

**Indonesia -European Community**

**Strategy Paper**

**2007-2013**

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## 1. ACRONYMS

|         |  |
|---------|--|
| ASEAN   | Association of South East Asia Nations   |
| BE-SCSP | Basic Education Sector Capacity Support Programme  |
| BESP    | Basic Education Sector Programme   |
| CGI     | Consultative Group for Indonesia (WB-GoI)  |
| CHS     | Community Health Services  |
| CSP     | Country Strategy Paper   |
| ECIFP   | European Community Indonesia Forest Programme  |
| EFA     | Education for All  |
| EIDHR   | European Initiative for Democracy and Human Rights   |
| EU EOM  | European Union Election Observation Mission  |
| FDI     | Foreign Direct Investment  |
| FLEGT   | Forestry, Law Enforcement, Governance and Trade  |
| FTA     | Free Trade Agreement   |
| GDI     | Gender-related Development Index   |
| GoI     | Government of Indonesia  |
| IT & C  | Information Technology and Communication   |
| JCLEC   | Jakarta Centre for Law Enforcement Co-operation  |
| LRRD    | Linking Relief, Rehabilitation and Development   |
| MDGs    | Millennium Development Goals<br>Goal 1 Eradicate extreme poverty and hunger<br>Goal 2 Achieve universal primary education<br>Goal 3 Promote gender equality and empower women<br>Goal 4 Reduce child mortality<br>Goal 5 Improve maternal health<br>Goal 6 Combat HIV/AIDS, malaria, and other diseases<br>Goal 7 Ensure environmental sustainability<br>Goal 8 Develop a global partnership for development |
| MONE    | Ministry of National Education   |
| MORA    | Ministry of Religious Affairs  |
| MTDS    | Medium Term Development Strategy (2005-2009)   |
| NIP     | National Indicative Programme  |
| PRS     | Poverty Reduction Strategy   |
| RRM     | Rapid Reaction Mechanism   |
| RTD     | Research and Technological Development   |
| SPF     | Small Project Facility   |
| SWAP    | Sector Wide Approach   |
| TREATI  | Trans-Regional EU-ASEAN Trade Initiative   |

## 2. EXECUTIVE SUMMARY

Indonesia has made substantial progress **towards the full restoration of democracy, transparency and the rule of law**. Parliamentary and Presidential elections took place in 2004, in a peaceful and transparent way, representing a significant step towards the consolidation of the process.

As regard the **macroeconomic situation**, Indonesia has made progress towards the **stabilisation** of the economy by reducing both its debt burden and budget deficit. Indonesia needs an accelerated economic growth of 6-7 % per year, in order to effectively address unemployment in a labour market where 2.5 million persons enter every year.

Several years after the Asian crisis, a majority of Indonesia's population continues to live in **poverty**. 52 % of the population is estimated to be living with less than US\$ 2 a day. Achieving Millennium Development Goals (MDGs) will require targeting the poorest segments of the population.

Indonesia is also facing **major environmental challenges**, in a number of areas such as forestry, air pollution, lack of access to clean water and sanitation, and industrial pollution.

**Governance** remains a key issue. Poor governance has a negative impact on the economic situation, with corruption and poor law enforcement standing out as major problems.

In line with the Indonesian government's priorities under the Medium Term Development Strategy (MTDS 2005-2009), the **key objectives** of EC assistance in 2007-2013 will be **poverty reduction**, the promotion of **economic growth** through trade and investment, and promoting **good governance** through better law enforcement.

Under the Development Cooperation Instrument (DCI), an indicative allocation of **€194 million** has been earmarked for Indonesia for the period 2007-2013. This allocation may be supplemented by relevant regional and thematic programmes.

Fighting poverty and achieving *Education for All* are key MDGs and government priorities. The **first** area of assistance will be **education**, with the support provided through a sector-wide approach ("SWAP"). The **second** area of assistance will be the support to **trade**, to improve the **investment** climate and promote economic growth in Indonesia too. The **third** area of assistance will aim at improving governance through reform of the **justice sector** and enhanced **law enforcement** capacity.

Given the proposed concentration of assistance on a limited number of sectors, to maximize the impact of EC assistance, key **cross-cutting issues**, in particular, environment, conflict prevention, gender issues, human rights and governance, are **mainstreamed** in all sectors covered by the present CSP.

The **tsunami** that affected the western most part of the country on 26 December 2004 has left a lasting impact on the development of Aceh and North Sumatra. This will entail the need of possible adjustments in the strategy of EC assistance to Indonesia. Moreover, the peace process in **Aceh** will also have an influence on the overall strategy towards the country and may entail further tuning in the priorities laid down in this document.

### 3. POLITICAL, ECONOMIC, SOCIAL AND ENVIRONMENTAL SITUATION

#### 3.1. Political situation

Having completed historic elections in 1998 and 2004, Indonesia continues to manage one of modern history's most **effective transitions from autocratic rule to democracy**. The European Union Election Observation Mission (EOM) of 2004<sup>1</sup> credited Indonesia with managing highly complex series of elections, including the first ever direct vote for president, in a peaceful, free and fair manner. This is all the more remarkable when seen against the background of Indonesia's high degree of cultural, ethnic, linguistic and religious diversity.

In October 2004, **Susilo Bambang Yudhoyono** was directly elected as President, with 61 percent of the vote. Throughout his five years term, he faces high expectations that his government will curb pervasive corruption, reverse the unemployment trend and stimulate pro-poor growth in rural parts of the far-flung archipelago.

The **Parliament** includes 16 parties, of which only two possess more than 20 percent of the total seats. Accountability to constituents has improved somewhat due to a new partially-open voting system. Nonetheless, most party revolve around powerful founders or chairs, who tend to influence their party's course of direction. In most parties, intra-party democratic processes still faces important challenges. The majority of political parties portray an Islamic-oriented image, but only a small number openly seek the formation of an Islamic state. Parties with an expressly sectarian or extremist agenda lack voter attraction and remain decidedly marginal. The large bulk of the **political mainstream** consists of moderate Islamic-oriented parties or secular-nationalist parties. In several provinces and districts, worrying trends towards religious intolerance, along with gender discrimination can be observed. These tendencies are mostly fuelled by small, but vocal groups who – in disregard of the constitutional multi-religious, tolerant character of the State – favour religious extremism.

Starting in 2001, an ambitious “big bang” decentralisation has devolved considerable authority to governors and lower-level district heads. This process has been particularly beneficial for resource-rich provinces, such as Riau, East Kalimantan and Papua. There are encouraging signs in several provinces that the legislation and programmes on decentralisation are taking into account the rights and claims of indigenous and minority groups (generally know as *adat*, or “traditional”, communities).<sup>2</sup> However, the legal framework for the protection of *adat* communities remains weak and participation of these groups in decision making could be improved.

