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Committee Secretariat
Joint Standing Committee on Foreign Affairs, Defence and Trade
Department of the House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Mr Lawson

JSCFADT INQUIRY INTO AUSTRALIA'S RELATIONS WITH INDONESIA

I am pleased to attach, for the Committee's consideration, a submission from AusAID to the above-named Inquiry.

As the submission makes clear, the aid program is a stable and positive element in Australia's bilateral relationship with Indonesia. It has facilitated people-to-people links and at the same time provided Indonesia with skilled people necessary for its development.

Despite the program's modest size in comparison to total aid flows to Indonesia, Australia has been a very active donor in Indonesia, with a broad range of interventions and strong engagement with Indonesians at all levels of government and civil society.

I look forward to receiving the outcomes of the Inquiry in due course.

Yours sincerely

Bruce Davis

23 DEC 2002



**JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS DEFENCE AND
TRADE**

FOREIGN AFFAIRS SUB-COMMITTEE

INQUIRY INTO AUSTRALIA'S RELATIONS WITH INDONESIA

**SUBMISSION BY AUSTRALIAN AGENCY FOR INTERNATIONAL
DEVELOPMENT (AusAID)**

AUSTRALIA'S AID RELATIONSHIP WITH INDONESIA

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1. INTRODUCTION

(i) Overview

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 struggles to emerge from a severe economic crisis and continue its difficult transition to a decentralised, democratic and prosperous society. This transition will take many years. Its success will depend heavily on reducing the poverty and vulnerability that currently affects more than half of Indonesia's 210 million citizens. The future holds enormous opportunities, but also great risks. The stakes are high – not only for Indonesia, but also for Australia.

The need for assistance in Indonesia is immense. AusAID's analysis suggests that sustainable poverty reduction in Indonesia will require: sound economic management which returns the country to a sustainable growth path; development of institutions for accountable government; public services targeted at the poor and near poor; increased economic opportunities for the poor; and a reduction in the factors which contribute to vulnerability, including conflict and natural disasters. Aid has an important role to play in facilitating Indonesia's achievement of these objectives.

Australia has the capacity to assist. Its breadth of experience and significant expertise on Indonesia places it in a unique position as a donor. We have a strong track record in supporting economic reform. We have established solid partnerships with a range of government institutions and (more recently) with civil society that provides a base for interventions targeted at institutional reform, transparency and accountability. We have decades of experience of working in regional Indonesia in the development of basic services. We have partnered with the government and non-government organisations to respond to crises resulting from conflict or disasters.

The aid response therefore represents a fundamental element of the broader Australian government agenda of ensuring stability and prosperity in Indonesia. The aid program has been a stable and positive element in the bilateral relationship. It has facilitated people-to-people links and at the same time provided Indonesia with skilled people necessary for its development. Despite the program's modest size in comparison to total aid flows to Indonesia, Australia has been a very active donor, with a broad range of interventions and strong engagement with Indonesians at all levels of government and civil society.

(ii) Achievements

In 2002-03 Australian official development assistance to Indonesia is estimated to total \$121.6 million. This maintains crisis levels of assistance to meet Indonesia's transition needs and compares with average annual Australian aid flows to Indonesia of around \$116.5 million over the previous five years. Australia's bilateral development cooperation program with Indonesia is second in size only to its program with Papua New Guinea.

Nevertheless Australia is only a modest donor to Indonesia relative to: the volume of total aid flows to that country (since the crisis these flows have amounted to several billion US dollars annually); the size of the Indonesian economy (\$US145.6 billion in 2001); the size of the Indonesian population (210 million; Australia is providing around 60 cents of aid per head of the Indonesian population); and the scale of poverty in Indonesia (around 100 million Indonesians are living in or near poverty).

Even so, Australian aid has achieved much and contributed substantially to Indonesia's development over the last few decades.

For example, ***during and after the East Asian financial crisis Australia helped Indonesia meet critical economic, financial and administrative reform needs*** by providing, promptly and responsively, thousands of hours of expert technical advice and assistance to agencies which are key to Indonesia's reform agenda. This assistance helped to improve, *inter alia*, public debt management capacity; performance monitoring and prudential supervision of state banks; implementation of Indonesia's decentralisation process through development of systems to enable the monitoring, evaluation and support of regional government performance; and investigative and performance audit capacity in the Supreme Audit Board. It has been necessary for the program to be flexible and responsive, adjusting through time to help meet Indonesia's crisis--then post-crisis--assistance needs.

During the crisis, Australia helped to ensure that tens of thousands of Indonesian children did not drop out of the school system, by working with other donors through the Back to School Program.

Australian aid has been responsive to issues of mutual national interest eg by: supporting the development and establishment of an improved national anti-money laundering regulatory framework, including new legislation; improving the capacity of the Ministry of Justice and Human Rights to draft anti-terrorism legislation; supporting strong linkages between Australian Government agencies and their Indonesian counterparts in areas such as border integrity, trade, customs, quarantine and transnational crime; supporting the Australian Federal Police in its efforts to combat people smuggling; and responding to the threat of terrorism with assistance to strengthen Indonesia's own counter-terrorism capacity.

Australian aid has also helped Indonesia address endemic access and quality problems in basic services such as education and health. Over the last few decades Australia has helped ensure better education and training for tens of thousands of Indonesians through long term support to strengthen Indonesia's tertiary and technical and vocational education systems. It has also helped Indonesia address its significant human resource capacity development needs through specialised short course training for around 15,000 Indonesians from both the private and public sectors in areas such as health, gender, environment and governance.

During the last four decades Australian aid has helped Indonesia develop a cadre of more highly trained people through provision of in-Australia tertiary scholarships for around 7,500 Indonesians in a range of priority developmental disciplines related to sectors such as governance, education and health.

