> These objectives were to be achieved by supporting development of a social safety net, strengthening civil and economic governance, and protecting and building the platform for the resumption of sustainable growth and development.

In response to changing conditions in Indonesia, the strategy was modified for the FY2001-03 programming period. The objective for this period was "...to contribute to poverty reduction, sustainable economic recovery and democratisation in Indonesia." The central role accorded to poverty reduction in the AusAID assistance program for Indonesia led to the design of a detailed poverty reduction framework for the FY2001-03 country strategy. From this analysis, six main sectors were identified for AusAID involvement in Indonesia: health, water supply and sanitation, natural resource management and rural development, education and training, governance, and humanitarian relief. The strategy called for a two-pronged approach to implementation of the program: (i) including activities that contribute indirectly to the poverty objective by promoting improved governance; and (ii) addressing the poverty objective directly through interventions that target specific vulnerable communities. The strategy indicated that Australia would adopt a highly selective approach to the design of its program. A limited number of areas of cooperation, where Australia had the skills and capacity to have a measurable impact were selected within each sector. Moreover, the focus was on the needs of vulnerable communities in a small number of provinces with a high incidence of poverty, and where Australia has relevant experience. Australia's long-standing commitment to and involvement in Eastern Indonesia was expected to continue.

Looking ahead, the strategy for the medium term, will continue to evolve. Modifications to the strategy will be driven by changing circumstances within Indonesia, lessons drawn from past experience, changing perceptions of Australia's comparative advantage and by feedback from consultations within the Australian Government, with the Indonesian Government, with other donors and civil society in Australia and Indonesia.

#### **Lessons from the Past**

The shift to an unequivocal focus on poverty reduction has been accompanied by a determined effort by AusAID to improve the effectiveness and impact of development

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<sup>9</sup> AusAID, *Australia-Indonesia Development Cooperation Program: Country Strategy, 2001-2003*. p.6.

assistance. Adjustments have been made in the program in response to concerns that it has not paid sufficient attention to poverty reduction and sustainable development in the past. A concerted effort has been made to engage in a dialogue with civil society within Australia and Indonesia, and to expand the dialogue with other donors in Indonesia. The dialogue about priorities has been maintained with the Government. Improving the quality of Australian assistance to Indonesia will remain a focus of effort throughout the period of this strategy.

Past assistance programs have focused heavily on individual project interventions with less attention being given to the overall policy framework within which these projects are implemented. Despite recent progress in formulating a framework for poverty reduction, the on-going Indonesia program remains a collection of individual projects only loosely related to broader thematic objectives and the overarching goal of poverty reduction. Part of the problem is that there is no agreed framework for assessing the extent to which specific program/project interventions contribute to achieving the strategic objectives for Indonesia and the corporate objectives of AusAID. Compounding these difficulties is an assistance program that consists of a large number of small interventions spread across many geographic areas and sectors. The country program for FY2000-01 for example, consisted of 58 actively disbursing projects spread across at least 19 provinces. If the ADS and Specialised training projects are excluded, average disbursements for the remaining 56 projects was less than A\$1 million per project that year.

Although the performance ratings for the bulk of the projects are satisfactory or better, there are no measures of the impact of the program on poverty and vulnerability at the national level. As a practical matter, direct links between Australian assistance and aggregate changes in the incidence of poverty will be tenuous at best at the national level. This is because development spending in central and local government budgets is about 5% of Indonesia's GDP, whereas Australia's aid contribution is less than .04% of GDP. However, Australia (and other donors) has deepened its understanding of the challenge of poverty reduction in Indonesia, and with better targeting of activities on a smaller number of geographic locations and issues, we expect to have a measurable impact. There is a need to establish a much stronger monitoring and evaluation framework, in order to be able to monitor progress against core program objectives.

Project interventions aimed at reducing poverty and vulnerability must be well designed and there must be clear demand for projects from well-identified target populations. Moreover, international experience has highlighted the fact that even well designed projects at the local level can fail if the policy environment at the national level is inimical to development. The implication is that Australian assistance should not simply focus on a series of local interventions. It must also be concerned about the overall policy environment in Indonesia.

In the past, there has been a somewhat fragmented approach to management of Australian assistance to Indonesia. The non-country program component currently accounts for close to 20% of total assistance. Non-country program components have been designed and managed somewhat independently of the country program. Efforts are already underway to strengthen intra-agency coordination to improve potential synergies and aid effectiveness.

Flexible mechanisms have given the program capacity to respond to emerging Indonesian priorities in a timely manner and in a way consistent with whole-of-government concerns. The program has been able to play a critical role in issues such as anti-money laundering and anti-terrorism legislation, conflict resolution and humanitarian assistance, all of which

impinge on Indonesia's stability. A clear lesson is the importance of retaining this sort of capacity in the program.

Building closer bilateral relations has been only an indirect objective for Australian assistance. There has not been a clearly articulated view of how Australian assistance contributes to building and enhancing the relationship between the two countries, although the program has supported a vast number of people-to-people linkages across many fields of endeavour in civil society and in government. More attention will be given to promoting the aid program in Indonesia and Australia, as part of broader whole-of-government efforts to maintain the positive bilateral relationship.

### **Feedback from Consultations**

In preparing this strategy for Australia's aid program to Indonesia, AusAID has engaged in consultations with the Government of Indonesia, other agencies within the Australian Government, with representatives of local government in Indonesia, with other donors active in Indonesia, with business groups, and with representatives of civil society in Australia and Indonesia. The discussions were wide-ranging and covered poverty reduction measures, prospects for economic recovery and growth, prospects for a successful transition to democracy, improving governance and building institutional capacities at the national and local levels, health and education, decentralisation, the role of women and gender inequality, and the development of civil society.

A number of important themes emerged from these consultations including that aspects of the program are poorly understood, in both countries. For example, some senior Indonesian officials view Australia as a donor who is mainly interested in providing a small number of well-to-do Indonesians with scholarships to train in Australia and in making direct interventions in those Eastern provinces in close proximity to Australia that are predominantly Christian.

Local government representatives welcomed the emphasis that Australia will place on helping build decentralisation capacities, but warned that the finances available to local governments for development spending were totally inadequate for the task at hand. The implication was that unless these funding problems were resolved, there could be little progress at the local level on poverty reduction and improved access to services by the poor.

The point was made that Australia has built up a significant body of expertise and understanding about Indonesia that sets it apart from many other donors. Donors in particular wondered whether the program was making full use of this knowledge and suggested that Australia could play a stronger role in the dialogue with the Indonesian Government.

### **Australia's Comparative Advantage**

Australia and Indonesia are neighbours, sharing a vast sea border and trade and cultural links that stretch back over centuries. We share an interest in stability and prosperity in the Asia Pacific region. Development cooperation forms part of a wide-ranging relationship.

Australia as an aid donor has not established a level of engagement comparable to that of other major donors. Possible exceptions may be the overseas scholarship program (where there is a large alumni) and the long-standing focus on the Eastern Islands (which represents

decades of partnership with provincial and lower levels of government). But even in these areas, questions remain. Historically, the program did not make any concerted effort to provide advice to senior Indonesian officials and Indonesian Ministers responsible for political, social and economic policies, which could have enhanced engagement with the leadership of the country. Opportunities for policy assistance engagement were limited during the Soeharto era. However the program has been moving toward much greater policy engagement than in the past as opportunities to do so have opened up, and this trend will be continued.

Indonesia has access to large amounts of technical expertise and financial resources. The official donor community in Indonesia includes 13 multilateral organisations and 20 bilateral aid agencies, with programs of varying size and diversity. The IMF, ADB and World Bank are the largest multilateral sources of financial support. The most significant bilateral sources of funding come from Japan, United States, Germany and Australia in that order. While Australian assistance makes up a sizeable proportion of grant aid to Indonesia, it accounts for a little less than 2% of Indonesia's total donor assistance (see Appendix 1, Table 2 for details). Indonesia also has support from many NGO programs, including those of the Asia Foundation, the Ford Foundation, the World Wildlife Fund and others.

As the Indonesian Government's objectives shifted from crisis management to an emphasis (at least at the rhetorical level) on reform and sustained growth, donors have adjusted their assistance strategies accordingly. There is increasing convergence among donors on the main areas of assistance. Most donors are increasingly addressing the broad range of development challenges outlined earlier in this paper. All major donors now emphasise poverty reduction, good governance, environmental protection, human development through improved access to quality basic services, and support the move towards decentralisation.

Prior to the financial crisis, Australia's aid program focused almost exclusively on a discrete set of project interventions mostly unrelated to policy advice. Australia is increasingly adopting a more selective approach in its assistance to Indonesia and seek to link policy advice and project interventions. AusAID will draw on the considerable expertise available in Australia to focus on a select set of policy issues and interventions where Australian assistance can facilitate change.

Although the Indonesia program is Australia's second largest country aid program, its size is modest relative to the scale of poverty and developmental challenges in Indonesia. Consequently, given the diverse range of activities of other donors, the impact of Australian assistance can be enhanced by collaborating with other providers of assistance whenever possible.

### **3.2 DEVELOPMENT CHALLENGES AND PRIORITIES FOR AUSTRALIA**

#### **Strategic Objectives for the Decade Ahead**

In accordance with Australia's national interest ensuring a stable and prosperous Indonesia, and in light of the threat posed to this by large numbers of poor, the long-term goal of Australia's development cooperation program with Indonesia over the next decade will be to assist that country to reduce poverty and achieve sustainable development.

To achieve this goal, Australia will target its efforts on four inter-linked strategic objectives:

- **Improve economic management** through support for critical measures for accelerated structural reform, including assistance for revenue enhancement, financial sector restructuring and supervision, and debt management;
- **Strengthen the institutions and practices of democracy** through assistance for legal and judicial reform, the institutions of human rights and public accountability, electoral and parliamentary processes and institutions and civil society;
- **Enhance security and stability** through support for law enforcement and counter-terrorism capacity building, conflict and disaster prevention and humanitarian assistance for vulnerable groups; and
- **Increase the accessibility and quality of basic social services** through policy engagement at the national level and support for planning and implementation at district level and support for community-based approaches.

These strategic objectives are the outcome of an assessment of how Australia can best assist Indonesia meet its current development needs (as examined above), Australia's capacity to assist, and the lessons that Australia has learned from past operations in Indonesia. They also reflect AusAID's poverty framework<sup>10</sup> and, as such, reflect a broader agency assessment of how Australia can most effectively assist developing countries to reduce poverty

Achievement of the goal of poverty reduction and sustainable development in Indonesia will take a long time. Progress will be uneven. However it is important that Australia remain engaged--and recognise that success can only be measured--over the long term.

### **Objective 1: Improve economic management through support for critical measures for accelerated structural reform, including assistance for revenue enhancement, financial sector restructuring and supervision, and debt management**

As the preceding analysis has suggested, higher economic growth rates are key to reducing poverty and achieving sustainable development in Indonesia. This analysis also suggests that higher rates of economic growth will be unlikely without improved economic management.