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<sup>1</sup> EU EOM report can be accessed at: [http://www.id.eueom.org/final\\_reports.html](http://www.id.eueom.org/final_reports.html)

<sup>2</sup> Indonesia comprises around 500 ethnic groups speaking more than 600 languages. This ethnic diversity is understood as an asset which is reflected in the national slogan, *Bhinneka Tunggal Ika* (“unity in diversity”). While there is no single definition of indigenous peoples or minorities, “traditional communities” are recognised under the 2002 amended Constitution (article 18B) as *adat* law (or customary law) communities. Other Government rules or laws refer also to “isolated communities”, reflecting the marginalisation or physical isolation of some communities, in particular in the remote parts of the Indonesian archipelago. See Asian Development Bank report: *Indigenous Peoples/ Ethnic Minorities and Poverty Reduction – Indonesia*, June 2002.

In mid-2005, for the first time ever, regional governments convened direct elections for governors and district heads and mayors. Eventually, these elections promise to deliver greater local-level accountability. Due to strict eligibility requirements, most candidates for regional-head posts are establishment figures, rather than independent outsiders; nonetheless, the electoral structure helps curb the influence of powerful special interests.

The **human rights** situation improved substantially with Indonesia's democratic transition,<sup>3</sup> notably in the areas of freedom of expression and press freedom. A diverse set of NGOs are active and prominent, although the 2004 assassination of Munir – the leading human rights activist – underscored the latent risks that exist. Occasional challenges to restrict press freedom occur, but meet determined public resistance, as well as judicial scrutiny.<sup>4</sup>

Progress however has been slow and limited in tackling impunity over past human rights abuses. Although special human rights courts were set up, investigations were mostly aborted and the few convictions obtained were overturned on appeal. Weak, limited mandates apply to both the permanent Human Rights Courts, established by law in 2000, and the Truth and Reconciliation Commission, established by law in 2004. The elimination of torture in detention remains to be achieved. Capital punishment for drug related offences is commonplace in Southeast Asia, and many Indonesians believe that the death penalty provides a deterrent effect. In August 2004, Indonesia resumed use of the death penalty (by ending a *de facto* moratorium).

A critical factor limiting progress on human rights is the institutional weaknesses of the judiciary and law enforcement agencies. Democratisation and modernisation of the security sector started in 2000 with the formal separation of police and military forces, but progress has been lacking in recent years. Progress on human rights is also critical with regard to maintaining national cohesion, notably in Aceh and Papua, where centrifugal forces derive from perceived and real injustices, both past and present. The visible improvement in Aceh shows how conflict resolution and improvements in human rights can be mutually reinforcing.

Pervasive **corruption** presents the single most important obstacle in the way of advancing pro-poor economic policies, including restoration of a climate conducive for investment, the repair of the wayward legal system, the reform of the police and the armed forces, and the socially responsible management of Indonesia's unique natural heritage. New laws mandate independent supervisory bodies, or "commissions", for the judiciary, state prosecutors and the police. Meanwhile, the prosecution of corruption cases, driven by the Attorney General and a special Anti-Corruption Commission (KPK) is making steady progress. The fight against corruption is made difficult by the culture of patronage that has been the hallmark of Indonesia's body politic for over fifty years.

Since 2002, on account of the terrorist acts in Bali and Jakarta, Indonesia is perceived as a source and target of terrorist attacks inspired by religious extremism. It is indeed a challenge to secure an open and vast archipelago such as Indonesia against terrorist attacks. With the help of partners, Indonesian police has been able to largely dismantle terrorist networks but continued risk comes from small terrorist cells that may act autonomously. Transnational

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<sup>3</sup> The recent ratification of the International Covenant on Civil and Political Rights is another indication of Indonesia's commitment to adhere to international human rights standards.

<sup>4</sup> A ruling by the Constitutional Court, in December 2006, has declared unconstitutional a set of laws that protected Indonesia's leaders from peaceful political criticism.

crime is an issue of more general concern in Indonesia, in particular piracy in the Malacca Straits, illegal logging, money laundering, drug trafficking and trafficking in human beings.

The tsunami of 26 December has hit Indonesia's **Aceh** the hardest of the countries struck by the disaster: the toll of dead and missing is approaching 230,000 with over a half million people displaced. It has struck a province that had already experienced three decades of separatist struggle, with tens of thousands killed or driven into exile. This conflict had left the inherently rich area deeply impoverished even before the tsunami struck. The tsunami improved prospects for a negotiated settlement of the conflict, paving the way for a peace agreement between the Government of Indonesia and the Free Aceh Movement (GAM) on 15 August 2005. The EU has been supportive of the mediation efforts of former President Martti Ahtisaari and, together with a number of ASEAN countries, has played a leading role in the implementation of the peace agreement through the Aceh Monitoring Mission (AMM), and through EC support to governance, rule of law and elections in Aceh.

In the immediate wake of the tsunami, the Government, assisted by multilateral agencies, developed a comprehensive plan for reconstruction and set up a dedicated agency charged with co-ordinating the multifarious actions of foreign donors that have pledged more than €6 billion towards reconstruction. The EU provided some €40 million in first-line humanitarian assistance through ECHO and has pledged to commit in 2005-2006 some €210 million to a €500 million multi-donor trust fund to tackle reconstruction over a five year span.

### **3.2. Economic situation**

Indonesia's recent macroeconomic performance suggests the **economy has finally recovered from the 1997 Asian financial crisis**. The challenge has now shifted from recovery to sustaining a growth rate of 6-7%. The Government has set a target of 7.2% economic growth for 2009, with an average of 6.5% per year over the period 2005-2009. Recent policies have helped achieve macroeconomic stability, but more is needed in the area of structural reform. Indonesia's performance has lagged behind some of its regional partners and GDP growth remains below potential, due to investment and export weaknesses. The relatively weaker export performance compared to some other Asian countries is rooted in a number of factors, in particular declining foreign direct investment to export sectors and rising unit labour costs which have eroded cost competitiveness in the manufacturing sector.

**Creating enough jobs to absorb new entrants** to the labour market, estimated at 2.5 millions every year, is a key challenge. The total number of unemployed and underemployed people in Indonesia now stands at 41.6 million or 40.4% of the labour force (with an official unemployment rate of 9.5 %). Unemployment has been rising since 1997 in particular due to the fall in formal sector unemployment, affecting in particular young, low-skilled and poorer workers.<sup>5</sup> Some of the keys to job creation are: foster investment and entrepreneurship, make formal sector more attractive by reforming labour laws, improve workers skills through basic and vocational education, improve school-to-work transitions and ensure equal opportunities.<sup>6</sup>

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<sup>5</sup> The unemployment rate of young men has risen to above 25% and those of young women to above 30%. Moreover, close to 60% of the youth work in the informal economy. Most jobs in the informal economy are in low productivity activities where earnings are low and unstable. In contrast, the formal sector can provide young workers with better quality jobs and higher wages and better working conditions.