Australian aid has helped improve Indonesian public sector capacity at all levels to deliver better basic health services for the poor in areas such as maternal and child health (better health for more than 2 million Indonesian women and children through the training of thousands of midwives in hundreds of villages, health centres and hospitals); communicable diseases (1.3 million children immunised against polio and 30,000 Indonesians immunised against Hepatitis B); and HIV/AIDS (improved national HIV/AIDS awareness, improved non-government capacity to deliver community-based preventive approaches and improved public sector capacity to address the disease, including through support, as a leading donor, for development of a national HIV/AIDS strategy).

Australian aid has helped Indonesia to address serious problems of access to safe water and sanitation by providing improved access to potable water and better sanitation for hundreds of thousands of poor Indonesians in provinces like East and West Nusa Tenggara, and by supporting development of a national water supply policy framework.

Australian aid has also helped Indonesia to address environmental management and protection issues. Over the last decade Australian aid has helped to: strengthen national Indonesian environmental protection and waste management capacity; support the decentralisation of environmental management arrangements through assistance to Provincial and District level agencies; and facilitate the development of community-based management of natural resources.

Australia has provided prompt, appropriate and generous humanitarian assistance in response to natural and man-made disasters in Indonesia. This assistance, which has totalled around \$108 million since 1997-98, has benefitted hundreds of thousands of affected poor and vulnerable Indonesians. Some of this assistance has been channelled through international organisations such as the UN World Food Program.

2. INDONESIA'S DEVELOPMENT CONTEXT

Indonesia's devastating 1997-99 economic and political crisis dramatically altered its development prospects. In the twenty five years prior to the crisis, Indonesia's economy grew rapidly (growth averaged 7% annually), poverty was sharply reduced (from around 60% to around 12% of the population) and key socio-economic indicators (eg in areas such as health and education) improved significantly. However the crisis exposed fundamental weaknesses in Indonesia's financial system and institutions of law and government.

The Megawati Government confronts a daunting array of economic, social and political problems--and so will its successors. Reform has started but progress in establishing the momentum of economic, political and social reform required to build a democratic society capable of sustained strong economic growth is slow.

As Indonesia now begins to emerge from four years of crisis, it is also undergoing massive and simultaneous social, political and economic change. Its daunting agenda includes deep-seated economic and financial sector reform; a fundamental

process of democratisation and major development and strengthening of civil society; and a process of radical decentralisation and regional and special autonomy.

The Bali bombings have intensified Indonesia's transition challenges. The degree and duration of the economic downturn they will cause will depend, to a large extent, on how consumers, tourists and investors perceive the extent and effectiveness of Government of Indonesia (GOI) action to find and punish the perpetrators; to address the threat of terrorism more broadly; and to accelerate broader reform efforts.

(i) Economic Crisis and Recovery

Macroeconomic stability has been restored, but economic recovery is slow. The financial crisis of 1997 and subsequent political upheavals ended Indonesia's era of rapid economic gains. GDP contracted by some 13% in 1998. The economy began to recover in 2000, registering growth of almost 5%, but slowed again, to about 3.3%, in 2001, reflecting slower world growth as well as internal structural impediments.

By August-September 2002 Indonesia's macroeconomic performance indicators had all improved substantially. The exchange rate had appreciated significantly, year-on-year inflation was down from 15% (February) to 10% (August) and nominal interest rates had fallen. The Bali bombings undermined the growth prospects suggested by this relatively favourable macroeconomic situation. Estimates indicate the bombings will slow Indonesia's economic growth by up to 0.3% in 2002--to around 3.2%--and by up to 1% in 2003, to 3.5-4%, depending in particular on their impact on consumer confidence. GOI has revised downwards its 2002 and 2003 growth forecasts, from 4% and 5% to 3.5% and 4% respectively.

Prior to the Bali bombings, market sentiment towards Indonesia (as measured by portfolio--rather than foreign direct--investment trends) had been improving over the course of 2002. The rupiah appreciated 17-18% over 2001, stabilising at around Rp8,700 - 9,100/US\$, and the risk premium on Indonesian paper in international markets has improved. Post-Bali, market sentiment toward Indonesia is fragile, even though, by mid-November 2002 (a month after the bombings), the rupiah had returned to its pre-bombing level of around Rp9,000/\$US and, after an initial drop of 10% in a single day, the Jakarta sharemarket had regained about half of its losses. Increased uncertainty is likely to delay investment and consumption decisions. A firm, controlled and pro-active response by the Indonesian government will be crucial to encourage potential investors.

Ensuring fiscal sustainability over the short- and medium-term is the greatest challenge to continued macroeconomic stability. Despite the economic impacts of the Bali bombings, GOI is on track to achieve its 2002 budget deficit target of 2.5% of GDP. However, it has increased its estimated 2003 budget deficit from 1.3% to 1.8% of GDP (around \$US3.8 billion) due to necessary post-Bali changes in underlying 2003 budget assumptions, as well as the costs of a (\$US1.1 billion) fiscal stimulus package to promote job creation and offset the impacts of the bombings. GOI fiscal consolidation in recent years has come at the cost of reductions in the development budget eg from 3.1% of GDP in the 2001 budget to 2.8% in 2002--the fourth consecutive year of development budget cuts in relation to GDP. The consequence is

infrastructure deterioration and declining quality in already inadequately funded social services. It remains to be seen whether local governments will increase development spending to compensate for these cutbacks, or whether decentralisation will lead to further development spending cuts.