Indonesia's economic and financial reform program presents a very diverse potential agenda for assistance and Australia is already supporting many aspects of the reform program. Australian assistance actively supports efforts to develop a solid foundation for future economic growth based around the IMF Letters of Intent. Future Australian assistance would continue to prioritise support for critical areas of the government's economic and financial reform program but focus on a more limited range of interventions with the greatest potential impact, including: debt management; revenue enhancement and taxation reform; financial sector restructuring and supervision, and regional economic management.

Debt Management is being handled with increasing success by the GoI. The large stock of external debt continues to be a source of pressure on both the balance of payments and the exchange rate and public sector debt burden remains a threat to fiscal solvency. However, ongoing assistance to the Centre for Bond Management (PMON) and Bank Indonesia are

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<sup>10</sup> This framework identifies four types of intervention (referred to as 'pillars' of the framework) that are considered to be the most effective means of reducing poverty: (i) strengthen frameworks for sustainable and inclusive *growth* that will benefit the poor; (ii) support interventions that enable the poor to increase their *productivity*; (iii) encourage governments, institutions and donors to be more *accountable* to the poor; and (iv) reduce *vulnerability*.

important in developing the capacity of the GoI to manage this debt into the future. As the issuance of Government securities progresses, increasingly sophisticated methods for the sale and tracking of these assets are needed, both to accurately monitor debt levels and ensure the greatest possible return to the GoI. Australia will continue to provide assistance in areas such as government securities, management of risks around domestic public debt and total government debt monitoring and analysis.

Revenue Enhancement is crucial to improving fiscal sustainability. Indonesia's taxation system has problems that range from inadequate resourcing and systemic weaknesses in tax administration to widespread tax evasion and endemic corrupt practices to minimise tax payments. Approximately 3 million taxpayers are registered out of a workforce of 98 million – and of these 3 million, only about 500,000 submit assessable tax returns. With taxation receipts at only 14 per cent of GDP, there is considerable scope for the GoI to increase taxation revenue. Key necessary reforms include widening the tax base, raising the tax rate and improving the effectiveness of revenue collection. Australia will continue to provide assistance in areas of tax reform and examine options for assistance in other areas of revenue enhancement.

**Financial Sector Restructuring and Supervision** is of vital importance if Indonesia is to maintain investor confidence. The Indonesian banking sector is still weak, characterised by under capitalised banks with high levels of non-performing loans, but there are signs of improvement, with several former state owned banks now being fully or partially privatised. Within the banking system, non-performing loans remain high, bank profitability is low and banks remain undercapitalised. Not surprisingly, banks have been slow to resume new lending, but progress in this area has recently accelerated.

Many issues must be addressed if the GoI is to succeed in its efforts to expand the role of the private sector. These include transferring back to the private sector the large amount of assets held by the public sector, accelerating corporate restructuring, improving corporate governance, enhancing competition policy and developing the small and medium enterprise sector. Progress on this agenda is essential for a recovery in investor confidence and improved prospects for economic growth.

Australia will continue to assist the Indonesian government undertake bank restructuring and reform through operational and financial restructuring of key banks and programs to support the privatisation program for state banks and so improve the standards and accountability of these institutions.

Audit in is not in itself a guarantee of good government. Quality auditing encourages transparency in government and in the financial sector. Open and consistent auditing procedures will increase investor confidence in a marketplace by reducing the opportunities for market “surprises”. Accurate auditing of the banking and financial sector also reduces the potential for money laundering activities to occur. By improving both availability and quality of GoI auditing capacity, government revenues will increase. Australia has provided a range of assistance to the GoI to assist in improving the capacity and capability of the National Audit Office (BPK), the Large Taxpayers Office (LTO) and the banking industry to conduct audits, and will continue to provide support in this area.

**Economic Management at the district level** is a current policy priority for the GoI under decentralisation, however there is still considerable uncertainty about the outcome of the process. Substantial reform of the existing system of administration should yield long-term

improvements in the efficiency and responsiveness of the public sector. District government economic management is likely to become an increasingly important area in which to conduct activities. As clear and beneficial areas of intervention present themselves, it is anticipated that Australia will provide more assistance for this area.

**Objective 2: Strengthen the institutions and practices of democracy through assistance for legal and judicial reform, the institutions of human rights and public accountability, electoral and parliamentary processes and institutions and civil society.**

Stronger democratic institutions and legal reform will improve accountability by opening up greater space for all members of Indonesian society, and particularly the poor, to influence policy-making. Further reform in this area will be crucial to improve investor confidence and growth of the private sector.

Australia has sought to strengthen democratic institutions and practices in Indonesia in the past and has sufficient relevant expertise to provide further democracy-building assistance in the future. In particular, it will give priority to assistance aimed at strengthening legal and judicial institutions, improving the promotion and protection of human rights, strengthening civil society, strengthening electoral processes and institutions, supporting more decentralised and participatory decision-making, and improving gender equality.

**Legal and judicial institutions:** successful transition to a more democratic state will require reform of institutions at the core of the legal system - such as the judiciary, the prosecutor's office and law enforcement agencies. As the analysis above indicates, reform of the legal system will be a long-term process.

The strategy for Australian support for legal and judicial reform balances Indonesian needs and intentions against Australian capabilities and takes into account existing bilateral and multilateral programs. Priority areas of focus will continue to be judicial reform, support for advocacy and legal education civil society organizations and anti-corruption. Further consideration is being given to how best to address gender issues in legal reform.

**Human rights advocacy and practice:** closely linked to legal reform is the promotion and protection of human rights. Australia will give priority to strengthening key institutions directly and indirectly involved in the human rights field. Attention will also be given to increasing the capacity of civil society organisations actively engaged with these institutions or involved in the promotion of human rights.

**Civil society:** Support for capacity building in civil society groups will need to focus on two broad areas: (i) developing civil society capacity to deal independently with community problems, to provide models of democratic and professional governance, to build civil and civic trust and to critically inform, lobby, direct and cooperate with the state to solve community problems; and (ii) developing the capacity of state institutions to partner with civil society in pursuit of development goals and respond to civil society needs in a manner that is transparent, equitable and accountable. The challenges are in developing an understanding within the Bureaucracy of the importance of listening to society, seeking local knowledge, and accepting and responding positively to public criticism. National and local politicians have little experience in making the bureaucracy accountable or the legislature, representative and investigative. They also lack legal and technical skills in drafting legislation and

independently assessing the impact of proposed legislation. Nor is there much experience in assessing majority support or considering the rights of minorities in government decisions. Australia will seek to build capacities among a carefully selected group of civil society organisations, both at the national and local level.

***Electoral Processes and Institutions.*** Free and fair elections held regularly are recognised as the most basic of democratic rights. Electoral processes and systems need to be inclusive and be supported by a legislative framework that enables people to campaign, obtain information, and disseminate political views free from interference and financial manipulation. The success of an electoral process or system is readily reflected in the acceptance of the result by voters and political parties. In June of 1999, Indonesia held its first democratic elections in 40 years. Australia was strongly supportive of this process and provided \$15 million in electoral assistance and a 25-member team of election observers. Further support is being requested for the 2004 elections. Key issues include the strengthening of the successor organisation to the KPU (the equivalent of Australia's Electoral Commission), training of parliamentarians in democratic processes and the strengthening of electoral monitoring bodies. Future assistance may cover areas such as increasing voter awareness and registration numbers. This will be facilitated by support for the relationship developed between the Australian Electoral Commission and its counterpart in Indonesia.

***Decentralised and participatory decision-making.*** With the shift to more decentralised government in Indonesia, the role of regional parliaments and political parties in policy-making has increased significantly. Once virtually a rubber stamp, local parliaments now make crucial decisions about policy directions and the allocation of budgets. It is thus vitally important that these institutions operate effectively and in the interests of the people they represent. There is a broad agenda here for donors. Australia will give priority to promoting institutional reforms primarily at the District level, that make public decision-making more transparent and accountable and encourage effective participation of all stakeholders and in particular the poor in local policy-making processes.

***Gender Equality and Empowerment of Women.*** As noted earlier, the Government has embarked on major reforms in the treatment of women in Indonesian society, in the economy and in civic life. The main elements of the program centre on: removing barriers to participation through legal reform of gender discriminatory laws; mainstreaming gender equity and equality through institutional strengthening; promoting women in economic life; improving women's health and promoting reproductive rights; promoting gender equality in education; and developing gender based indicators for monitoring and evaluating implementation of the five year development plan.

Australia's aid program will support a number of these objectives, including in particular, measures that improve women's health and reproductive rights, and those that promote gender equality in education. Direct support for improved access by women to health and education services will be concentrated primarily in the eight target provinces. Most of these provinces trail the rest of the country in gender empowerment and development. South Sulawesi, Southeast Sulawesi, West Nusa Tenggara, East Nusa Tenggara and Papua all rank in the bottom one-third of provinces in the Gender Empowerment Index recently published by BPS, Bappenas and UNDP. And West Nusa Tenggara, East Nusa Tenggara, East Java, South Sulawesi and Papua rank in the bottom half of the Gender Related Development Index. As part of its support for legal reform, Australia will seek opportunities to support efforts to



reform gender discriminatory laws and, through the ACCESS program, support the removal of gender-based barriers to participation in the economy and in civic life.

**Objective 3: Enhance security and stability through support for law enforcement and counter-terrorism capacity building, conflict and disaster prevention and humanitarian assistance for vulnerable groups**

Recent studies of poverty in developing countries have highlighted the critical role that shocks such as conflict, drought, cyclones, environmental degradation or economic crisis can have on the poor. Indonesia's recovery from the economic crisis has been made more difficult by terrorism and violent conflict. Increased religious and ethnic conflict in Indonesia since 1997 has driven thousands, perhaps millions, of people into poverty and increased the number of people that are vulnerable to poverty. Tackling these issues effectively is a critical step in improving investor confidence and returning Indonesia to the high rates of growth it has enjoyed in the past. It is also critical for improving the lives of the poor.

**Humanitarian assistance** helps meet the immediate needs of those affected by disasters. Australia has provided generous humanitarian assistance to Indonesia and will continue to do so as needs arise. However, it has been recognised that a more proactive approach to crisis management is required.

**Peace Building and Conflict Prevention** interventions provide an opportunity to help communities prevent conflict or deal with its consequences. To this end, Australia has provided support for indigenous crisis management capacity and sought opportunities to support positive influences on peace-conflict dynamics. Support has been provided to the World Bank to integrate conflict prevention and peace building approaches in the Kecamatan Development Program, Phase 2 (KDP2). Peace building and conflict prevention initiatives will be incorporated into direct poverty reduction initiatives as appropriate.

AusAID will increasingly seek opportunities to collaborate with OCHA and other UN and multilateral agencies, and international NGOs, both in program delivery and strengthening its analytical capacity on the root causes of conflict and instability in Indonesia to inform and better target longer-term responses.

The importance of **counter-terrorism capacity building** was underlined by the Bali bombings. Australia will help Indonesia build its capacity to deal with terrorism by supporting links between government agencies in the two countries in areas such as policing (trans-national crime and counter-terrorism), customs and immigration.