<sup>6</sup> The World Bank, 'Creating Jobs' (Indonesia: Ideas for the Future – Indonesia Policy Briefs, 2005); Medium Term Development Plan 2005-2009; Indonesia Youth Employment Action Plan 2004-2007

In 2004, Indonesia's GDP exceeded its pre-crisis level for the first time in 8 years, reaching €207 billion, with a per capita GDP of €37. **Economic growth** momentum in recent years has been boosted as a result of a stabilised macroeconomic situation. The economy's real GDP growth reached 5.6% in 2005, while the inflation rate was 10.5%.<sup>7</sup> The budget deficit has fallen steadily to below 1% of GDP and the debt/GDP ratio declined to below 50%. Several shocks to the economy have however slowed down progress, in particular the steep increase in oil prices combined with a reduction in fuel subsidies resulting in a rising inflation and financial instability at the end of 2005 (which led to a sharp depreciation in the rupiah), which necessitated substantial interest rate hikes in the final months of 2005. The **tsunami catastrophe** at the end of 2004 (as well as the earthquake in Yogyakarta in 2006) had only a marginal effect on Indonesia's GDP. The debt moratorium from the Paris Club saved the government US\$ 2.6 billion in debt repayments in 2005, thereby helping to support the government's fiscal position and foreign exchange reserves.

Despite these positive trends, the country still faces major challenges in key areas, such as employment creation, the improvement of the investment climate and ensuring that Indonesia fully benefits from its integration into the international trading system.

**Improving the investment climate** is critical in order to sustain a high growth rate. Overall Foreign Direct Investment (FDI) has not recovered since the pre-1998 crisis, and actual flows are negative up to 2003, implying asset sales by non-residents. Only in 2004, did FDI slightly recover to just above US\$ 1 billion. Adverse factors that need to be tackled are: (i) cumbersome investment procedures both at central and local levels; (ii) weak law enforcement; (iii) governance problems, especially in the customs and tax administrations, agencies that consistently fail to both generate revenue for the government and offer a fair treatment for investors; and (iv) unattractive labour market conditions.

When it comes to **EU investment in Indonesia**, available figures show an overall decline (€2 billion in 2005, compared to €1.6 billion in 1997) and a reduction in share of total FDI (20% of total FDI into Indonesia in 2005, compared to 34% in 1997). These figures show that the EU remains a major investor, but risks losing its relative position compared with regional economic players such as China, Japan and other ASEAN countries.

As regards **trade policy**, Indonesia is a country open to foreign trade, with total external trade in goods amounting to 56% of GDP in 2004. Indonesia's trade policies have swung from high protection to openness in a comparatively short period and it has advanced with significant unilateral trade liberalisation measures, though lack of consistency between tariff and non-tariff policies sends conflicting signals about support for trade. The main issues impeding a full integration of Indonesia into the international trade system are the lack of a well defined trade strategy and of a proper co-ordination between stakeholders (Ministries at central level, local authorities, business sector). There is insufficient concentration of efforts in competitive export sectors and weak export promotion services. In addition, a number of Indonesia's export sectors are facing increased competition from China. Costs and delays in the transportation and import/export clearance process are high and there are difficulties in meeting international requirements in technical and in sanitary and phyto-sanitary standards. Technical skills in SMEs in export and marketing matters are also low.<sup>8</sup>

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<sup>7</sup> All figures are from IMF sources

<sup>8</sup> *World Bank* "Making Indonesia Competitive: Promoting exports, managing trade" (Nov. 2004); *World Bank* "Raising Investment in Indonesia: a second wave of reforms" (Feb. 2005).

The structure of Indonesia's trade with partners is characterized by a relatively high concentration. The **EU is a major trading partner** and the main destination for Indonesian (non-oil and gas) exports in 2005 (overall trade with the EU represented 15% of Indonesia's total external trade).<sup>9</sup> Japan is another major trading partner of Indonesia (also at almost 15% of Indonesia's total trade in 2005). Combined together, ASEAN countries are the largest partner, accounting for almost 25% of Indonesia's trade exchanges.<sup>10</sup>

Indonesia, an ASEAN founding member, is active in regional integration and has implemented preferential trade policies within ASEAN and it participates in the ASEAN Free-Trade Area (AFTA). Apart from the ASEAN initiatives on trade agreements, including Free Trade Agreements (FTAs) with China and India, Indonesia is currently engaged in negotiations or discussions with the US, Australia, Japan, South Korea and China. Given the importance of the EU as a trading partner, the perspective of a FTA between ASEAN countries and the EU will attract interest from Indonesia.

### 3.3. Social situation

#### *Poverty*

The **Human Development Report 2005** ranks Indonesia at 110 out of 177 countries in the Human Development Index (HDI) which places Indonesia in the medium human development category. Indonesia's achievements in reaching the **Millennium Development Goals** (MDGs) are mixed. In several key areas Indonesia is on track to achieve MDGs. The goal of halving the proportion of people who live on less than \$1 a day has been achieved, though this leaves about 7.5% of the population still in that category. Enrolment in primary education has not changed, but more 16 year olds have completed primary school, and the ratio of boys to girls is on track. While MDG 2<sup>11</sup> is eminently achievable for Indonesia by 2015, there is a great need to struggle for improved quality to avoid compromising this potentially major achievement.<sup>12</sup>

**Poverty remains a challenge**, while unemployment and underemployment remain high. Over 110 million (nearly 50%) of Indonesians live on less than US\$2 a day and are at great risk of falling below the poverty line.<sup>13</sup> Rural poverty is of particular concern and affects in particular isolated populations and *adat* communities. Although Indonesia recently approved a law on **social protection**, including social health insurance, its implementation will require further central and local regulations and substantial technical support, before it can be applied.

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<sup>9</sup> There is an asymmetry in trade relations between EU and Indonesia, with Indonesia exporting €10.1 billion to the EU in 2005, and importing only €5.7 billion, resulting thus in a large €4.4 billion trade surplus.

<sup>10</sup> The specific role and place of Singapore in Indonesia's trade and its position as a major trade hub for the whole region would however suggest that the figures may overstate the importance of ASEAN.

<sup>11</sup> Achieve universal primary education

<sup>12</sup> The Education Sector Review (ESR) of 2003 found that, while enrolment rates had improved and the gender gap had closed at primary level, 'striking inequalities remain at the junior secondary and senior secondary levels'. It also asserted that educational quality is still a major challenge.

<sup>13</sup> The World Bank, 'Reducing Poverty' (Indonesia: Ideas for the Future – Indonesia Policy Briefs, 2005).

The **gender-related development index**<sup>14</sup> indicates that women still face numerous social barriers although there have been improvement in terms of women's representation in parliament, the proportion of women in senior official managerial and technical staff positions at work.