The debt burden is declining but still high and increases Indonesia's vulnerability to recurring financial crises. GOI is burdened with debt equivalent to around 80% of GDP (down from around 100% in early 2000) and debt service payments equivalent to around 35% of fiscal revenues. Its outstanding debt as at February 2002 was around US\$126 billion equivalent--US\$62 billion in foreign debt and US\$64 billion equivalent in domestic debt. This high debt level is a potential source of financial instability. Large service payments constrain GOI's ability to maintain spending on basic services and development. Maintaining a budget deficit of no more than 2-3% of GDP will require significant effort to raise non-oil tax and other revenues. This will be difficult: GOI asset sales and privatisation may fall short of budget targets in the face of domestic opposition to particular transactions, and improved tax revenues will depend on extensive administrative reforms, reductions in tax exemptions and a concerted effort to broaden the tax base.

Progress in reforming the financial sector has been disappointing. Indonesia's financial system remains weak and vulnerable to further crises. The banking system is still not in a position to help lead a sustained recovery in Indonesia: non-performing loans remain high; bank profitability is low; banks remain undercapitalised; and there has been only limited progress on debt restructuring, operational restructuring, governance improvement and state bank privatisation. Progress in strengthening Bank Indonesia's supervisory capacity also has been slow. To protect macro-economic stability, GOI must also create an effective bond market to enable orderly refinancing of the large amount of government domestic debt reaching maturity in the next few years.

There has been serious erosion in private investor confidence, which has been worsened by the Bali bombings. Fixed investment declined from a pre-crisis level of around 30% to about 17% of GDP in 2000--a level insufficient to support sustained strong growth. Foreign and domestic investment approvals continue to fall, suggesting little immediate prospect of an investment recovery. As a result of Bali, Indonesia's country risk premium has increased and a war risk surcharge has been imposed by foreign shipping companies on all cargo leaving and entering Indonesia for the US and Europe. Foreign investors perceive Indonesia to be suffering from political and governance problems, a failure to address its many structural problems and, now, as having serious security problems. Investment funds have been shifted to other, less risky, emerging markets as Indonesia's large net outflow of foreign private capital continues. Indonesia has also experienced substantial domestic capital flight since 1997, primarily by Indonesian Chinese business interests.

Economic recovery depends primarily on renewed private investment. GDP growth of 5+% a year will require a recovery in investor confidence and aggregate investment spending of 25-30% of GDP on a sustained basis. GOI's heavy debt burden precludes the on-going large-scale use of fiscal stimuli in support of stronger economic growth. The private sector must therefore be the engine of growth in the Indonesian economy. Restoration of foreign and domestic investor confidence and establishment of a

vibrant private sector will require concerted effort on a wide-ranging agenda. Secure property rights, impartial enforcement of contracts and internationally accepted codes of commercial conduct must be implemented and supported by an impartially operating legal and judicial system. The large amount of assets now held by the public sector must be transferred back to the private sector. GOI must accelerate corporate restructuring, improve corporate governance, adopt policies that will foster competition and develop the small and medium enterprise sector.

Systemic corruption and lack of legal certainty make Indonesia an extremely difficult country in which to conduct business. Problems with the rule of law centre on an inadequate legal framework compounded by lack of enforcement and extensive bribery within enforcement agencies. Endemic corruption in these agencies took root in the long Soeharto era, during which there was minimal public accountability and transparency. Low salaries, poor training and inadequate budgets significantly compound the problems.

Progress on administrative and legal reform has been disappointing. There is no clearly articulated strategy for administrative reform and there may be little prospect for major reforms until after the 2004 elections. Successful reform will require stronger civil society organisations that can exercise advocacy and oversight functions. Administrative reform at the provincial and district levels is also critical to ensure accountable government.

(ii) Democratisation and the Growth of Civil Society

A start has been made in the transition to democracy, with a return to free and open elections and significant constitutional reforms.

A more vibrant and vocal civil society is beginning to emerge interested in improving oversight of political processes, government, the legal system and business activities. There is a lively and burgeoning free press, an increasingly vocal and active civil society, a growing free trade union movement and more open domestic debate about major issues such as corruption, debt and participation of civil society in public policy formulation. The Parliament now plays a meaningful role, in contrast to its “rubber stamp” role during the Soeharto era. With decentralisation, local governments and legislatures have become increasingly active.

This social mobilisation is increasing transparency in politics and building pressure for greater responsiveness at different levels of government.

Gender bias is a persistent problem in Indonesia. Persistent social, cultural, legal and institutional biases have denied Indonesian women greater benefit from the development gains that have been achieved over the past three decades. These biases are evident, *inter alia*, in education and health indicators and in the labour market, where women are found primarily in low-skill, low-paid employment. Women continue to be only a very small minority in politics and the upper echelons of the public and private sectors. In recent years GOI has attempted to better address the problem of gender inequality but budgetary support and institutional capacities for furthering its various initiatives remain limited.

(iii) Decentralisation and Regional Autonomy

Decentralisation is responding to local pressures for a greater role in government.

After decades of highly centralised government, decentralisation is widely seen as an imperative response to strong internal pressures 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. Local (district) governments are now responsible for delivering basic services, including health, education, environment and infrastructure; provinces play only a relatively minor role. The laws also provide for a doubling of the regional share of general government spending, to some 8% to 9% of GDP, or well over 40% of general government spending.

Decentralisation is an opportunity and a challenge. It is an area of great medium term uncertainty. If successful it will generate many political, economic and social benefits but, if badly managed, it could seriously undermine GOI efforts to maintain national macroeconomic stability. It could also seriously compromise the delivery of basic services to many Indonesian citizens, especially the poor and near poor, which in turn could lead to increased social unrest. The success of the transition to decentralised government, like other key reforms, will depend on efforts to prevent the spread of corruption and money politics.