**Environmental degradation** has caused many poor communities to lose their livelihoods. The Australian program has ongoing commitments to projects in coral reef management and the institutional strengthening of regional government environment agencies. It will see these projects through. Thereafter, environmental activities will be considered within the context of the area development work in the target provinces. Many people in the target provinces derive all or part of their livelihoods from natural resource based activities and it is therefore highly probable that any area development work that has as its fundamental aim to improve the livelihoods of the poor and near poor will need to address sustainable management of natural resources. While additional freestanding environment projects are not precluded, it is anticipated that this area development work will be the primary vehicle for environmental

interventions. Priorities will thus be dictated by the needs of local government and communities.

**Objective 4: Increase the accessibility and quality of basic social services through policy engagement at the national level and support for planning and implementation at district level and support for community-based approaches.**

Better education services will enable the poor to contribute to and share the benefits from economic growth. The poor suffer disproportionately from health-related problems and access to health care, clean water and adequate sanitation is fundamental to poverty reduction. Despite efforts to improve basic services, Indonesia's key development indicators lag behind its neighbours.

Decentralisation has radically changed the roles of different levels of government in service delivery. Some local governments, possibly up to one-third, are either coping reasonably well with their new responsibilities or have the prospect of doing so in the near future. But more than half Indonesia's regencies appear to be experiencing significant difficulties and will require extensive financial and technical assistance in order just to maintain their present level of services. Australia will give priority to promoting and supporting institutional reforms that strengthen the capacity of local governments to plan and implement programs and services for which they are responsible. Specific programs will be developed to support the design and execution of poverty reduction strategies by selected local governments. Attention will also be given to the issue of minimum service standards as a basis for budget decisions.

**Basic Education.** Support for education is an integral part of the strategy for poverty reduction. As stated above, there is a clear need to raise spending on public education within the next decade, and substantial part of this increase would need to address the inadequate quality of education at the primary level generally, as well as the problems of quality and access at the secondary level. The quality of education has in general been unsatisfactory, with problems of curriculum relevance, teacher quality, and provision of instructional materials. Although near universal access to primary education has been achieved, educational outcomes are poor and transition rates to junior secondary level remain low in some provinces. Dropouts and high repetition rates make the delivery of education costly and inefficient. Existing non-formal education alternatives reach only a small proportion of out-of-school youth.

Australia will significantly increase the share of aid funds directed to basic education over the period of this strategy. Involvement in policy dialogue on education reform will be increased through participation in a multi-donor sector review, and support for the delivery of basic education will be expanded with priority being given to the target provinces outlined below. Emphasis will be placed on interventions that improve the quality of instruction and reduce high dropout rates in these provinces, and on improvements in district and school administration, including for example, community based school management and measures to streamline complex budgetary processes that undermine the ability of local schools to plan and manage their resources effectively. Improving the quality of secular teaching in Islamic schools will also be a component of basic education activities.

Assistance will be delivered through a combination of bilateral projects and multilateral initiatives, closely linked to area development. Australia will increase its analysis and

research on issues relating to basic education to enable strong policy engagement with the GoI.

**Technical and vocational education** has been part of Australia's aid program to Indonesia since 1972, and support valued at over \$100 million has been provided. This has helped to upgrade school facilities, trained teachers, supported the development of a management information system and a monitoring and evaluation framework. The current component of this assistance is the Partnership for Skills Development Project, which is supporting the development of competency-based curricula that meet industry needs. Decisions about future assistance in this area will be taken in the light of Australia's assistance to the education sector as a whole.

**Health, water supply and sanitation.** While the basic structure of the health system is pro-poor (Indonesia was one of the first countries to apply the framework that was endorsed at the UN Health for All Conference in Alma Ata in 1979), Indonesia's health care system has low efficiency and effectiveness in allocating, utilising and managing resources. This situation has been exacerbated by the advent of decentralisation.

Currently the Australian program focuses on maternal and child health care services and communicable disease control. Australia will continue to focus on these areas as they represent an important part of Indonesia's health goals outlined in 'Healthy Indonesia 2010'. In addition, Australia will expand involvement in policy dialogue on health reform and health funding levels. In the context of developing new health interventions, AusAID will review the current program, possibly in the context of a multi-donor sector review. Australian support for the health sector currently involves a mix of large-scale multi-province bilateral projects, and co-financing of national health programs with multilaterals. There is a need to rationalise the extent of this involvement to reduce the administrative burden and better focus the program.

As a memorial to those who lost their lives in the Bali bombings of 12 October 2002, Australia is providing assistance to improve health and medical services in Bali. This assistance will include the construction of an intensive care centre and upgrading of selected facilities at Sanglah Hospital, a new eye clinic and training in a range of health and medical disciplines.

Support for the prevention of HIV/AIDS will continue to be given priority. With a current estimate of 80,000-120,000 HIV positive Indonesians, and a prevalence of over 5% among some vulnerable groups, Indonesia is at risk of an expanded epidemic. While assistance in other areas of health will be directed to the target provinces described below, assistance in HIV/AIDS will be directed to the areas of most need.

Continued support for access to safe water and sanitation will be an integral part of the overall approach to improved health and poverty reduction in Indonesia. Despite years of investment in infrastructure, large numbers of Indonesian communities continue to face inadequate access to clean water supply and poor environmental sanitation.

Under the recent policy initiatives of 'Healthy Indonesia 2010' and ProPenas the Government has committed itself to sustainable improvements in the provision of water supply and sanitation services for its people. However, it lacks a comprehensive framework for the water supply and sanitation sector, particularly for villages and small towns. A national policy

framework and guidelines are currently being developed in collaboration with the World Bank. Australia is providing the bulk of funding support for this process. Australia will continue to support the development of an appropriate overarching policy framework for regionally based water supply and sanitation sector interventions by the GOI and donors. In addition, Australia will continue to explore options for water supply and sanitation infrastructure planning, development and maintenance interventions using a combination of direct bilateral assistance and co-financing arrangements with multilateral donors to replicate the Australian experience on a larger scale. This builds on our substantial achievements and lessons learnt through more than 20 years of experience in the sector.

### 3.3 GEOGRAPHIC FOCUS AND TARGET POPULATIONS

A key element of the strategy over the medium-term is to reduce the geographic spread of the current program. Analysis of various provincial indicators has led to the choice of a group of eight provinces as the broad target for a substantial portion of the direct interventions at the sub-national level (see Appendix Table 7 for details). Within this broader grouping, three or four provinces will be selected as the core focus of intensive direct poverty reduction efforts.

Table 7: Characteristics of Populations in Target Provinces, 1999 (millions)

Province	Population (mill)	Absolute Poor (mill)	Life Expectancy (years)	Adult Literacy (%)	Illiterate (mill)	Lack Safe Water (mill)	Lack Health Facilities (mill)	Suffer Health Problems (mill)
East Java	34.5	10.3	65.5	81.3	6.5	14.8	5.9	8.9
South Sulawesi	7.8	1.5	68.3	83.2	1.3	3.8	2.0	1.9
East Nusa Tenggara	3.9	1.8	63.6	81.2	0.8	1.6	1.5	1.4
West Nusa Tenggara	3.8	1.3	57.8	72.8	1.0	2.4	0.7	1.3
Papua	2.1	1.1	64.5	71.2	0.6	1.2	0.8	0.5
Maluku / North Maluku	2.0	1.0	67.4	95.8	0.1	1.0	0.5	0.3
Southeast Sulawesi	1.8	0.5	65.0	87.1	0.2	0.8	0.4	0.3
<b>TOTAL/AVERAGE</b>	<b>55.9</b>	<b>17.5</b>	<b>65.2</b>	<b>81.3</b>	<b>10.5</b>	<b>25.6</b>	<b>11.8</b>	<b>14.6</b>
% of Indonesia total	27.5	36.5	98.4	92.0	45.2	24.2	26.8	29.5

Source: *Indonesia Human Development Report 2001*.

\* at the time of collection of this data, Nth Maluku and Maluku were the one Province. Data disaggregated for the new province is not currently available.

All of the target provinces have a high incidence of poverty and rank among Indonesia's poorest. Almost 20 million of the population in the target provinces is in absolute poverty, accounting for 37% of all people in Indonesia in absolute poverty. Life expectancy in this group of provinces is below the national average and the number of people who suffer from health problems is above the national average. Adult literacy is below the national average - 45% of all people in Indonesia who are illiterate live in these provinces. They are all in Eastern Indonesia, the preferred GOI geographic target for Australian assistance, and where Australia's aid has focused in the past.

The geographic focus of the Australian program will be achieved in two ways. First, where appropriate, support components of national programs in health and basic education to the eight selected provinces (and provide technical expertise in the development of these national programs where required); and second through area development work in targeted districts. In respect of the former, the specific interventions to be supported will be those that cannot be

addressed at the micro-level. That is, the intervention required is identified as being common across a range of the target districts or provinces. For example there would be greater efficiencies to be achieved in procuring vaccines for a national immunisation program at the central level and ensuring adherence to a common treatment protocol than it would be to attempt to establish district specific immunisation programs.

A significant implication of this approach, referred to as area development, is that Australian assistance will see a gradual shift from the current use of sectorally based, large scale, multi-province projects to area specific, integrated and programmatic approaches. Health interventions for example may be delivered as part of an integrated and broader program of support for improvements to basic services in a selected district. The key principle underlying this approach is that the identification and design of interventions will be undertaken with foremost consideration to the perspectives of the beneficiary and not the provider.

Direct interventions at the district level will not operate in isolation: central policy considerations will be addressed and locally learned insights will be fed back to the central policy level. While the focus of the analysis and interventions will be primarily on selected districts, all interventions will emphasise the importance of macro level policy and institutions to the livelihoods of the target populations and thereby attempt to bridge the gap between the micro and macro levels. On a practical level this will involve ensuring that higher-level policy development and planning (by government and donors) is informed by lessons learned and insights gained at the local level.

Australia will work with Indonesia to design sub-national poverty interventions, drawing on knowledge of local conditions in Indonesia, taking a systematic approach to the identification of target population groups, spearheading analysis of the underlying causes of poverty and vulnerability in collaboration with local planning agencies, CSOs and others, and designing interventions that address the causes of, and potential for reducing, poverty. As the lessons from the past indicate, good project design and careful targeting are important factors in determining whether project interventions are successful. In the event that solutions include interventions that are not part of the AusAID portfolio (for example, major infrastructure development), AusAID in conjunction with the local government will advocate for the channelling of national/Provincial government or other donor resources to the area. Co-financing arrangements with another donor will also be explored. Consistent with the principle of increased emphasis on partnerships and selectivity, Australia will collaborate closely with other donors in designing interventions in these target provinces.

Area development will be developed incrementally, initially in three ways: (i) by developing a more detailed understanding of poverty reduction issues confronting the Indonesian Government and how these are being handled, at national and local levels, (ii) by providing support for improved governance in targeted districts in development planning and financial management; and (iii) providing support for improved basic service delivery at district level.