### *Education and Health*

The **national education system** includes public and private secular schools under the auspices of the Ministry of National Education (MONE) and public and private Islamic schools, or madrasah, managed and regulated by the Ministry of Religious Affairs (MORA). The new education law of 2003 has established the basis for a national education system covering all providers, which are subject to standards set and enforced by MONE. Public MONE schools are by far the largest education provider.<sup>15</sup>

Disparities between rich and poor, rural and urban are significant. There is a significant group of young people in Indonesia who are effectively disenfranchised for lack of access to school, illiteracy and having to work.<sup>16</sup> Indigenous/minority populations tend to fall into this group due to their isolation and vulnerability. Out of approximately 38 million children aged 7-15, 3.3 million do not attend school. An estimated 1.5 million children (between the ages of 10-14) are at work, and 10% are illiterate at age 15. The participation rate in senior high school was only 51% in 2003. The participation rate in higher education was 14% in 2003

**Indonesia's investment in its education system** has been low compared to other countries in the region: Indonesia ranks low among its Asian neighbours in terms of its share of public education expenditures to GDP (while this ratio has now reached some 2.5-2.7%, it is still low compared with Thailand and Malaysia). In 2004, the State budget has allocated to education some 13-14% of overall government expenditure. This should be compared with the numbers for Malaysia, Korea, and Thailand (all above 20%). The target set by the education law of 2004 and the amended Constitution of 2002 is 20%.

**Public health** expenditure is only 25% of total expenditure on health, which is below the average for countries of East Asia and the Pacific (39%). Since the benefits of private expenditure tend to be weighted towards the rich, this has contributed to significant disparities with basic health interventions not reaching the poor. For example, infant mortality rates for the poor are three times higher than for the rich. One aspect of health that remains of concern is **maternal mortality**: around 20,000 women die each year from causes related to childbirth.<sup>17</sup> Other **health indicators** have improved significantly since the 1970s. Infant mortality rate decreased from 118 deaths per thousand live births in 1970 to 30 in 2004. Some 170 000 adults were living with **HIV** in 2005.<sup>18</sup> Vulnerable groups include in particular drug users and sex workers, but there are risks that HIV could spread to wider groups.<sup>19</sup>

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<sup>14</sup> Indonesia's Gender related Development Index (GDI) is lower than the HDI due to disparities in the literacy rate (86% of women are literate as opposed to 94% of men).

<sup>15</sup> 72.3% of Indonesian students attend public MONE schools; 14.7%: private MONE schools; 12.5%: private and public madrasah.

<sup>16</sup> 94% of the children in the wealthiest quadrant aged 13-15 attend school, meanwhile only 67% of the poorest quadrant do. 76% of rural children aged 13-15 attended school in 2003, against 89% of children in urban areas.

<sup>17</sup> The proportion of pregnant women who delivered with a trained attendant is 21% among the poorest women and 89% among the wealthiest.

<sup>18</sup> Data UNAIDS, 2006

<sup>19</sup> This is in particular the case in Papua province where HIV prevalence is particularly high.

The public health network is extensive and well distributed across the country. However it is underfunded, the quality is often poor – one of the reasons why utilisation rates for public health services are low and many people opt for private care. The **absence of a social insurance system** providing universal coverage leaves the poor in an extreme vulnerable position. Decentralisation offered new opportunities, but in many cases has only compounded to the existing problems. The health care system in Indonesia is not geared up for further population growth and the rise of non-communicable diseases, which make now up to 60% of all deaths.

### 3.4 Environmental situation

The **environmental situation** remains worrying, due to a number of factors the most important of which are population growth, rapid urbanisation and failure to enforce the environmental legislation available. The impact of the 1997 financial crisis has been especially acute in rural areas and for those that depend on forests for their livelihoods. The necessity to meet short-term needs assumed greater importance and the effects on the environment became more pronounced.

Urbanisation is leading to increased **air pollution** largely through vehicle exhaust emissions (in particular due to the lead content of fuel) and the use of fossil fuels in power generation. The disposal of domestic waste generates widespread contamination of surface and ground water sources. The disposal of refuse through burning further reduces air quality.

Currently 78% of the population has accessed to improved drinking water and around half of the population have access to adequate sanitation facilities<sup>20</sup> and **water demand** continues to rise at a projected rate of 6.7% per annum placing strain on the capacity of groundwater and surface water sources. Pollution, the over-exploitation of ground water, and the degradation of water catchments make it difficult to meet an increasing demand.

**Industrial pollution** and a lack of capacity for the recycling of hazardous waste are other causes of concern. Mining, and in particular open-caste mining, continues to cause environmental problems. Poor land use planning in urban and rural areas compounds many environmental problems.

The continued destruction of **forests through illegal logging** continues at an estimated current rate of 2.8 million ha per year.<sup>21</sup> The effect of this is to reduce the environmental services provided by such areas, such as clean and reliable surface water flows, as well as impacting directly on livelihoods.

The environmental sector is plagued by **weak enforcement of environmental legislation**, contradictory legislation at central, provincial and district levels and light sanctions for those breaking the law. This area has not received the attention necessary to provide a comprehensive and enforceable legislative framework for the environment.

**Natural resources are important in shaping Indonesia politically.** Regional autonomy, introduced in 2001, was driven in a large part by the need for a more equitable distribution of

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<sup>20</sup> Source: UNICEF Indonesia Web Site

<sup>21</sup> Source: Ministry of Forestry, 2005. This represents an increase in forest loss compared to the period 1997-2001 which saw an annual loss of 2.1 million ha.

natural resource revenues between the centre and the regions. Political power relies in some parts of the country on the control of natural resources. The military, which raises 70% of its funding from non-budget sources, has enormous interests in natural resource exploitation. **Natural resources are also vital for local livelihoods**, in particular for indigenous populations who live in resource-rich areas but are often excluded from the economic benefits. In 2000 (last census), 58% of Indonesians lived in rural areas, and in 2002 an estimated 40.6m people were employed in agriculture, forestry, hunting and fisheries.

Indonesia is vulnerable to climate change. **Climate change** may lead to an increase in extreme weather events, sea level rise and increasing droughts, thus affecting food security. The main source of greenhouse gas emissions is deforestation (Indonesia is responsible for approximately one tenth of global emissions from deforestation).

#### **4. THE POLICY AGENDA OF THE BENEFICIARY COUNTRY**

The programme of President Yudhoyono's administration outlines three key priorities in the **Medium Term Development Strategy (MTDS 2005-2009)**.<sup>22</sup> The first priority is to **promote security and peace** by solving separatist conflicts in particular in Aceh and Papua and fighting trans-national crime, in particular terrorism. The second priority is to **improve justice and democracy** by improving governance and through improved public administration, law enforcement and decentralised public services. The third priority is to **increase prosperity and welfare** with the overarching priority of job creation, and poverty reduction through economic growth, in order to halve unemployment and poverty by 2009. The Government also underlines its wish to put a halt to the degradation of environment.