Indonesia has made little progress in combating environmental degradation. The virtual disappearance of central authority over natural resource extraction after the fall of the Soeharto Government in 1998 has seriously weakened control mechanisms. Illegal logging and mining has mushroomed and public environmental expenditure, already low compared with neighbouring countries, has declined sharply. There has been little progress in bringing the large-scale deforestation of the past 20 years under control. Water resource management is poor; water quality is deteriorating in many locations due to pollution and inadequate sanitation. Decentralisation carries serious risk of accelerating environmental degradation in the near term and perhaps beyond, due to local natural resource agencies lacking authority and funds to protect and manage the local resource base; official corruption; and further breakdown of law and order.

(iv) Internal Conflict

Recent studies of poverty in developing countries have highlighted the critical role that shocks such as conflict can have on the poor. Increased religious and ethnic conflict in Indonesia since 1997 has driven large numbers of people into poverty and increased the number of people that are vulnerable to sudden and chronic destitution. Well over one million people are displaced and sheltered in different locations throughout Indonesia as a result of conflict and natural disasters. There is need to develop capacity to 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.

Conflict is now seen as a chronic malaise affecting much of Indonesia and threatening the transition. The new post-Soeharto freedoms have given rein to long-

suppressed ethnic divisions, deterioration in law and order and an increase in politically motivated violence. Durable solutions to a number of current conflicts have not yet emerged. Communal violence of the kind that has occurred in the Maluku, Central Kalimantan and South Sulawesi appears particularly intractable

GOI has responded with the 1999 regional autonomy laws and the 2002 special autonomy laws for Aceh and Papua. The former address some of the concerns underlying local aspirations for self-rule. The latter aim to address the concerns of secessionist movements in Aceh and Papua. A ceasefire agreement has been signed between GOI and the Free Aceh Movement (GAM), and a ceasefire monitoring group is being deployed. Crucial to all efforts to address conflict—and an important barometer for democratic transition—will be GOI's assertion of civilian control over its military and security forces and a respect for human rights. .

(v) Dimensions and Determinants of Poverty

Definition

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

Progress In Reducing Poverty

In the three decades prior to the financial crisis of 1997, Indonesia made exceptional progress in reducing the incidence of absolute poverty, rising from impoverishment to the ranks of middle-income countries. The incidence of absolute poverty as measured by income declined from some two-thirds of the population in the early 1970s to about 11% by the mid-1990s.

A range of key indicators improved significantly: 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%. The maternal mortality rate was reduced from around 800 in 1980-87 to 373 by 1995. The status of women also improved considerably: male-female gaps narrowed at all levels of education and women's earnings increased as a proportion of earned family income.

However Indonesia's economic crisis caused the number of Indonesians living in poverty to jump sharply (see Table 1). Poverty declined markedly in 2000 and 2001--due to increased real wages, growth in sectors providing jobs for the poor and a drop in the relative price of food--but increased between 2001 and 2002, due to an increase in the price of rice (which is a very important determining factor for poverty).

Table 1: Estimates for Indonesia's Poverty Rate
(Headcount index: percent of population)

	1996	1999	2002
National poverty line			
Urban	7.2	16.5	7.5
Rural	20.5	33.7	23.1
Indonesia	15.7	26.9	16.0
International poverty line at 1993 PPP prices			
US\$1 a day	7.8	12.0	7.4
US\$2 a day	50.5	65.1	53.4

Source: World Bank.

According to the World Bank, the Bali bombings could push some 2-3 million more Indonesians into poverty than would have been the case otherwise, through the effect on relative food prices of lower growth and a weaker rupiah. This is another illustration of the vulnerability to such shocks of the millions of Indonesians who live close to the poverty line.

At least half of Indonesia's entire population is affected by 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 also lack access to basic education, medical services and adequate nutrition. More than 100 million people lack access to safe water; some 25 million are illiterate; almost 50 million suffer from health problems; and a similar number lack access to health facilities. Many poor communities have inadequate (if any) basic infrastructure like sanitation, transport/roads and electricity. Significant biases against females persist in employment and participation in public life. Conflict and natural disasters have displaced around 1.4 million people and driven many into--or made them very vulnerable to--poverty.

What Are The Characteristics Of Poverty?

The incidence of poverty in Indonesia is heavily concentrated among those with little or no formal schooling. Research indicates that the heads of 87% of all households below the national poverty line in 1999 were illiterate or had only primary education. Improving access of the poor to basic education and improving the quality of their education is of great importance to successful poverty reduction. Basic education quality in Indonesia is low, partly because Indonesia allocates a much lower share of GDP to public education than many other countries (3% during 1994-97 compared with around 5% amongst lower middle-income countries). The story is similar for health services.

The characteristics of poverty in Eastern Indonesia are different from those in Java/Bali. Unlike Java/Bali, most poor Eastern Indonesian rural households own

agricultural land and do not rely primarily on uncertain and poorly paid wage labour for their incomes. The main cause of their poverty is poor land quality, together with low productivity technologies, limited educational attainment and limited access to basic services such as health and water supply and sanitation infrastructure. Poor infrastructure such as roads and lack of access to input and product markets compound the region's problems. The combination of growing populations and declining crop yields results in lower incomes, worsening poverty and food insecurity.

Who And Where Are The Poor in Indonesia?

Three-quarters of Indonesia's poor live in rural areas. Poverty is particularly concentrated in the agriculture and small-scale trade sectors of the economy.

There is considerable variation in the incidence of poverty among and within provinces. The highest incidences of poverty are recorded in Maluku, North Maluku, East Nusa Tenggara (NTT) and Papua provinces, where these incidences are more than ten times that of Jakarta and five times that of Bali, followed by West Nusa Tenggara (NTB), Southeast Sulawesi and East Java. Java/Bali have lower poverty incidences but, because of population densities, account for about 60% of Indonesia's poor and near poor.