## 4 MANAGEMENT OF THE PROGRAM

### 4.1 GUIDING PRINCIPLES FOR PROGRAM MANAGEMENT

The following principles will guide the design of the program:

- **Concentration of effort:** As a medium-sized donor, the key to an effective Australian program will be concentration of effort and careful targeting of assistance. While the thematic scope will continue to be relatively broad, concentration of effort will be achieved in a number of ways. Assistance will be directed to a small number of priority provinces in which the incidence of poverty and vulnerability is relatively high. As stated above, eight provinces are to be given priority for Australian assistance. These provinces have a total population of some 56 million people. Greater selectivity in Australia's assistance will also be achieved by gradually reducing the number of project interventions under active implementation. While Australia will continue to support broader processes of policy dialogue such as through the CGI, it will concentrate its efforts on a limited number of specific policy issues. Practically this will involve allocating resources for analysis and monitoring and for informing and influencing developments in respect of a select set of issues within the wide range that now constitute Indonesia's reform program.
- **Linking activity development directly to strategic objectives:** The activity design process used to develop specific interventions will assess explicitly how each proposed intervention fits within the country strategy framework, and how each would contribute to achievement of the strategic objectives and the program goal. Increased use will be made of progressive engagement and rolling designs to ensure that interventions meet these considerations.
- **Informed by a strong analytical framework:** The program will conduct in-depth analysis of the causes of poverty and underdevelopment in Indonesia and its regions in order to establish priorities for intervention. In conducting this analysis, the program will take advantage of the unparalleled Indonesia expertise that exists within Australia (relative to the donor community) and also increasingly draw on the expertise of Indonesian nationals.
- **Recognising the central role of governance:** The focus of the program will be on improving governance by supporting more efficient, effective, transparent and accountable institutions, systems and processes. This is because governance issues lie at the heart of most of Indonesia's development problems. Whether one is talking about banking supervision, legal and judicial institutions, basic education, or conflict prevention, improved governance is the key to better outcomes. Governance will therefore no longer be treated as a sector but as a crosscutting theme that underpins most, if not all, interventions. This will involve linkages between support for policy development and programs.
- **Demonstrating tangible outcomes:** It will be important to ensure that the program achieves a balance between focussing its efforts to improve the enabling environment (the policy context, systems and processes of institutions, and skills base) and tangible and direct improvements in the well being of the poor and near poor.

- **Emphasis on monitoring and evaluation at the program level:** A framework would be developed for monitoring changes in poverty and vulnerability to poverty in the eight provinces targeted for Australian assistance.
- **Replicability:** The program will seek to develop successful, replicable solutions to the development constraints it addresses, in order to facilitate the leveraging of funds from larger donor partners. This will enhance the impact of Australian assistance.
- **Partnerships:** The impact of Australian assistance will also be broadened through the development of strong partnerships with the Indonesian government, civil society organisations and other donors. Particular emphasis will be given to participatory processes which ensure that the design and delivery of interventions are informed by the perspectives and direct involvement of the ultimate beneficiaries. It will also seek to increase Indonesian involvement in the development and oversight of Australian interventions through participation in such mechanisms as policy and technical advisory/reference groups, and in design, monitoring and evaluation exercises. Overall much greater weight will be placed on partner consultation in all program development work.
- **Flexibility:** While the strategic framework has been developed with long-term scenarios in mind, programming will be undertaken over the medium term (commitments of up to 5 years where appropriate). The program will be responsive to changing circumstances and requirements in Indonesia through the use of staged designs and annual reviews. These reviews will assess the continuing relevance of the program to: Australia's national interests in Indonesia; the priority poverty reduction and development goals at the national and regional levels; and Australian aid policy.
- **Enhancing the bilateral relationship:** The aid program will contribute to strengthening the bilateral relationship through the formulation and implementation of well-targeted interventions and which reflect Indonesia's development needs and Australia's national interest. The aid program will also seek to promote interaction and dialogue between policy-makers and opinion-makers in Indonesia and Australia. This will be done through conferences, guest lectures, and other special events that are designed to further understanding in areas relevant to the aid program. Emphasis will also be given to expanding the current modest program of public information about Australian assistance to Indonesia. An enhanced communication strategy at the post will target, *inter alia*, specific Indonesian audiences and would provide information about the nature and benefits of Australian assistance.
- **Support for whole-of-government priorities:** The aid program plays a major role in supporting Australia's national interest in a stable and prosperous Indonesia. Its engagement in areas of critical interest to Australia (eg economic reform, governance and conflict) provides a rich source of analysis through which AusAID can contribute to development of whole-of-government policies towards--and understanding of--Indonesia. The program is an effective vehicle through which Australia can respond to emerging issues that impinge on the national interest. For example, the Government Sector Linkages Program (GSLP) provides a flexible mechanism through which departments can address key development-oriented issues arising out of the

Australia Indonesia Ministerial Forum process. GSLP enables the program to access and bring to bear the significant body of relevant expertise resident in the federal government system.

## 4.2 IMPROVING DONOR COORDINATION AND PARTNERSHIPS

***Current status of donor coordination.*** The large number of active donors in Indonesia makes effective donor coordination essential. The principal donor coordination mechanism is the CGI chaired by the World Bank. Aligned to the CGI process are the Working Groups that parallel the CGI agenda. Each working group comprises interested donor representatives and representatives from relevant GOI agencies. The purpose of the groups is to develop action plans that provide a framework for donor support for tangible steps being undertaken by GOI to progress the reform agenda. Australia is active in the working groups that are relevant to the bilateral program. The donor community has also set up a series of coordination mechanisms in Jakarta, such as monthly donor roundtable meetings. Donors also frequently hold briefing sessions for the donor community at the completion of major missions or strategy review exercises.

Generally there is a high degree of interaction and information sharing among the main donors. This has been particularly evident as donors adjust to decentralisation and develop criteria for selecting and channelling assistance down to the regional level. Donors seem well aware of the need to avoid duplication of effort and excessive fragmentation of their programs. The amount of aid resources available to Indonesia is modest in relation to the range of possible interventions that confront the donor community in Indonesia and overall levels of spending by the government. Donors will need to watch that they don't overload limited institutional capacities for reform, especially at the local level, with advocacy and support for an excessive number of policy initiatives at any one time. A concentration on the poorer provinces and districts will require close attention to donor coordination to minimise burdens on local administrations and reduce the risk of duplication of effort.

The World Bank, ADB and UNDP have collaborated to form the Partnership for Governance Reform, an institutionalised mechanism that aims to focus the international community's support for governance reform. To avoid a donor driven agenda, the Partnership has made a concerted effort to involve leading Indonesians in its work. The Partnership reports to a Governing Board that comprises senior Indonesians, Cabinet Ministers and Ambassadors from the main donor countries, including Australia.

Bappenas has traditionally played a major role in coordinating the activities of donors and in minimising the risk of donor duplication among sectors and overlap at the provincial or district level. With responsibility for much of the development spending now shifted to local government, the role of Bappenas is much less clear. Some donors have not decided how they will approach coordination with the National Government, especially when it comes to projects and programs implemented by local governments or by CSOs. Some are apparently bypassing completely the National Government and are dealing only with local entities. Others are relying increasingly on national line ministries to build links to district governments. Although it may be technically possible to bypass National Government completely, the importance of the Australia-Indonesia relationship is such that it will be essential to consult with and keep National Government agencies informed about the sub-national components of the aid program. This will support replication of the program to other



districts and provinces in the future. To this end, Australia sees a strong role for Bappenas, while also seeking to strengthen partnerships with local governments and civil society organisations.

Australia will strengthen existing and emerging partnerships by:

- Maintaining the relationship with Bappenas and other traditional national government partners, and selectively strengthen ties at senior levels through the provision of policy advisory services and related technical assistance.
- Deepening relations with a select group of local governments, with first priority being given to the eight provinces targeted for assistance at the sub-national level.
- Selective engaging with civil society organisations. Such groups may have particular local skills and knowledge that can facilitate project design and implementation or contain the costs of implementation. AusAID already makes use of local groups within Indonesia to assist in project design and implementation.
- Emphasising on participatory processes in the design and delivery of interventions and on increased Indonesian involvement in the development and oversight of Australian interventions.
- Where appropriate, drawing on the significant expertise on Indonesia available in Australia in the academic, government and non-government sectors and use aid interventions to deepen linkages between these groups and their counterparts in Indonesia.
- Increasing the emphasis on cooperation with other donors. This will involve encouraging and participating in multi-donor sector reviews in key sectors of interest, cooperating with other donors on project/program design and implementation, as well as increased use of co-financing arrangements. Cofinancing allows Australia to share experiences with other donors and leverage additional resources in priority areas. Such arrangements, however, will have as a first principle Australian involvement as an *active* partner in formulation, review, dialogue and evaluation.
- Supporting partnerships between Australian and Indonesian communities through exchange programs between Australian and Indonesian academic institutions, support for joint research relevant to the development cooperation program and other initiatives. The program may also include increased collaboration between professional associations, including for example, police and judicial associations, accountancy and audit bodies, and various regulatory and administrative bodies at the national or sub-national level.

### **4.3 MONITORING PROGRESS AND MANAGING RISKS**

#### **Portfolio Management**

The primary focus of portfolio management will be on improving the quality of the portfolio and on assessing the impact of interventions at the program level – i.e. its impact on the

factors that contribute to poverty and vulnerability and against the specified strategic objectives. Actions taken to improve the quality of the portfolio will draw on the lessons from the past and will include: (i) increased attention to design; (ii) ensuring that interventions respond to a clear demand; (iii) identifying clearly the target beneficiaries; (iv) strategic management of implementation; (v) increased emphasis on thematic supervision of groups of interventions to ensure that systemic issues are identified and discussed at the regional and national level as appropriate; and (vi) early restructuring of problem interventions. Consolidation of the program and increased focus on poverty reduction will facilitate monitoring and evaluation of the performance of the portfolio.

### **Monitoring Performance and Progress**

Measurement of program performance is critical to enable AusAID and the Government of Indonesia assess the appropriateness of the aid program and its effectiveness. It will assist both countries determine how best to manage the portfolio.

The effectiveness of the program strategy will be assessed in terms of its relevance to: (i) key GoI documents such as the Poverty Reduction Strategy Paper, development plans and sector strategies, (ii) Australia's national interest and (iii) the extent to which new interventions are clearly linked to the strategy goal and objectives. As part of the process of reviewing the program strategy, AusAID will periodically hold seminars that will bring together academics, government officials and development workers to discuss current issues in development in Indonesia.

The continuing volatility of the Indonesian political, economic and security climate will necessitate regular and ongoing monitoring of both the strategy and the program to Indonesia. While it is unlikely that the overall direction of the program will change rapidly, the monitoring and reviews will serve to adjust the relative emphasis accorded to each of the strategic objectives. For example where GOI commitment to reform in the economic and financial areas significantly exceeds commitment to legal and judicial reform, resources may be increased in the former and reduced in the latter.