##### **4.1. Political agenda**

To attain its objectives, the new administration will have in particular to deliver on improving the **judicial system** and in general **law enforcement** capacity and curbing an all-pervasive **corruption**. As an indication of general political commitment to reform, a significant increase in state budget allocation for law enforcement agencies over the past year should be noted. However, the Government's anti-corruption approach is based on long-term institutional measures and reform, rather than law enforcement alone. The **Parliament** has set up new supervisory bodies, or "commissions" for the judiciary, the police and state prosecutors. Meanwhile **prosecution of corruption cases**, driven by the Attorney General and a special Anti-Corruption Commission (KPK) is making steady progress. The fight against corruption is made difficult by the culture of patronage that has been the hallmark of Indonesia's body politic for over fifty years.

Linked to the government's institutional reform agenda is the policy of military reform by gradually **withdrawing the military from its business ventures** as mandated by the Military Law of 2004. To flank this policy, government aims at inserting all armed forces costs within the national budget, also with a view to achieving full civilian control of the forces.

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<sup>22</sup> Republic of Indonesia-Bappenas, 2005, Indonesia's Medium Term Development Strategy 2004-2009

On **foreign policy**, the new administration strives to bring to bear its newly reinforced democratic credentials. The government is keen to accelerate **ASEAN integration**, around shared political objectives set out in the context of the ASEAN Security Community, including the promotion of what it calls “minimal democratic standards”. Indonesia is further weighing options that would allow balancing the increasing economic and political weight of **China** in the region. Hence it pursues an active policy to engage key powers in the region, such as **Australia** and **Japan**. A key foreign policy objective is normalisation of relations with the **United States**, including in defence co-operation. In the case of Australia and the US, such policies carry domestic risks, notably from a number of its Islamist/reformist parliamentary allies, which may object a stance seen as excessively pro-Western.

In this context, **relations with the EU** are valued as a balancing factor in a context of major strategic changes in Asia. Although the EU is seen first of all as a major trading partner, it is also increasingly seen as partner on political and security issues, given its “soft power” image and the model for political cooperation offered by the EU. The opening of negotiations on a new **Bilateral Cooperation and Partnership Agreement** shows the interest of Indonesia to enhance relations with the EU.

## 4.2. Economy and Trade

The Government recognises that the most pressing economic issue is **job creation** in order to absorb the 2.5 million new entrants on the labour market every year. Its broad targets are to accelerate **export growth**, expand markets access, and increase the variety of goods exported and their added value. Improving domestic trade and business environment, including legal background, transport, distribution system and insurance are also priorities.

The Government’s **policy** is to pursue **macroeconomic stabilisation**; improve **labour market** conditions by introducing more flexibility, and strengthening of workers skills, in particular by improving the quality of school education; upgrade the environment for **exports** through export promotion and export supporting services; improve the **investment climate**, including the acceleration of infrastructure development; and support the recovery of the **SME sector**. Creeping protectionism in some sectors threatens to undermine the Government’s economic strategy.

In a first test of his commitment to economic and social reform, President Yudhoyono pushed through, in March and September 2005, highly unpopular **reductions in fuel subsidies**. The Government has however made sure that part of the budgetary savings would be allocated to social programmes targeting the poor.

As regards infrastructure investment, following the **Infrastructure Summits** of January 2005 and November 2006, the Government has begun to enact key regulations (i.e. land acquisition) that have started to boost investment in the area. However, implementation remains critical to the effectiveness of the reform in investment rules.

**Legal certainty** is another important related issue for economic development, and it is also a focus for the Medium Term Development Plan, where the need to continue with legal reform, particularly in the Commercial Court, is emphasized.

### 4.3. Social Sectors / Poverty Alleviation

A major challenge will be **poverty reduction**. In the **MTDS 2005–2009**, the government aims to reduce the nation's poverty rate from 36.1 million people or 16.7 % of the population (in 2004) to 8.2 % in 2009. The government also foresees to reduce the unemployment rate from 9.5 % of the work-force in 2003 to 6.7 % in 2009. To achieve these goals, sufficient economic growth is required, as well as the funding for the development programs.

**The Poverty Reduction Strategy (PRS)** is an integral part of the MTDS Plan and emphasises creating employment and business opportunities, empowerment and capacity building for the poor, and social protection. The Government plans also to put emphasis on the need to address other dimensions of poverty, including access to quality education, health services, clean water and sanitation, and strengthening social rights of the poor, from legal protection and employment.

The Ministry of Education (MONE) has developed an **Education Strategy Paper**. This document takes significant steps towards Education for All (EFA), for a statutory 9 years of basic education until 2010, and focuses on improvement of education quality, with the introduction of Minimum Service Standards. In order to fund these policies, the Government will increase education spending to some €5 billion or 20% of overall public expenditure by 2009, of which 2/3 should go to the regions.

### 4.4. Environmental Policy

The government has underlined its policy to put a halt and possibly reverse the environment degradation. Environment is a **cross cutting issue** and several institutions are involved in environmental legislation and management. The State Ministry of the Environment is the principal body with direct responsibility for the environment at the national level, but a number of other ministries are also implementing legislation linked to environment. Moreover, the recent decentralisation spreads responsibility between central, provincial and district levels. The Ministry of the Environment works at the level of policy formulation, coordination and monitoring, but it no longer has control over the provincial and district environmental agencies which are funded and directed by the respective local governments.

**Environmental policy** currently focuses on five areas:

- Improvement of access to natural resources and environmental information
- Improvement of natural resources management, conservation and rehabilitation
- Environmental pollution and damage prevention
- Building institutional capacity and law enforcement in natural resources
- Raising the role of the public in natural resources management and conservation

Funding for the environment and natural resource management was 0.69% of the State budget in 2002. Historically, spending on environmental activities has always been low and there is currently no indication that the level of spending will increase.

The **legal framework** is generally considered to be adequate in the major sectors of air and water quality, waste disposal and land and forest management (including bio-diversity). As of 2004, Indonesia has also ratified many of the major multi-lateral agreements on the environment, including 14 international agreements, covering the air and atmosphere, climate change, sea, biodiversity, hazardous and toxic materials and forestry. The **main concerns**

identified as regards environment regulation are the lack of proper funding, the absence of adequate and consistent law enforcement, and the lack of trained manpower.<sup>23</sup>

## **5. OVERVIEW OF PAST AND ONGOING EC CO-OPERATION, COORDINATION AND COHERENCE.**

Combined **EU development assistance** (including EC and Member States bilateral assistance) accounts for approximately **20%** of total aid to Indonesia of which around 60% is in grant aid, reflecting the EU's key role in Indonesian development. With reference to 2004 figures, the four largest sectors in grant aid were Governance (20%), Education (14.5%), Agriculture, Forestry and Fisheries (13%) and Health (13%).<sup>24</sup>

The **Commission's Country Strategy Paper 2002-2006** (CSP 2002-2006) for Indonesia outlined a five year programme of cooperation with an indicative budget of **€216 million**.<sup>25</sup> The **overarching objective** of the CSP 2002-2006 was to encourage the consolidation of democracy and promote good governance through the provision of EC support to Indonesia's sustainable economic, social and environmental development. Following the **tsunami disaster**, the EC has allocated additional €40 million in humanitarian assistance through ECHO and €200 million in assistance to reconstruction (part of the Tsunami Indicative Programme 2005-2006). Following the **earthquake in Yogyakarta** in May 2006, humanitarian assistance has been allocated (€10 million) and the Commission intends to allocate up to €40 million to reconstruction and disaster prevention.