The Bali bombings are likely to considerably worsen poverty in that province. The World Bank has suggested that several hundred thousand tourism-related jobs could be lost as a result of a fall in tourist numbers. Poverty in other parts of Indonesia linked to Bali's tourist industry will also worsen.

There is also significant variation in poverty-related indicators, especially at district level eg only 65% of females are literate in Papua and NTB, compared with more than 95% in Jakarta and North Sulawesi. Almost 80% of West Kalimantan's population does not have access to safe water, compared to 34% in Bali and 36% in East Kalimantan. Some 42% of the children in West Kalimantan are undernourished, compared to 17% in Yogyakarta. There are districts in South Kalimantan, NTT and Central Sulawesi where the infant mortality rate is three or four times higher than that in Jakarta or Yogyakarta..

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

The Degree of Inequality

The degree of income inequality in Indonesia is lower than in all other major developing countries in East Asia except Korea and is substantially lower than in many Latin American countries. If this continues it could ease the task of poverty reduction to some extent, since international experience shows 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 industries like financial services, construction and trade. Those most vulnerable--unskilled workers--appear to have moved back into agriculture, forcing down real agricultural wages. With high inflation, this probably contributed to the temporary increase in the incidence of poverty in 1998-1999. A large part of this surge in poverty took place in Java and Bali.

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. The nature and size of the informal economy is problematic but some estimates attribute as much as 50% of economic output to it. Typical informal economy activities include small-scale retail trade, catering, personal/ household services and food processing.

A number of measures taken by GOI helped to moderate the poverty impact of the crisis. Chief among these was the provision of cheap rice, which helped many millions of families, including many poor families, maintain acceptable food intake levels. GOI also adopted measures to protect educational participation and quality at the primary and secondary levels throughout Indonesia.

Prospects For Poverty Reduction

There is extensive empirical evidence 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 2 illustrates the likely incidence of poverty in Indonesia (as measured by the number of people who are living on less than US\$2 a day per capita) under each of three possible growth scenarios.

Table 2: Illustrative Projections of Poverty Rates, 2000-2010

Growth scenario	GDP Growth rate (% p.a.)		Population Below US\$2 per day per capita (%)			Population Below US\$2 per day per capita (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

The following analysis assumes that, by the end of 2003, the Indonesian economy will have largely recovered from the impacts of the Bali bombings. This assumption will require that GOI maintains macroeconomic and political stability, and improves security, and thereby re-builds investor, consumer and tourist confidence to previous levels.

The most likely scenario is a prolonged period of weak economic growth of around 4% a year; it would mean that the recent slowdown in poverty reduction would persist. This scenario is based on the evidence of recent years that Indonesia's political elite is not prepared to push in a concerted and consistent way for rapid change on many fronts. In the view of the international donor community, this is the sort of change needed if Indonesia is to make a successful transition to a stable democracy with sustained strong growth.

In this scenario Indonesia would have difficulty absorbing the more than two million people projected to enter the labour market each year for the next decade. The incidence of poverty could drop to around 42% of the population by 2010, reducing by only 20 million the number of people living on less than US\$2 a day per capita. But some 100 million people would continue to live in--or be vulnerable to--poverty.

Prolonged weak economic growth would have profound implications for employment creation and poverty reduction in Indonesia. It might give rise to social and political unrest, especially among young people entering the labour force with inadequate education and skills. More than 20 million people will enter the labour force over the next decade. An Indonesian economy growing at 4% per year will be hard pressed to create productive employment for these people while, at the same time, creating better opportunities for the millions of poor or near poor already in the labour force.

The sustained recovery scenario (economic growth of 5% or more a year) is less likely, but nevertheless essential, for a serious reduction in the huge numbers of Indonesians currently living 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, from about 120 million in 2000 to 90 million in 2010. The dramatic reduction in poverty achieved by Indonesia in the 25 years prior to the crisis required an average growth rate of around 7% annually.

The likelihood of sustained 5+% growth seems quite remote in the decade ahead. It would require substantially higher levels of investment on a continuing basis, and concerted action on a wide range of institutional and structural issues, 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. 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.

For long-run political and social stability, it is imperative that Indonesia avoids the third, economic stagnation, scenario unfolding. In this scenario, Indonesia's GDP growth performance could deteriorate further, to around 2.5 - 3% a year, given the uncertainty surrounding the likely pace and extent of future reform, and the vulnerability of Indonesia to further financial crises. A period of protracted slow growth in this range would place considerable strains on the revenue side of the budget, with continued under-funding of development investment and expenditures. The debt burden could not be reduced and the country would be very vulnerable to bouts of financial instability. The spectre of high inflation would impact negatively on domestic interest rates and on investor willingness to make long-term investments in Indonesia.

Growth stuck at around 2.5% a year would allow only 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--but their total number 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.

Such a scenario has serious strategic implications for stability in Indonesia, especially in Java. There would be almost no growth in the average incomes of large segments of society. This is therefore an important issue for the Government of Indonesia and a key strategic issue for Australia and the region.

Where will the Poor be Located?

Under the stagnation scenario the brunt of an economic slowdown could be concentrated in Java and those Outer Island provinces with weak resource bases and limited human capital. East Kalimantan, Papua and resource rich provinces in Sumatra, which account for about 40% of GDP, may enjoy higher growth driven by resource exploitation. National economic growth of 2.5% a year might come from growth of 4% a year in these provinces and 1.5% a year in Java and the other provinces. With a population growth rate of a little over 1% a 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 would 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 poverty reduction strategies. The rural poor might move in larger numbers to urban areas in search of work and access to better basic services. 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 would be significant changes in the location of the poor over the next decade at least. With slower population and economic growth, the urban population growth rate might slow from the 1990s average of 4.4% a year. At say 3-4% a year for the decade ahead it 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 65-70 million of the 110 million rural people in 2010 would be among the poor and near poor.