AusAID will monitor country-level progress on poverty reduction. At the November 2001 CGI meeting in Jakarta, the Indonesian Government agreed to draw up a poverty reduction strategy for the country, and an interim document was presented at the January 2003 CGI. AusAID has indicated its interest in supporting the development of the final PRSP, which is expected to include an agreed set of poverty reduction indicators to be monitored at the national level. The indicators are expected to go beyond the standard measure of the headcount of expenditure poverty and include measures for human development, access to basic services and vulnerability to material poverty. These indicators will form the basis for judgments about progress in poverty reduction at the national level.

AusAID will develop a companion set of monitorable indicators for poverty reduction for those provinces and districts to be included in the Australian assistance program. AusAID will work closely with national and local government, as well as with other donors active in the same areas, in developing these core indicators. The objective will be to ensure comparability and uniformity among local jurisdictions and with the national indicators.

AusAID has developed an initial set of indicators to monitor progress against the core objectives for the Australian assistance program (see table 8). These indicators will be further

developed over the first year of the strategy to ensure that they provide an appropriate basis for performance monitoring.

Increased attention will be given to benchmark surveys before project start-up and after project completion. As the lessons from the past indicate, evaluation of the impact of projects designed to reduce poverty has been hampered by lack of information about the target populations. Increased attention will therefore be given to benchmark surveys that determine the extent of deprivation of intended beneficiaries prior to project start-up. These surveys would include measures of income or expenditure, access to basic services that fail to meet or exceed agreed minimum standards, extent of gender inequality, and other indicators as appropriate. At project completion, evaluations with particular emphasis on progress against the benchmark surveys will be undertaken, for example, to measure the extent to which the living conditions of the beneficiaries have been improved and the extent to which improvements can be attributed to the project.

### Managing Portfolio Risks

***The Indonesia portfolio faces increased risks.*** A recurring theme in this framework paper is the increased uncertainty associated with the future course of development in Indonesia. When combined with the fact that the program will be moving into areas that are less familiar, the consequence is more risk associated with the Indonesia program than in the past. These risks may translate into a combination of poorer portfolio performance during implementation, increased costs of portfolio management, and reduced project benefits. Effective management of these risks must play a larger role in future programs for Indonesia.

There are three broad categories of risk to be considered in managing the Indonesia program: (i) risks that are external to Indonesia; (ii) country risks; and (iii) project and program risks.

- ***Risks external to Indonesia.*** The primary risk here is an international economic environment that is less favourable to Indonesia. The main concerns in this regard are a rapid decline in oil prices or a prolonged slowdown in international trade. For the immediate future, the issue is the timing of the global recovery. Strong OECD growth, would be beneficial for Indonesia. However, as long as the Indonesian financial system remains weak and fiscal balances are open to question, the country is vulnerable to financial crises that may originate elsewhere in the world.
- ***Country risks.*** It is this category of risk that is responsible for the increased uncertainty about Indonesia's prospects. The range of country risks is discussed at some length in Section I. These risks can be summarised as follows: (i) continued political tensions and violence at the national level or provincial level; (ii) failure to make effective progress with decentralisation and regional autonomy; (iii) lack of progress in governance and building administrative capacities, particularly in the lead-up to the 2004 elections; (iv) civil society fails to be a constructive and effective voice for reform in Indonesia; (v) macroeconomic instability and weak progress on structural reform and legal reform undermine prospects for investment and growth; and (vi) failure to stem the rapid environmental degradation.
- ***Project and program risks.*** The increase in country risks can have a deleterious effect on the operating environment for individual projects. As a result, project risks have

also increased. The main projects risks are those associated with project preparation, design and implementation. These will typically include, but are not limited to, inadequate assessment of the degree of support for projects among intended beneficiaries, inadequate assessment of the environmental consequences of projects, inappropriate technical packages, overestimation of government and other partner capacities for implementation or funding, cost overruns during implementation, procurement problems, contractor performance problems, and shortfalls in intended benefits that erode community support for projects.

Several mechanisms are available to Australia for managing these risks. One is to vary the size of the overall assistance program, depending on Indonesia's progress with broad-based reform and poverty reduction. The other is to maintain the size of the program but deploy funds away from sectors or activities in which there is little or no progress. While the first option cannot be ruled out entirely, the operative assumption for the program is that the second option will be used to manage country risk. Resources can be reallocated to national activities or to provinces and districts where performance is strong. This can be done by closing badly performing programs ahead of schedule and reallocating the funds or by changing the thematic mix of projects entering the pipeline. Yet another option will be to scale back projects and programs to cover only technical assistance and training requirements. However, as noted earlier, providing aid in a poor overall policy environment runs the risk of being wasted with no significant beneficial impact on poverty at the national or local level.

A further means of improving risk management is the use of pilot projects and the principle of progressive engagement. As the lessons from the past indicate clearly, project and program effectiveness are enhanced by the use of preparatory technical assistance and pilot projects that test new applications and programs. This approach will be expanded, along with increased emphasis on the principle of progressive engagement. The nature and level of ongoing cooperation will be linked to the level of commitment and progress demonstrated by target institutions and communities. Such an approach will help improve the effectiveness of the program and will allow for better management of risks.

#### **4.4 OTHER ISSUES IN PROGRAM MANAGEMENT**

##### **Cost Sharing Policies**

AusAID currently has a flexible approach to requiring counterpart contributions to the capital costs of projects and programs; and in contrast to a number of donors, its policies also permit financing of recurrent costs. Decisions on these matters are currently made on a project-by-project basis.<sup>11</sup> In an environment in which local government budgets are severely constrained, a realistic approach needs to be taken during project design to ensure that demands placed on local budgets can be met.

The general approach will be to adopt a sliding scale for local cost financing: for example, some local cost items may be picked up at the beginning of the activity, but by the end, the relevant government agency would have taken responsibility for all local costs. Rather than deciding these matters on a project-by-project basis, broad guidelines would be adopted for several categories of local government. More generous local cost financing policies would apply to the poorest group of local governments; for those governments that are financially

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<sup>11</sup> See discussion of counterpart and recurrent cost financing in AusAID, *Promoting Practical Sustainability*. September 2000.

stronger, more stringent financial contributions would be required. Very poor districts that are potential project partners may, on occasions, have considerable difficulty in meeting local cost financing guidelines. In these cases, the first issue to be addressed will be the size of the project. A smaller project with clear local cost contributions from a district government may be much more effective than a large project that does not place any particular financial demands on the local government.

### **Enhancing the Public Image of Australian Assistance to Indonesia**

There is a need for better information in the public domain about how Australia benefits from assistance to Indonesia and how Australia's assistance benefits Indonesia. There are four sets of issues to be addressed in formulating a more comprehensive public information/communications strategy.

- ***How does Australian assistance benefit Indonesia?*** The "Program Profiles" booklet will be updated regularly as the key source of general information on the program. In addition, opportunities for media releases and briefings will be produced to mark key events such as the completion of major activities and the beginning of new ones.
- ***What are Indonesia's perceptions of the program?*** There is work to be done in influencing Indonesian perceptions about Australia's aid program, especially among senior officials. Anecdotal evidence suggests that Australia is seen as a medium-sized donor who is mainly interested in providing a small number of Indonesians with scholarships to train in Australia and in making direct interventions in Eastern provinces in close proximity to Australia that are predominantly Christian. This perception is clearly inaccurate and needs to be addressed. The Jakarta post, with assistance from Canberra, will undertake a public awareness campaign to improve knowledge and understanding of the program.
- ***What are the benefits of the Indonesia program for Australia?*** There are several messages to be conveyed within Australia. As a good neighbour, Australia is helping address the needs of poor people in Indonesia and helping local governments build their capacities to reduce poverty and inequality. Australia's security and economic progress are closely linked to the fortunes of countries in the Asia-Pacific region. National and regional security can be challenged by non-military threats, including domestic conflict and violence in neighbouring countries that destroys livelihoods and undermines growth opportunities, by financial instability, by cross-border criminal activities, by adverse environmental impacts and by the spread of communicable diseases. An economically stronger Indonesia also means greater trade and investment opportunities for Australia. This message will be conveyed through publications.
- ***What developments within Indonesia will have a negative impact on Australian public support for the aid program?*** There is a reasonable chance that the incidence of poverty will not be reduced significantly in Indonesia over the next decade. This may undermine support for the program. It will be important to avoid overselling the prospects for poverty reduction in Indonesia, and to give a clear understanding of the role of the program in facilitating and supporting positive developments, but ultimately the achievement of poverty reduction will rest primarily with the people and Government of Indonesia.

## **Resource Implications**

Commencing in March 2003, responsibility for the management of aid activities is progressively shifting to Jakarta. Aligning activity and contract management functions with in-country field monitoring will eliminate duplication between Canberra and Post functions, simplify lines of authority and enhance the responsiveness of activity-level decision making. Crucially, it will also release Australian-based resources to focus on design and policy work to improve aid quality. Alongside this devolution of responsibility for activity management, the program will develop specific means to strengthen capacity for policy dialogue with key Indonesian interlocutors, and strengthen its capacity to monitor and respond to program performance and risks, as well as donor coordination issues.

To achieve these aims, the program will improve its in-house and external access to priority sectoral and economy-wide policy and program advice and analysis. Strategies will also be developed to significantly enhance in-house design-related skills, particularly of Canberra-based staff responsible for program and pipeline development. Options for strengthening the skills base of staff in-country and in Australia include training and professional development, targeted recruitment and/or 'contracting-in' of required expertise. Improved access to ongoing, externally sourced consulting expertise may include the establishment of standing 'sectoral monitoring and review' teams based in-country and/or in-Australia.