The **CSP 2002-2006 has led to a more balanced mix of interventions** after years of focusing on forestry and natural resources. As of June 2006, overall active **commitments of EC assistance** in Indonesia stood at **€466 million**.<sup>26</sup> More than €60 million are allocated to projects in the **forestry and natural resources sector**, including NGO projects under Tropical Forests. This reflects the priority given to this sector so far. With the closing of large forestry projects, this share will decrease to some €60 million. Projects in the **social sector are increasing** from €35 million in 2004 to €75 million in 2006 (€35 million in health and €40 million in education), that is, from some 10% to 30% of our assistance. In **governance/rule of law/economic co-operation** projects **are increasing** from roughly €50 to €70 million in 2005/06, or from 15% to some 30% of the assistance.

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<sup>23</sup> For example, the use of leaded fuel in Jakarta has been banned since July 2001 and some other cities have also phased out its use. However, the exhaust emissions from vehicles in Jakarta continue to exceed the legal limits with 36% of gasoline vehicles and 60% of diesel fuelled vehicles exceeding the limits during surveys in 2004. In the area of water pollution, Government Regulation No. 82 of 2002 regulates water quality and pollution control including monitoring measures. Under this regulation, some offenders have been prosecuted but the quality of surface water remains poor with the five largest rivers in Java contaminated to levels preventing water from being processed to be drinkable.

<sup>24</sup> Source: "Blue Book" on European Union Development Cooperation in Indonesia (2005)

<sup>25</sup> It is expected that actual commitment will be lower, as €30 million foreseen under the National Indicative Programme (NIP) 2005-2006 have been reallocated to the urgently needed post-tsunami reconstruction programme in Aceh, where the EC has committed €200 million for 2005 and 2006. Moreover, €15 million have been allocated to the Aceh peace process on top of the funds available under the indicative programme.

<sup>26</sup> composed of some €230 million from regular bilateral assistance, €200 million for post-tsunami support and the remainder from uprooted and human rights budget lines.

As for **implementation** and **disbursements**, as of June 2006, funds yet to be disbursed stood at some €297 million (including €159 million for post-tsunami assistance). With the acceleration of disbursement, in particular as regards post-tsunami assistance, it is expected that funds yet to be disbursed will be reduced to some €191 million by end-2006 (including €100 million for post-tsunami assistance). The relatively slow trend in implementation and disbursement shows the limits of traditional project designs based on a decentralised implementation model with Project Management Units (PMUs) and a government contribution. Such projects have become increasingly cumbersome to prepare and implement, due to the heavy requirements of EC and local procedures.

### **5.1. Economy and Trade (see details in annex 5)**

The Country Strategy Paper 2002-2006 included economic co-operation as an important area of focus. The total budget allocated to this was **€28 million**. As of June 2005, €18 million had already been committed. An additional €10 million allocated to public finance reform are expected to be committed in 2005.

The CSP 2002-2006 singled out specific barriers affecting **EU-Indonesia trade flows**, related to standardization and quality control mechanisms which were undermining the ability of Indonesian companies to export to the EU. Other **trade facilitation** areas, like the Indonesian customs operations, were also recognized as critical factors for the support of this two-way trade. Improving the conditions for **EU investment in Indonesia**, especially for investment licensing processes, had been a key demand from EU companies, and as such is also reflected in the CSP 2002-2006. It was also recognized that it would be necessary to bring the main actors from private and public sectors more closely together.

### **5.2. Good Governance (see details in annex 6)**

The CSP 2002-2006 identified the **reinforcement of good governance and the rule of law** as a major objective for co-operation with Indonesia. The total budget allocated to this area was **€ 42.3 million**. The EC policy was to contribute to developing and consolidating democracy and rule of law and encouraging respect for human rights and fundamental freedoms. Law enforcement and judicial reform were to be strengthened in order to rebuild public trust in law enforcement agencies and support democracy.

Following the **terrorist attacks** which have taken place in Indonesia, in particular in Bali in October 2002, the EC has initiated support in the area of **counter-terrorism**, through backing **anti-money laundering** activities and assistance to the Jakarta Centre of Law Enforcement Co-operation (JCLEC) under the Rapid Reaction Mechanism (RRM).

### **5.3. Social Sectors (see details in annex 7)**

In the **education sector**, the preparation of EC assistance has been characterised by an emphasis on donor coordination and collaboration from the outset, and programming has been complementary to the efforts of other donors. This approach was underpinned by the 2003 *Education Sector Review* (ESR), a joint effort between the government and the donor community in Indonesia.

Building on the ESR, under the **NIP 2002-2004**, the €20 million Basic Education Sector Capacity Support Programme (BE-SCSP, starting in 2006) provided the preparatory stage for a Sector-Wide Approach (SWAP), building on the relatively advanced state of developments between donors and MONE.<sup>27</sup>

In the **health sector**, EC interventions before the CSP 2002-2006 had been limited to alleviate the effect of the socio-economic crisis (1997-98). The CSP 2002-06 emphasised the role of support to basic health services as part of good governance. As a result the project '**Support to Community Health Services**' (CHS - **€35 million**) started in 2003 and will be implemented over a period of 54 months. The overall objective is to improve population health and nutrition status particularly in relation to the socially deprived and those living in poverty, through community health system development at the district and sub-district levels.

#### **5.4. Environment (see details in annex 8)**

The EC has been a major supporter of joint efforts with the Government of Indonesia to support environmental issues principally in the forestry and water sectors. Through the **EC-Indonesia Forest Programme** (ECIFP), a series of projects totalling some **€150 million** over the past 10 years have helped strengthen the capacity of the Ministry of Forestry and provincial Forestry Departments.

Efforts by the EC and Government of Indonesia to improve sustainable forest management have been hindered by the continued **illegal logging** and associated trade on both domestic and external levels. In addition, past activities have focused on area-based projects working in specific projects, drawing heavily on European technical assistance, and in partnership with a single government department (usually the Ministry of Forestry). This project model presents a risk of marginalisation, as reliance on a single project partner prevents the diffusion of impacts into the wider political process, and isolates donors in particular provinces.