The Impact Of Decentralisation On Poverty

It is too soon to identify the impact of decentralisation on the poor and near poor. It will depend in part on the responsiveness of local governments to the needs of the poor and near poor and on their levels of development spending on basic services like health and education. There is already concern that development spending levels are 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. GOI's current revenue equalisation formula does not adequately consider expenditure needs for minimal service provision: poorer regions could be left with insufficient funds to meet the basic service needs of their constituents. Systems are not yet in place to monitor local government expenditures on key services.

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. Research underscores the importance of anticorruption measures and good governance as a means of reducing poverty. Recent IMF analysis suggests that a 1% increase in the rate of corruption reduces the income growth of the poorest (bottom 20%) by almost 8% per annum¹.

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 GOI, with assistance from the donor community. A stronger growth performance will help but, as already discussed, the prospects for growth of 5+% a year are not good. Thus, 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 governance.

¹ 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.

GOI has reaffirmed that poverty reduction is central to the development effort in Indonesia. It has prepared an interim poverty reduction strategy for tabling at the next meeting of the Consultative Group on Indonesia (CGI). GOI's approach to poverty reduction is broadening. It is giving increasing attention 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 social and economic progress. Poverty reduction programs will need to be designed and implemented quite differently from past highly centralised approaches. Decentralisation offers an opportunity for provinces and districts to formulate strategies that are responsive to local needs and possibilities. Such strategies are difficult to define at the central level.

AusAID's analysis indicates that a broad set of interventions directed at the poor and near poor will require a multi-pronged GOI strategy and provide a diverse range of areas for donors to support:

- ***Building national institutions for accountable government***, especially legal and judicial reforms, civil service reforms, improved financial and natural resource management, strengthened democratic institutions and increased opportunities for the poor to participate in policy-making and implementation.
- ***Delivering better public services for the poor***. Decentralisation has given local governments responsibility for programs like education, health, agriculture and environment that lie at the heart of poverty reduction. Their service delivery capacities will need strengthening and they will have to adopt targeted pro-poor interventions if the decline in the incidence of poverty is slow. Sustained improvements in the health and educational status of the poor and near poor will require significant increases in spending on these services. The development and application of minimum standards will be particularly important to protect services to the poor.
- ***Measures that improve access to economic opportunities for the poor and the vulnerable***. These will include: (a) secure possession of land and natural resources; (b) legal improvements related to titling and pledging of collateral and other institutional measures that support increased lending to the poor, many of whom use micro-finance programs; (c) further micro-finance market development; and (d) improved links between micro-finance programs and the formal banking system.
- ***Renewed attention to agriculture and rural development*** as an integral part of national poverty reduction strategies, since poverty in Indonesia is likely to remain predominantly rural. Action should centre on such basics as agricultural research, rural extension services, reduced post-harvest crop loss rates, improved rural infrastructure, improved smallholder tree crop productivity and expanded access to rural credit, including micro credit programs. The specifics of programs will depend on conditions in each province eg since over 70% of incomes in rice-

growing areas is from non-rice sources, efforts in these areas must focus on improved opportunities and support for off-farm activities.

- ***Mitigating conflict, reducing vulnerability to natural disasters and strengthening counter-terrorism capacity.*** Conflict is now seen as a chronic malaise affecting much of Indonesia, a country that is also highly prone to natural disasters. This combination has displaced millions, driven perhaps millions into poverty and certainly has 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 economic impact of the Bali bombings has demonstrated the importance of Indonesia addressing the threat of terrorism in a serious and sustained way in order to attract and retain investment.

3. AUSTRALIAN AID TO INDONESIA

Australia's strategy for assistance to Indonesia has undergone significant change over the past five years. Prior to 1998, the Indonesia country strategies and programs included poverty as an objective along with trade and commercial objectives, but these strategies were not based on detailed analyses, nor were activities justified in terms of the relationship between a given intervention and poverty reduction. The program has evolved substantially since 1998, influenced strongly by two developments: (i) the introduction of a new Australian government objective for AusAID: to advance the national interest by assisting developing countries to reduce poverty and achieve sustainable development; and (ii) the financial and political crisis that engulfed Indonesia from 1997.

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."² 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 current (FY2001-03) strategy aims "to contribute to poverty reduction, sustainable economic recovery and democratisation." On the basis of a detailed poverty reduction framework, six target sectors were identified: 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: (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.

² AusAID, *Australia-Indonesia Development Cooperation Program: Country Strategy, 2001-2003*. p.6.

The strategy's approach to program design is highly selective. 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 continued.

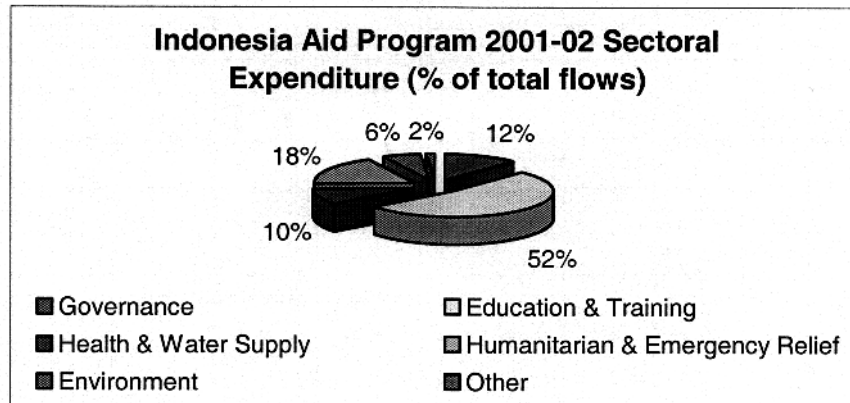
New activities in health and water and sanitation are being developed to deliver direct poverty alleviation outcomes for vulnerable groups, especially women and children. In addition to humanitarian assistance, a conflict prevention and peace building activity has been incorporated into the program to assist victims of widespread violence.