Table 8: Indonesia Program Overview

	<b>Economic Management</b>	<b>Democracy</b>	<b>Security</b>	<b>Service delivery</b>
<b>Strategic Objectives</b>	<b>Improve economic management</b> through support for critical measures for accelerated structural reform including, assistance for revenue enhancement, financial sector restructuring and supervision, and debt management;	<b>Strengthen the institutions and practices of democracy</b> through assistance for legal and judicial reform, the institutions of human rights and public accountability, electoral and parliamentary processes and institutions, and decentralisation;	<b>Enhance security and stability</b> through support for law enforcement and counter-terrorism capacity building, conflict and disaster prevention and humanitarian assistance for vulnerable groups;	<b>Increase the accessibility and quality of basic social services</b> through policy engagement at the national level and support for planning and implementation at district level, particularly in basic education, health and water supply and sanitation.
<b>Key Challenges for Indonesia</b>	<ul style="list-style-type: none"> <li>. Maintenance of macro-economic stability by:               <ul style="list-style-type: none"> <li>- Improving revenue raising capacity through tax and customs reform;</li> <li>- Maintaining the program of IBRA asset sales and improving transparency;</li> <li>- Reduction of the massive debt burden</li> </ul> </li> <li>. Improvement of the investment climate;</li> <li>. Improved financial accountability to address corruption;</li> <li>. Improving financial sector regulation;</li> <li>. Financial management by District Governments</li> </ul>	<ul style="list-style-type: none"> <li>. Corruption of the political system;</li> <li>. Weak capacity in parliaments at all levels;</li> <li>. Corruption in the justice sector,</li> <li>. Lack of accessibility and responsiveness to the needs of the poor in the justice sector;</li> <li>. Lack of high level leadership for justice sector reform;</li> <li>. Limited institutional capacity for protection and promotion of human rights;</li> <li>. Lack of certainty and high costs of electoral processes;</li> <li>. Weak capacity of government and non-government watchdogs.</li> </ul>	<ul style="list-style-type: none"> <li>. Politically motivated violence based around ethnic, religious or separatist causes;</li> <li>. Limited capacity of law enforcement agencies to proactively deal with groups committed to violence;</li> <li>. Participation of elements of the police and military in violent conflict;</li> <li>. Weak institutional capacity to reduce vulnerability and improve responsiveness to natural disasters.</li> </ul>	<ul style="list-style-type: none"> <li>. Lack of capacity to deliver services is creating instability and delegitimising government</li> <li>. Poor health and education outcomes in relation to other SEA countries, stemming from:               <ul style="list-style-type: none"> <li>- low levels of government spending on basic social services;</li> <li>- poor quality of services and lack of minimum standards;</li> <li>- lack of capacity at district levels;</li> <li>- lack of oversight of local service provision by the National Government;</li> </ul> </li> <li>. Lack of clarity in the outcome of decentralisation of fiscal and administrative responsibility for pre-tertiary education.</li> <li>. Management of HIV/AIDs</li> </ul>
<b>Australia's Key Interventions</b>	<ul style="list-style-type: none"> <li>. Support for revenue enhancement by capacity building in the Large Taxpayer's Office (LTO);</li> <li>. Improving the capacity of the Centre for Government Bonds Management (PMON) to oversee GOI domestic bond (debt) management;</li> <li>. Improving financial sector supervision by Ministry of Finance;</li> <li>. Improving capacity of National Audit Office;</li> <li>. Supporting trade liberalisation efforts of the Ministry of Finance.</li> </ul>	<ul style="list-style-type: none"> <li>. Support judicial reform, including capacity building in the Supreme Court by Australia's Federal Court;</li> <li>. Improved human rights advocacy and practice;</li> <li>. Strengthen civil society organisations that advocate legal and human rights reform;</li> <li>. Support electoral processes and institutions;</li> <li>. Support improved accountability of district governments.</li> </ul>	<ul style="list-style-type: none"> <li>. Supporting linkages between Australian Government agencies and their Indonesian counterparts to improve capacity in areas such as border integrity, customs, quarantine, <i>transnational crime and counter terrorism</i>;</li> <li>. <i>Strengthening the capacity of communities to identify and arrive at peaceful resolutions to conflict</i>;</li> <li>. Strengthening the capacity of agencies responsible for managing Indonesia's anti-money laundering and counter terrorist financing efforts.</li> <li>. Humanitarian assistance to IDPs;</li> <li>. Emergency assistance.</li> </ul>	<ul style="list-style-type: none"> <li>. Support for a multidonor review of the education sector, including the Islamic education system;</li> <li>. Building capacity of district governments to plan and implement basic services;</li> <li>. <i>Building capacity to manage quality and standards in the education system</i>;</li> <li>. <i>Support improved management of the teaching force</i>;</li> <li>. Piloting community based management structures for basic education;</li> <li>. <i>Leveraging the resources of the international financial institutions in basic education and health</i>;</li> <li>. Support for vocational education and training agencies to strengthen their capacity to provide programs based on workforce needs;</li> </ul>
<b>Outcomes</b>	<ul style="list-style-type: none"> <li>. Increased taxation collection from large taxpayers;</li> <li>. Better government domestic bond management;</li> <li>. Better supervision of government-owned banking sector;</li> <li>. Improved National Audit Office effectiveness.</li> </ul>	<ul style="list-style-type: none"> <li>. Better performing judiciary;</li> <li>. Establishment of effective mechanisms to deal with allegations of human rights abuses;</li> <li>. Stronger civil society role in democratic processes;</li> <li>. Improved capacity of election officials to undertake their duties;</li> <li>. <i>Selected district governments have improved public and performance accountability</i></li> </ul>	<ul style="list-style-type: none"> <li>. Stronger GOI capacity in counter-terrorism and related functions;</li> <li>. <i>Better community capacity to peacefully resolve conflict</i>;</li> <li>. PPATK able to undertake effective monitoring of transactions and prepare appropriate reports on suspicious transactions;</li> <li>. Effective Australian emergency and humanitarian assistance.</li> </ul>	<ul style="list-style-type: none"> <li>. Improved capacity in selected district governments to plan and implement basic services;</li> <li>. Improved planning, management and delivery of basic education's physical resources in selected districts ;</li> <li>. Improved management of the teaching force;</li> <li>. Community based management structures for basic education piloted;</li> <li>. Increased international financial institutions support for basic education and health</li> <li>. Improved vocational education and training agency capacity to provide programs based on workforce needs;</li> <li>. Improved health services in Bali.</li> </ul>
<b>Outcome Indicators</b>	<ul style="list-style-type: none"> <li>. LTO taxation revenue collection data;</li> <li>. IMF assessment of GOI bond management;</li> <li>. Ministry of Finance State-Owned Banks Monitoring and Governance Unit compliance data;</li> <li>. Professional reviews of National Audit Office reports indicate improving standard and number of reports.</li> </ul>	<ul style="list-style-type: none"> <li>. Increase in high profile cases being sensibly resolved by the judiciary;</li> <li>. UNHCR (or other) endorsement of appropriateness and effectiveness of mechanisms;</li> <li>. ACCESS data;</li> <li>. Consensus amongst national and international stakeholders of credibility of election processes;</li> <li>. <i>Surveys and audits of local governments: Data on local governments meeting minimum accountability/transparency standards.</i></li> </ul>	<ul style="list-style-type: none"> <li>. Documentation on national and international stakeholder views;</li> <li>. <i>Data on community-level training, UN etc data showing decrease in the number of violent internal conflicts, IDPs etc</i>;</li> <li>. AUSTRAC and APG assessments of PPATK monitoring and reporting capacity;</li> <li>. AusAID data on numbers assisted with Australian EHA</li> </ul>	<ul style="list-style-type: none"> <li>. Documentation from selected district governments on changed basic services planning and implementation procedures;</li> <li>. Surveys of access to and quality of basic services;</li> <li>. Higher basic education enrolment, retention and graduation;</li> <li>. GOI documentation on changed teacher management procedures;</li> <li>. GOI and donor reporting;</li> <li>. IFTA and loan portfolio data;</li> <li>. GOI documentation on progressive introduction of competency-based tech/voc education and training.</li> </ul>

*Italics indicate emerging areas of support  
Australian Agency for International Development*

## APPENDICES

## APPENDIX 1: TABLES

Table 1: Selected economic indicators for Indonesia

	1996	1997	1998	1999	2000	2001 (est)
Population (millions)	197.2	200.4	203.7	207.0	210.4	211.2
GNI (current US\$ b) <sup>1</sup>	208.9	196.4	89.4	129.0	147.1	n.a.
GDP (current US\$ b) <sup>2</sup>	227.4	215.7	95.4	141.3	153.3	141.7
Inflation, GDP deflator (annual %) <sup>3</sup>	8.9	12.6	75.3	15.2	11.0	n.a.
Exchange rate (Rupiah to US\$ end of period average) <sup>4</sup>	2342.3	2909.4	10013.6	7855.2	8421.8	10260.9
Gross investment (% of GDP) <sup>5</sup>	30.7	31.8	16.8	12.2	17.9	17
Current revenue, excluding grants (% of GDP) <sup>6</sup>	17.0	18.1	16.5	17.9	..	n.a.
Overall budget balance, including grants (% of GDP) <sup>7</sup>	1.2	(0.7)	(3.0)	(1.1)	..	n.a.
Exports of goods and services (US\$ b) <sup>8</sup>	58.7	60.1	50.6	49.7	59.1	n.a.
Imports of goods and services (US\$ b) <sup>9</sup>	60.1	60.7	41.2	38.4	47.0	n.a.
Current Account Balance (us\$ b) <sup>10</sup>		(4.8)	4.1	5.8	8.0	8.6
FDI (us\$ b) <sup>11</sup>	6.2	4.7	(0.4)	(2.7)	(4.6)	n.a.
Portfolio investment (us\$ b) <sup>12</sup>	5.0	(2.6)	(1.9)	(1.8)	(1.9)	n.a.
Gross international reserves (includes gold, current US\$ b) <sup>13</sup>	19.4	17.5	23.6	27.3	29.4	n.a.
Gross international reserves in months of imports (months) <sup>14</sup>	3.5	3.0	5.2	6.1	5.3	n.a.
Total External Debt (us\$ b) <sup>15</sup>	128.9	136.2	150.9	150.1	146.6	135
Total External Debt (% of GDP) <sup>16</sup>	56.7	63.1	158.2	106.2	95.6	95.3

*Sources:*<sup>1, 10, 12</sup> International Monetary Fund (IMF)<sup>2</sup> Australian Department of Foreign Affairs and Trade Indonesia Country Fact Sheets (DFAT CFS)<sup>3, 6, 7, 8, 9, 13, 14</sup> World Bank Development Indicators (WDI) 2002<sup>4</sup> International Monetary Fund (IMF)<sup>5, 11</sup> Asian Development Bank (ADB)<sup>16</sup> Total External Debt figures is sourced from ADB and GDP figures from DFAT CFS

n.a. = not available



Table 2: Disbursement Offers by Donors at CGI, November 2001

<b>Donor</b>	<b>Amount</b>	<b>Share</b>
	<b>US\$ million</b>	<b>(%)</b>
<b>Multilateral</b>		
ADB	1,150.0	30.2
World Bank	1,000.0	26.3
UN	113.8	3.0
Nordic Investment Bank	19.5	0.5
Islamic Development Bank	16.3	0.4
European Investment Bank	-	-
Kuwait Fund	-	-
Saudi Fund for Development	-	-
<i>Sub-total</i>	<i>2,299.6</i>	<i>60.4</i>
<b>Bilateral</b>		
Japan	720.0	18.9
United States	376.5	9.9
Germany	116.0	3.0
Australia	62.5	1.6
Netherlands	60.0	1.6
Spain	57.0	1.5
United Kingdom	34.1	0.9
South Korea	26.6	0.7
Canada	17.5	0.5
Austria	15.0	0.4
Italy	10.0	0.3
Belgium	6.3	0.2
Denmark	2.5	0.1
New Zealand	2.2	0.1
Switzerland	1.0	0.0
Portugal	0.9	0.0
Finland	-	-
France	-	-
Norway	-	-
Sweden	-	-
<i>Sub-total</i>	<i>1,508.1</i>	<i>39.6</i>
<b>TOTAL</b>	<b>3,807.70</b>	<b>100.0</b>

Source: World Bank.