As a consequence of this, the EC and Government of Indonesia have developed the **EC-Indonesia FLEGT Support Project** (€15 million) under the NIP 2002-2004 to be implemented from 2005-2009. This initiative focuses on law enforcement, governance and trade issues to put in place the conditions for sustainable forest management over the medium to longer term. This project is part of a broader approach by the EC (EU FLEGT Action Plan) and other donors which aims to address governance reform on the one hand, and measures to control the trade in illegal timber on the other hand.

#### **5.5. Thematic and regional programmes (see details in annex 9)**

In addition to the assistance under the CSPs and NIPs, **6 horizontal and thematic budget lines** and **11 regional ASEAN and Asia-wide** programmes are operational in Indonesia. Such budgetary instruments are subject to bi-annual or annual programming processes.

Between 2000 and 2005, **€42 million have been committed** for horizontal and thematic budget lines' projects in Indonesia. Efforts have been made to achieve **better synergy** between the CSP 2002-2006 and the horizontal budget lines. Projects funded under thematic

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<sup>27</sup> Under the **NIP 2005/06**, the planned €50 million sector programme has been scaled down to €20 million in order to provide rapid funding for reconstruction activities in the tsunami-affected province of Aceh.

and horizontal budget lines have significantly contributed to addressing some **key cross-cutting issues** relevant to EC-Indonesia cooperation, in particular:

- **Conflict prevention** and post-conflict recovery have been addressed through the **uprooted people** budget line, which has contributed to reconciliation in a number of conflict-ridden Indonesian provinces (in particular Maluku, Central Sulawesi, West Timor).
- **Environment:** the **Tropical Forest** budget line addresses various forestry issues complementary to the actions foreseen in the CSP, such as illegal logging, certification, governance, and community forestry
- **Human rights:** complementary to government-to-government cooperation, and given Indonesia's vibrant democratic environment, the role of civil society as a co-operation partner has been enhanced considerably, notably through the *European Initiative for Democracy and Human Rights (EIDHR)* and the *Small Projects Facility*. Although modest in funding, they continue to make a vital contribution to the building the ground for "people-to-people" relations by facilitating up networks between social multipliers, including academics, consumer and rights activist, think tanks and indigenous peoples organisations.

EU-Indonesia cooperation has also been complemented by a number of **regional initiatives at the Asia-wide and ASEAN level**. Indonesia has increased its participation in the Asia Wide Programmes such as **Asia Link** (15 projects in the period), **Asia Invest** (7 projects), **Asia Pro Eco** (3 projects), **Asia IT & C** (2 projects) and **Asia Urbs** (2 projects).

Indonesia has participated in the different **EC-ASEAN economic co-operation programmes**. Some of these programmes, particularly on standards, effectively complement the bilateral actions already being implemented. In the light of future developments at regional level (in particular the possibility of a Free Trade Area between ASEAN countries and the EU), such synergy between regional and bilateral programmes will continue to be sought.

## 5.6. Lessons learned

A **key feature** of the Country Strategy 2007-2013 is to move **from a project-based approach to a sector-based approach ("SWAP")**, supporting government sector policies, and concentrating the assistance on a limited number of sectors.

The limits of traditional project designs, based on a decentralised implementation model with Project Management Units (PMUs) and a government contribution, are obvious. Such projects have become increasingly cumbersome to prepare and implement, without any significant impact on policy reform.

A "SWAP" approach will increase the impact of EC assistance and ownership by the Indonesian Government. This approach will also need to be closely coordinated with other donors. In order to do so, implementation arrangements in partnership with UN or other multilateral agency, such as the World Bank will be considered in order to allow faster

contracting, mobilisation and disbursements and leveraging of the support through pooling of donors assistance.

Future EC assistance in the economic field should be based on a more focused, institutionalized **dialogue with the Government and private sector** in order to monitor more closely progress on trade and investment issues. A more responsive new government and organized European and Indonesian business communities should help make this possible.

Concerning **forestry**, past approaches have been unable to effectively curb illegal logging and unsustainable exploitation of resources, due to governance problems such as corruption and lack of implementation and law enforcement capacity.<sup>28</sup> Moreover, more than €50 million for projects in the forestry and natural resources sector are unspent. It is therefore proposed, as suggested by the Country Environment Profile, to focus on the underlying issue of governance, through effective mainstreaming of environmental issues into all relevant sectors (e.g. law enforcement) and possibly thematic budget line support.

Given the proposed concentration of assistance on a limited number of sectors so as to maximize the impact of EC assistance, particular attention will be paid to ensure that key **cross-cutting issues**, in particular, environment, conflict prevention, human rights and governance, are **mainstreamed** in all sectors covered by the CSP.

## 6. THE EC RESPONSE STRATEGY

The **key objectives** of EC assistance in 2007-2013 will be **poverty reduction**, the promotion of sustainable **economic growth** through trade and investment and promoting **good governance and security** through better law enforcement.

Under the Development Cooperation Instrument (DCI), an indicative allocation of **€194 million** has been earmarked for Indonesia for the period 2007-2013. This allocation may be supplemented by relevant regional and thematic programmes.

The **first** priority will be **education**, based on the development with the Government of a sector-wide approach (“SWAP”), in line with poverty reduction and achieving *Education for All* which are key MDGs and government priorities. Support to education will also contribute to upgrading human resources and contribute to economic growth. This sector is therefore critical to improve both social conditions and the quality of economic growth.

It is therefore proposed to concentrate assistance on **education** as a **focal sector** that promises the highest impact and responsiveness, including absorption capacity. This focal sector will receive up to 80% of assistance.

The **second** area of assistance will be the support to the development of **trade** and to improving the **investment** climate, in order to promote economic growth in Indonesia, through increased trade and investment and boost important trade relations with the EU. Full

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<sup>28</sup> A number of evaluations have been carried out by the European Commission, which have pointed out the insufficient impact of the approach chosen so far. See in particular: *Review of the EC-Indonesia Forestry Programme (ECIFP)*, Landell Mills/PCA consultants, Jakarta, October 2004

account will be taken of the various commitments to strengthen the social dimension of globalisation.<sup>29</sup>

The **third** area of assistance will aim at improving governance and security through reform of the **justice sector** and enhanced **law enforcement** capacity.

The specific needs that can result from **post-tsunami reconstruction** (as well as the support to reconstruction following the Yogyakarta earthquake), in particular in terms of disaster prevention and management, as well as the long-term consolidation of the **Aceh peace process**, may have an influence on the present strategic document and demand specific adjustments to provide appropriate responses.

## **6.1. Focal Sector: Education**

**Education sector support** will aim at ensuring and sustaining achievement of **MDG 1<sup>30</sup> and 2<sup>31</sup>** and **Education for All (EFA)** goals, by bringing children from poor and disadvantaged families into school and keeping them there through the 9 years of Basic Education.<sup>32</sup> It will further aim at ensuring and sustaining achievement of MDG 8<sup>33</sup>, by promoting access to vocational and higher education. This support will also help to address the crucial issues that have pulled down Indonesia's education system and led to a lack of competitiveness internationally.