A range of new measures are being taken in response to the increased risk of international terrorism. On 25 October 2002, the Prime Minister announced a \$10 million commitment over four years to assist Indonesia build its counter-terrorism capacity. This commitment identified three areas of support: enhancing travel security by strengthening airport, immigration and customs control systems and capabilities; restricting the flow of financing to terrorists; and building the capacity of the Indonesian National Police on counter-terrorism and transnational crime. This commitment will be implemented through existing program mechanisms (such as the Government Sector Linkages Program and the Technical Assistance Management Facility (TAMF) II) and, where appropriate, through stand-alone activities with other Commonwealth departments on a case-by-case basis.

AusAID recognises that ***direct counter-terrorism assistance will be ineffective unless the development needs of the Indonesian people are addressed, including through an effective mainstream education system that adequately prepares students to enter the workforce.*** Consequently AusAID is re-examining its current approaches to education assistance in Indonesia, with a view to expanding--and perhaps refocussing--this assistance. Initially Australia is taking a substantial role in the comprehensive multi-donor Education Sector Review in Indonesia, to ensure any program expansion is well targeted and co-ordinated. The review is focused on primary and lower secondary education and an initial report is due in June 2003. AusAID is also investigating co-financing options with other donors, including the World Bank, the Asian Development Bank and USAID.

Currently, Australia is supporting GOI efforts to ensure universal basic education and stronger links between education and employment. A major project is aiming to raise the quality of primary schooling in NTT province through teacher training and support for school management. In addition, a large project is upgrading technical and vocational education and making it more relevant by strengthening its links with industry. In the area of training, a key program is assisting Indonesia address priority skills gaps through provision of specialised short course training to middle level managers in both the public and private sectors. Over 700 Indonesians from both the public and private sectors are studying in Australia on full post-graduate tertiary scholarships in fields such as economics, science, health, agriculture, law and the environment. 50% of awards are provided to females.

The geographic focus of the aid program remains eastern Indonesia, which includes some of Indonesia's poorest provinces. The program's growing governance component is centred on Jakarta.



Activities in support of economic reform in Indonesia continue to expand. The program has a strong focus on helping Indonesia implement its economic and financial reform agenda, including its IMF commitments, through a package of support for the development of effective, transparent and accountable institutions of government and civil society. Support areas include economic policy, banking and finance sector reform, debt management, decentralisation, public sector reform, legal and judicial development, fiscal decentralisation, prudential regulation, taxation reform, fiscal management, fraud awareness and detection, performance auditing and general economic capacity building through scholarships (see below).

Australia is helping strengthen Indonesian civil society to enhance non-government participation in democratic processes. Current and future support aims to strengthen non-government and civil society organisations, promote and protect human rights (including through support for Indonesia's National Human Rights Commission), promote gender equity, strengthen local governance in the context of decentralisation and support development of effective electoral administration.

Australia is supporting improvement in GOI and community capacity to deliver basic health care services, particularly for women and children, including the utilisation of maternal and neonatal health and family planning care services to reduce the incidence of maternal morbidity and mortality. Support is also being provided for national surveillance programs like childhood immunisation and HIV/AIDS and STD prevention. To support GOI's decentralised health program, Australia's activities will assist in strengthening health policy management at central, provincial and particularly district level through activities that integrate health planning and development, as well as contributing to the development of human resources, health information systems and community capacity building.

Water supply and sanitation (WSS) activities aim to improve rural community access to safe drinking water supply and adequate sanitation, as well as rural water supply policy and standards development. Australia will continue to work in WSS because of its importance in poverty reduction efforts.

Australia continues to support strengthening of Indonesia's environmental management capacity. Projects in East Java and Denpasar are strengthening the capacity of regional and district level environmental agencies to manage natural resource and environmental issues and to implement environment protection and pollution control legislation. Australia, with other donors, is also supporting a major Coral Reef Management and Rehabilitation Project to improve the management of coral reef ecosystems and rehabilitate degraded coral reefs for the protection of biodiversity and the sustainable use of marine resources. This project is part of Indonesia's national coral reef strategy.

4. FUTURE DIRECTIONS

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 goal of Australia's aid program over the next decade should be to assist Indonesia reduce poverty and achieve sustainable development.***

Achievement of this goal 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. AusAID's analysis indicates that, to achieve this goal, Australia will need to target its efforts on four inter-related strategic objectives:

- ***Increase economic growth*** by improving economic management and accelerating the process of structural reform;
- ***Improve accountability*** by strengthening democratic institutions and practices;
- ***Improve productivity*** by increasing the human capital of the poor and near poor; and
- ***Reduce vulnerability*** by mitigating the impact of conflict, natural and other disasters on vulnerable communities.

Higher rates of economic growth are key to reducing poverty and achieving sustainable growth in Indonesia. Future Australian assistance will need to prioritise support for critical areas of GOI's economic and financial reform program but focus on a more limited range of interventions to achieve the greatest potential impact. Specific areas of focus could include taxation reform, financial sector restructuring and supervision, legal reform in areas relevant to improved economic and financial management, and debt management. Given the importance of security for economic growth, attention will also need to be paid to building Indonesia's capacity to counter international terrorism.