Table 3: Allocations of Australian Aid to Recipient Countries

Country	1997-98			2000-01		
	Population (millions)	Aid (A\$ mill)	Aid per capita(A\$)	Population (millions)	Aid (A\$ mill)	Aid per capita(A\$)
East Timor	-	-		1.0	133.8	140.10
Tonga	0.1	10.1	103.06	0.1	11.7	115.27
Kiribati	0.1	7.1	82.56	0.1	10.1	112.22
Vanuatu	0.2	13.7	69.19	0.2	19.2	97.22
Samoa	0.2	12.8	77.58	0.2	14.7	84.97
Papua New Guinea	4.5	339.7	75.49	4.8	344.5	71.77
Solomon Islands	0.4	11.0	26.19	0.4	24.4	55.58
Micronesia	0.1	2.6	22.41	0.1	3.0	24.79
Fiji	0.8	19.3	24.81	0.8	18.2	22.36
Maldives	0.3	2.5	9.51	0.3	3.4	12.36
Laos	4.9	17.2	3.51	5.3	18.7	3.53
Cambodia	11.1	34.1	3.07	12.1	37.9	3.13
Mongolia	2.3	2.5	1.09	2.4	3.2	1.33
Bhutan	0.8	0.5	0.65	0.8	1.0	1.24
Vietnam	74.1	64.9	0.88	78.4	73.1	0.93
Philippines	71.1	55.4	0.78	76.1	63.2	0.83
Indonesia	200.8	97.1	0.48	207.7	120.8	0.58
Mozambique	16.8	10.0	0.60	17.8	10.1	0.57
Sri Lanka	18.6	12.8	0.69	19.3	10.8	0.56
Seychelles, Mauritius	1.3	2.6	2.06	1.3	0.5	0.39
Thailand	67.3	20.9	0.31	70.0	24.8	0.35
Nepal	22.5	6.7	0.30	24.2	7.9	0.33
Bangladesh	123.3	33.7	0.27	130.8	37.8	0.29
Malaysia	21.6	3.2	0.15	23.3	6.2	0.27
Egypt	60.0	14.3	0.24	64.1	16.3	0.25
South Africa	39.7	10.0	0.25	42.4	10.1	0.24
Myanmar	43.8	3.2	0.07	45.8	4.2	0.09
China	1,218.7	52.0	0.04	1,266.8	57.4	0.05
Afghanistan	25.2	5.4	0.21	26.7	1.4	0.05
Pakistan	129.0	3.7	0.03	139.3	4.4	0.03
India	958.4	16.6	0.02	1,017.1	20.1	0.02
Regional & other territories	-	128.5	-	-	164.8	-
<b>TOTAL</b>	<b>3,117.9</b>	<b>1,014.1</b>	<b>0.33</b>	<b>3,279.7</b>	<b>1,277.7</b>	<b>0.39</b>
<b>Memo</b>						
All countries except China & India	940.8	817.0	0.87	995.8	1,035.4	1.04
Pacific Islands	1.9	76.6	41.16	1.9	101.3	52.32
Southeast Asia except Indonesia & Timor	293.9	198.9	0.68	311.0	228.1	0.73

Source: Aid allocations from Australia's Overseas Aid Program, 2001-02; population data from World Bank.

Table 4: Indonesian Provinces in which Australian Aid Program Operates

Province	Number of Projects	Project Activities
<b>Java</b>		
DKI Jakarta	15	ADS, LRP, TAMF II, IASTP II, SMERU, BPKP, Komnas HAM, MOHA Decentralization TA, GSLP Debt Management, WASPOLA, WHO TB, HIV/AIDS AIMRI, COREMAP
West Java	2	UNICEF Safe Motherhood
Central Java	1	SAS
DI Yogyakarta		
East Java	3	Bapedalda IS, IASTP II, WSLIC II
Banten	1	PSD
<b>Number of provinces with projects</b>	<b>5</b>	
<b>Sumatra</b>		
Lampung		
Bengkulu		
South Sumatra	2	SAS, WSLIC II
Riau	1	PSD
Jambi		
West Sumatra	1	WSLIC II
North Sumatra	2	SAS, IASTP II
Aceh		
<b>Number of provinces with projects</b>	<b>4</b>	
<b>Kalimantan</b>		
West Kalimantan		
Central Kalimantan		
South Kalimantan		
East Kalimantan	1	SAS
<b>Number of provinces with projects</b>	<b>1</b>	
<b>Sulawesi</b>		
Central Sulawesi	1	EIIDP
North Sulawesi	1	EIIDP
South Sulawesi	5	SAS, IASTP II, PSD, EIIDP, HIV/AIDS
Southeast Sulawesi	2	SAS, HMHB
<b>Number of provinces with projects</b>	<b>4</b>	
<b>Other Islands</b>		
Bali	2	Bapedal Regional, HIV/AIDS
West Nusa Tenggara	5	SAS, IASTP II, Bapedal Regional, WHFW, WSLIC II
East Nusa Tenggara	9	WHO TB, HIV/AIDS, Alor Health, PEP, COREMAP SAS, IASTP II, Bapedal Regional, WHFW
Maluku	2	HMHB, UNICEF Safe Motherhood
Papua	3	Jayawijaya WATCH, UNICEF Safe Motherhood, PSD
<b>Number of provinces with projects</b>	<b>5</b>	
<b>TOTAL number provinces with projects</b>	<b>19</b>	

Source: AusAID.

Table 5: Classification of Provinces by Poverty Incidence, Resource Base and Human Capital Base

Human Capital Base	High Incidence of Poverty		Moderate Incidence of Poverty		Low Incidence of Poverty	
	Good Resource Base	Moderate to Weak Resource Base	Good Resource Base	Moderate to Weak Resource Base	Good Resource Base	Moderate to Weak Resource Base
<b>Strong</b>		Maluku	East Kalimantan Central Kalimantan North Sumatra	D I Yogyakarta North Sulawesi	DKI Jakarta Riau Bali	West Sumatra
<b>Moderate to Weak</b>	Papua West Kalimantan	East Java Central Java West Java East Nusa Tenggara		Southeast Sulawesi Central Sulawesi South Sumatra Lampung West Nusa Tenggara	D I Aceh South Kalimantan	South Sulawesi Bengkulu Jambi

### Note on procedure and sources

Step 1: Select the eight provinces in the highest quartile of poverty incidence in 1999: Papua, East Nusa Tenggara, Maluku, West Nusa Tenggara, East Java, Southeast Sulawesi and Lampung.  
Source: BPS et al., *Indonesia Human Development Report 2001*.

Step 2: Drop provinces in which AusAID has little or no operating history and add an equal number of provinces that have a strong history of cooperation: drop Lampung and add South Sulawesi.  
Source: Appendix Table 6.

Step 3: Separate final list of eight provinces into groups based on recent ADB analytical work:

- Those with moderate to weak human capital and resources bases:* East Nusa Tenggara, West Nusa Tenggara, East Java, Southeast Sulawesi and South Sulawesi.
- Those with moderate to weak human capital base and strong resource base:* Papua.
- Those with strong human capital base and moderate to weak resource base:* Maluku.

Table 6: List of Indonesian Projects with Donor Cofinancing

Project	Partner Agency	Date Commenced	Authorised Amount (A\$)	Total Donor Funding (US\$)		
				AusAID	Partner	Total
<b>Projects with Donor Cofinancing</b>						
Land Administration	World Bank	8-Aug-94	28,234,000	20,658,818	62,600,000	83,258,818
Coral Reef Management & Rehabilitation	WB/ADB/JICA/GEF	4-Oct-96	9,000,000	7,046,100	19,800,000	26,846,100
WB WS&S Policy & Action Planning WASPOLA	World Bank	11-Sep-97	9,015,000	6,708,062	6,193,000	12,901,062
WB WS&S for Low Income Communities II	World Bank	18-Jan-00	11,133,000	6,482,746	100,200,000	106,682,746
Back to School Program	WB/ADB	14-Aug-98	8,000,000	5,035,200	380,000,000	385,035,200
UNDP/WB/ADB Partnership for Governance Reform	UNDP/WB/ADB	Jan-00		2,700,000		2,700,000
Social Monitoring & Early Response Unit	SMERU	29-Oct-98	1,800,000	1,132,920	200,000	1,332,920
Health Services TA - ADB DHS	ADB	5-Jun-00	1,057,476	615,768	65,000,000	65,615,768
WHO Sub-National Immunisation Day	WHO	19-Jul-00	1,000,000	582,300	2,212,792	2,795,092
ANU Indonesia Project	ANU	22-Jul-97	750,809	558,677		558,677
WB Kecamatan Development II	World Bank	1-Jun-01	900,000	468,000	320,000,000	320,468,000
<b>TOTAL</b>			<b>70,890,285</b>	<b>51,988,590</b>	<b>956,205,792</b>	<b>1,008,194,382</b>
<b>Projects with Donors as Executing Agent Only</b>						
WHO Tuberculosis Assistance	WHO	20-Nov-97	4,405,022	-	-	-
WB SANIMAS Sanitation by Neighbourhoods	World Bank	29-Sep-00	930,000	-	-	-
UNDP Nth Maluku & Maluku Recovery Program	UNDP	Nov-01	500,000	-	-	-
<b>TOTAL</b>			<b>5,835,022</b>	<b>-</b>	<b>-</b>	<b>-</b>

Source: AusAID

Table 7: Indonesian Country Program Portfolio under Implementation as of 30 June 2002