Greater accountability will reduce corruption and other activities that disadvantage the poor. Stronger democratic institutions will improve accountability by opening up greater space for all members of Indonesian society--particularly the poor--to organise and thereby influence policy-making. The analysis indicates that Australia should 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.

Improving the productivity of Indonesia's poor and near poor will increase their capacity to generate income and improve their well-being. Increasing the human capital of the poor and near poor through improvements in education, health, water supply and sanitation is a key way in which their productivity can be enhanced. AusAID's analysis suggests that Australia should focus both on the issue of access to these basic services and on the structures and policies which govern the delivery of these services. A particular focus on basic education will have long-term benefits.

In regard to ***vulnerability***, recent studies of poverty in developing countries have highlighted the critical role that shocks such as conflict, natural disasters, environmental degradation or economic crisis can have on the poor. The Australian strategy will need to focus on building institutional capacities within Indonesia for effective disaster preparedness and management and conflict prevention and transformation.

At the activity level, the focus of the program should be on improving governance by creating more efficient, effective, transparent and accountable institutions, systems and processes. Technical assistance and training and skills development will be the two main forms of assistance in achieving the strategic objectives.

A key medium term priority should be 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: East Java, South Sulawesi, Southeast Sulawesi, East Nusa Tenggara, West Nusa Tenggara, North Maluku, Maluku and Papua. More than 30 million of the 56 million people living in these provinces are poor or near poor. Almost 20 million of them live in absolute poverty, accounting for 37 per cent of all Indonesians living in absolute poverty.

Within this broader target, three or four focus provinces will be selected for intensive direct poverty reduction efforts utilising the sustainable livelihoods approach. It is anticipated that up to 40% of program resources eventually may specifically be targeted at no more than 10 local governments in these provinces.

The analysis suggests some key strategic issues, such that, in delivering Australian aid to Indonesia in the future, AusAID needs to:

- ***concentrate the Australian aid effort***, given the relatively small size of our aid program in comparison to total aid flows to Indonesia, by: (a) *limiting the number of target provinces* to a small group of eight with relatively high incidences of poverty and vulnerability; (b) *significantly reducing the total number of individual activities*; and (c) *focussing on a limited number of specific policy targets* rather than the wide range of issues encompassed by Indonesia's reform program.

Program focus will continue to be narrowed and consolidated through processes like sector strategy development and periodic review and evaluation. Provision of technical assistance and training will remain at the core of all interventions, with training much more strongly aligned to achievement of program strategic objectives.

- ***improve governance*** by supporting the creation more efficient, effective, transparent and accountable institutions, systems and processes. Governance

issues lie at the heart of most of Indonesia's development problems. Improved governance is the key to better outcomes in everything from banking supervision and legal reform to basic education and conflict prevention. Improving governance will be a central element in all program assistance. It includes support to build Indonesia's counter-terrorism capacity;

- ***retain health and basic education as flagship sectors that produce tangible outcomes.*** The program will strike a balance between support to improve the enabling environment (by supporting the reform agenda and improvements in the policy context, institutional capacity and the skills base) and tangible and direct improvements in the well-being of the poor and near poor;
- ***make Australian aid interventions serve as catalysts and models for the development programs of GOI, IFIs and other donors.*** Given the relatively modest size of the Australian aid program, and to maximise development impact, we will seek to develop solutions to targeted development problems that can be set up as models replicable by others;
- ***enhance partnerships*** with GOI, civil society, other donors and key Australian agencies, including through ***engaging eminent Indonesians and Australians*** to guide the direction of elements of the program. Particular emphasis will be given to increasing Indonesian involvement in the development and oversight of Australian interventions by using eminent individuals with access to Indonesian Ministers in senior level Policy Advisory/ Reference Groups;
- support the whole-of-government agenda by retaining mechanisms which enable ***effective responses to emerging issues of national interest***

The program is an effective vehicle through which Australia can respond to emerging issues that impinge on the national interest in a stable and prosperous Indonesia. Mechanisms like the Government Sector Linkages Program, the Technical Advisory Management Facility and the Legal Reform Program provide the capacity for quick response to emerging priorities, including those arising through the Australia Indonesia Ministerial Forum process. They will enable the program to draw on the significant expertise residing within the Australian government, and to develop strong partnerships with other departments through aid interventions that deliver on our national interest. The program's 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 policies towards--and understanding of--Indonesia;

- ***measure and monitor the impact of the strategy*** as well as of specific interventions--a clear framework will be developed for monitoring changes in poverty and vulnerability to poverty in the eight targeted provinces. Emphasis will be given to monitoring impact at the program level;
- ***enhance the bilateral relationship by maximising interaction and dialogue between policy and opinion makers*** in Indonesia and Australia, through development of conferences, guest lectures and other special events to promote understanding in program-relevant areas and facilitate a dialogue and exchange of ideas on critical development issues; and

- ***monitor program performance as 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.

Conclusion

Poverty reduction in Indonesia is an issue of strategic importance and national interest to Australia.

AusAID's analysis indicates the likelihood that, in a decade's time, there will still be around 100 million Indonesians living in poverty or vulnerable to falling into poverty. This situation has clear implications for social stability, civil order, national unity, political cohesiveness and security in Indonesia.

The aid program allows the Australian Government to demonstrate to the Indonesian Government in a tangible and effective way its commitment to helping Indonesia address the interlinked challenges of poverty, growth and political, social and economic transition which will continue to confront that country in the coming decade and beyond.

AusAID engages actively in policy dialogue with the Indonesian Government in order to maximise program impact. Because the program is based on significant research and analysis, it targets key issues that are critical to achieving its objectives.