Activity Name	Commenced date	Completion date	Approved Amount	Expense Total	Undisbursed Balance
<b>Natural Resources</b>					
Bapedal Regional Denpasar Project	10-Jul-97	30-Jun-04	10,283,267	5,289,038	4,994,229
Coral Reef Rehabilitation and Management	04-Oct-96	31-Mar-04	10,037,500	6,120,647	3,916,853
BAPEDAL East Java Inst. Strgth	10-Jul-97	31-Aug-05	8,518,300	3,124,893	5,393,407
Forestry Reform Support	25-Jul-00	30-Jun-05	1,000,000	410,803	589,197
World Summit on Sustainable Development	23-Jan-02	23-Jan-03	500,000	461,936	38,064
<b>TOTAL</b>			<b>30,339,067</b>	<b>15,407,317</b>	<b>14,931,750</b>
<b>Health</b>					
HIV/AIDS & STD Prevention & Care Phase II	02-Aug-99	31-Dec-06	30,412,500	384,329	30,028,171
Women's Health and Family Welfare	12-Feb-98	31-Dec-05	29,385,000	7,293,831	22,091,169
HIV/AIDS & STD Prevention & Care Project	10-Sep-95	30-Dec-01	28,477,170	27,031,617	1,445,553
UNICEF Safe Motherhood Programme	23-Jul-97	31-Dec-03	16,125,200	13,155,682	2,969,518
Healthy Mothers Healthy Babies	15-Jan-96	16-Nov-03	15,265,141	12,827,993	2,437,148
Health Services TA- ADB DHS Project	05-Jun-00	30-Jun-04	2,057,477	54,296	2,003,181
Health Sector Technical Advisory Group	05-Nov-98	31-Dec-02	1,850,000	906,655	943,345
Health- AIMRI Medical Research Project	01-Jun-97	30-Jun-04	1,756,886	1,702,146	54,740
<b>TOTAL</b>			<b>125,329,374</b>	<b>63,356,549</b>	<b>61,972,825</b>
<b>Water Supply &amp; Sanitation</b>					
WB WS&S for Low Income Communities Ph II	18-Jan-00	31-Dec-06	12,500,000	3,405,161	9,094,839
WB WS&S Policy & Action Planning - WASPOLA	11-Sep-97	30-Jun-03	9,105,000	8,698,239	406,761
WB SANIMAS- Sanitation by Neighbourhoods	29-Sep-00	30-Jun-04	930,000	334,876	595,124
Water Supply & Sanitation TAG	08-Oct-97	30-Dec-01	610,500	443,131	167,369
WSS NTT & Southeast Sulawesi	13-Aug-01	01-Dec-02	450,000		450,000
<b>TOTAL</b>			<b>23,595,500</b>	<b>12,881,407</b>	<b>10,714,093</b>
<b>Basic Education</b>					
NTT Primary Education Project	19-Sep-00	03-Apr-08	25,478,243	574,240	24,904,003
Back-To-School Program	14-Aug-98	30-Jun-03	8,030,000	7,636,823	393,177
Virtual Colombo Plan	18-Jan-02	30-Jun-05	26,289	19,761	6,528
<b>TOTAL</b>			<b>33,534,532</b>	<b>8,230,824</b>	<b>25,303,708</b>
<b>Education</b>					
INDONESIA - ADS	18-Aug-95	30-Jun-03	246,450,000	200,141,831	46,308,169
Partnership in Skills Development	15-Jun-98	30-Apr-05	50,882,426	26,246,360	24,636,066
Specialised Training Project - Phase II	17-Oct-97	30-Jun-03	46,696,663	40,484,668	6,211,995
Off-shore Management of ADS	08-May-98	31-Dec-02	26,400,000	13,945,942	12,454,058
Sponsored Student Activities & PCE	30-Jun-95	30-Dec-02	22,124,007	14,237,221	7,886,786
Ad Hoc Training	01-Jul-95	30-Jun-01	2,838,104	2,785,279	52,825
<b>TOTAL</b>			<b>395,391,200</b>	<b>297,841,301</b>	<b>97,549,899</b>
<b>Governance</b>					
Government Sector Linkages Program	01-Feb-96	30-Jun-03	22,160,000	11,101,931	11,058,069
ACCESS	28-May-98	15-Aug-06	13,100,000	1,041,200	12,058,800
Electoral Assistance	11-Feb-99	31-Aug-99	10,155,000	9,728,000	427,000
TAMF Phase II	15-Jun-00	30-Jun-03	8,095,000	4,717,064	3,377,936
Legal Reform Program Facility	31-Mar-00	26-Mar-03	5,170,000	1,316,678	3,853,322
Eastern Indonesia Investment Development	08-Feb-99	30-Jun-04	4,678,900	162,737	4,516,163
Debt Management Project	31-Aug-00	20-Sep-04	4,340,160	970,238	3,369,922
Civil Governance	10-Sep-99	15-Sep-01	2,824,900	2,206,262	618,638

Social Monitoring & Early Response Unit	29-Oct-98	31-Dec-03	2,732,000	1,921,765	810,235
Institutional Support for Komnas HAM	30-Mar-98	30-May-02	1,975,000	1,600,087	374,913
Decentralisation Activities	20-Mar-01	30-Jun-06	1,232,750	442,721	790,029
ANU Indonesia Project	22-Jul-97	31-Aug-02	1,207,120	1,135,371	71,749
Strengthening Microfinance Institutions	06-Nov-00	31-Jul-03	1,061,000	1,050,712	10,288
Financial & Economic Reform Expert Team	09-May-01	30-Nov-03	800,000	158,381	641,619
Australia-Indonesia Development Area	28-Jan-97	31-Jan-99	466,000	476,027	-10,027
AIDA Business Directory	10-Jan-01	30-Jun-01	280,000	228,951	51,049
Partnership for Governance Reform	10-Jan-02	30-Jun-03	50,000	3,975	46,025
<b>TOTAL</b>			<b>80,327,830</b>	<b>38,262,100</b>	<b>42,065,730</b>
<b>Humanitarian Assistance</b>					
Emergency and Humanitarian Program	14-May-01	15-May-03	17,438,700	10,478,916	6,959,784
West Timor Humanitarian Assistance	20-Dec-99	30-Dec-00	3,000,000	2,930,191	69,809
<b>TOTAL</b>			<b>20,438,700</b>	<b>13,409,107</b>	<b>7,029,593</b>
<b>Program Management</b>					
Small Activities Scheme	01-Jul-98	30-Sep-02	10,064,997	9,150,820	914,177
Indonesia Program Support Unit (PSU)	01-Jul-98	30-Jun-03	6,833,509	5,552,925	1,280,584
Program Management & Travel	01-Jul-95	30-Jun-03	3,324,741	3,121,447	203,294
<b>TOTAL</b>			<b>20,223,247</b>	<b>17,825,192</b>	<b>2,398,055</b>
<b>GRAND TOTAL</b>			<b>729,179,450</b>	<b>467,213,797</b>	<b>261,965,653</b>

Source: AusAID

Table 8: Activities of Major Donors

Donors	SECTOR BREAK-UP (IN PERCENTAGE)																		
	Funding Disbursed in US\$ (per Million) Year			Health		Education & Training		Water Supply & Sanitation		NRM / Rural Dev.		Governance & Eco. Reform (incl. SME)		Humanitarian/ Conflict Res.		Transport		Communication	
	2000	2001	*2002	2001	*2002	2001	*2002	2001	*2002	2001	*2002	2001	*2002	2001	*2002	2001	*2002	2001	*2002
Japan	185.9	53	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
United States	113	133	128	22	29	-	**2	-	-	10	10	50	45	18	14	-	-	-	-
Germany	115.2	88.9	116	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Australia	62	63	63	16	18	51	45	4	6	6	6	13	15	1	1	-	-	-	-
Netherlands	67	70	60	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Canada	35	30	30	15	15	10	13	-	7	11	17	51	35	13	13	-	-	-	-
European Union	18	40	69	2	51	-	-	15	-	24	23	36	26	12	-	11	-	-	-
United Kingdom	10	9.75	15	-	-	-	-	-	-	51	43	8	33	41	24	-	-	-	-
NZ	2.2	2.2	3.9	-	-	53	50	-	-	21	20	2	16	24	14	-	-	-	-
France	2.4	2.4	2.4	-	1	77	72.3	-	1	11	7.3	2	3.7	1	1	2	2.7	7	11

**NOTE :**

Yearly disbursement figures are for Grants only

\* : Estimate figure

\*\* : USAID funding under the 2002 Education &amp; Training column is for an education activity only. Training components are included under each category (health, NRM, etc.)

NA : Data Not Available

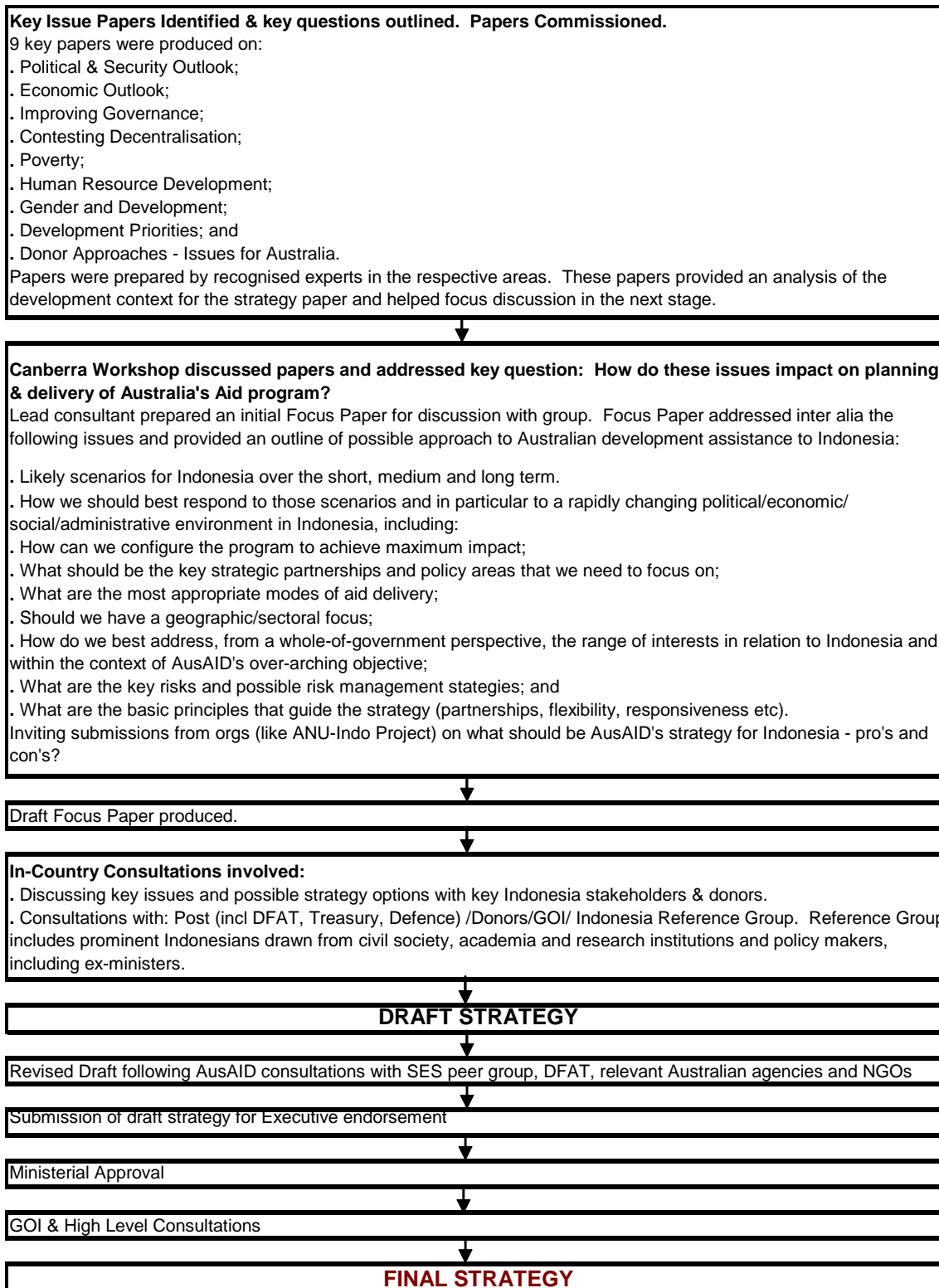
: Capital Grant only. Data on Technical Coop. Assistance not available.

: Converted to US\$ Dollars. Original figures provided by the Netherlands Dev. Coop. in Euro dollars.

Exchange rate for 2000 : 1 US\$ = 0.9230 Euro &amp; 2001 : 1 US\$ = 0.8822 Euro (Source : US Federal Reserve Foreign Exchange Rates)

: Figures taken from the CGI disbursement offers list (World Bank, November 2001)



**APPENDIX 2: THE COUNTRY STRATEGY PROCESS**

**APPENDIX 3: KEY DOCUMENTS CONSULTED**

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