### *Basic Education*

The EC will concentrate most of its assistance to support a **sector-wide approach** ("SWAP") in basic education. Significant progress towards a sector approach has taken place recently. High level policy dialogue on the subject between the EC and the various key Indonesian agencies is under way through the ongoing EC programme of support to education.

The development of a SWAP will build on the work done in the field of **donor coordination** since 2001. The EC intends to take a leading role in this regard and in building and sustaining policy dialogue with concerned ministries. Donor coordination has accelerated since 2004 and a core group, the Education Sector Working Group, is working to develop a sub-sector approach in Basic Education, in which EC is likely to be the largest contributor. Donors which have already expressed interest in participating in a SWAP include NL, NZAID, WB, and UNESCO, and a further group of donors active in the education sector is willing to coordinate and line up behind government strategy more broadly, including USAID, JICA and AusAID. The total amount of funding going to education annually from donors and lenders is estimated at less than 10% of government expenditure on education.

The **overall objective** of this operation, in line with the new government's Medium Term Development Strategy 2005-2009, will be to contribute to achieve sustained poverty reduction by improving equitable access to quality education.

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<sup>29</sup> World Commission on the social dimension of globalisation "A Fair Globalisation: Creating Opportunities for All", 24.02.2004; Communication from the Commission "The Social Dimension of Globalisation – the EU's policy contribution on extending the benefits to all", COM(2004) 383 final, 18.05.2004.

<sup>30</sup> Eradicate extreme poverty and hunger.

<sup>31</sup> Achieve universal primary education.

<sup>32</sup> A strong focus will be on children from remote areas, indigenous/minority groups and those with special needs

<sup>33</sup> In cooperation with the developing countries, develop decent and productive work for youth

The **specific objectives** will be to contribute to the government policy/strategy to improve basic education, in particular with reference to (a) governance and management systems, (b) overall quality, (c) planning and budgeting process for education and to upgrade the efficiency of those resources, and (d) performance of teachers.

The indicators of the attainment of the objectives are:

- § Increased levels of education of Indonesian citizens
- § Increase in number of Indonesians graduating from Junior and Senior High School
- § Increase in number of university/college graduates
- § Improved education quality
- § Increased relevance of education to sustainable development needs
- § More efficient and effective management of education service provision

In terms of **mainstreaming**, this strategy will also encourage **environmental sustainability** by working with MONE and the Ministry of the Environment. These two ministries have signed a memorandum of understanding to include environmental education in the school curriculum from as early an age as possible and to train teachers to provide this education. **Gender-related aspects** will also be taken into consideration to improve the Gender-related Development Index (GDI).

A number of challenges and risks need to be taken into account while developing a sector-wide approach:

- **Decentralisation** poses a challenge for this strategy, especially as the process of reconciling the new roles of the central ministry, the province, the district/city, the sub-district and the school has yet to be completed. This change is a work in progress and will be supported by BE-SCSP.
- **Education financing:** Indonesia's investment in its education system has been low compared to other countries in the region. The Government plans to increase education funding under the Education Law of 2003 and MDTS 2005-2009. In any case, a vast proportion of funds are committed to routine expenses including primarily salaries, so there is little room for manoeuvre when it comes to funding education development.
- **Civil service reform** could be a major stumbling block, as there is a reluctance to deal with this issue at all levels. Key challenges will be: the sheer size of the bureaucracy, corruption, inefficiency and low pay.
- **Transparency:** in a country with a reputation for corruption and poor governance, proper financial management mechanisms will have to be put in place as well as appropriate auditing and monitoring mechanisms.

### ***Higher Education***

The main objective of higher education cooperation in Asia is to enhance international cooperation capacity of universities in third countries by facilitating transfer of know-how and good practices in the field of student and academic staff mobility. The European Commission will contribute to financing a mobility scheme between European universities holding an Erasmus Charter and third country universities that will complement existing programmes in the field of higher education. The types of mobility to be funded are:

Ø for students: master, doctorate and post-doctorate mobility opportunities

Ø for academic staff: exchanges for the purposes of teaching, practical training and research.

Higher education cooperation activities will be funded under the regional programming for Asia.

### *Vocational Education and Training (VET)*

Senior High School education splits into vocational and academic tracks, aimed at preparing students for work or tertiary education. There is a great need to **match skills available with those needed in the job market**. This is an issue that has been mentioned recently by a number of private companies operating in Indonesia, who state that employees coming straight from school always need additional training before they can start work. It directly affects Indonesia's competitiveness as a nation and can partly explain the fact that unlike its Asian neighbours, Indonesia is not present in some of the higher added-value sectors such as electronic goods or cars.

Unemployment among young people is high and this group is a key target group in need of **decent and productive work**.<sup>34</sup> Among the keys to job creation identified by a number of national programmes are to improve school-to-work transitions, job quality and workers' skills through basic and vocational education; ensure equal opportunities.<sup>35</sup>

The EC, in close coordination with the private sector and other donors (especially Germany particularly active in this field), will assist the MONE and the provincial levels to define a more detailed strategy and policy for enhancing the skill base through vocational training. In the short term, EC intervention will be limited to policy definition and, possibly, pilot projects under the "trade and investment" component.

## **6.2. Area 2: Trade and Investment**

Tackling trade and investment issues requires a comprehensive multi-donor approach. The EC will ensure that its assistance is based on a **policy dialogue and possible joint approaches** carried out in coordination with other bilateral and multilateral donors involved in this field. EC assistance will be based on the firm commitment of the present Government to its **reform agenda**.

The EC response strategy should be supported by the important weight of the **EU trade and investment relations with Indonesia**. The ongoing EC-ASEAN trade and investment dialogue under the TREATI initiative, and the possibility of a Free Trade Area (FTA) between ASEAN countries and EU will only enhance the importance of the EU as a major economic partner.

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<sup>34</sup> The concept of "decent work" is defined by the ILO. It covers employment, social protection, fundamental rights at work including core labour standards, social dialogue and gender equality.

<sup>35</sup> Medium Term Development Plan 2005-2009; Indonesia Youth Employment Action Plan 2004-2007; Indonesia Tripartite Action Plan for Decent Work 2002-2005

The **overall objective** of the assistance in this area will be to improve Indonesia's economic performance through support to an outward oriented strategy based on increased trade and investment, while taking full account of the social dimension of globalisation.

The **specific objectives** of EC-Indonesia co-operation are identified as follows:

- Supporting Indonesia's economic reform effort to integrate into the **international trade system** and **improve its investment climate**.
- Continuing to address **specific issues affecting EU-Indonesia trade and investment flows** through long-term bilateral technical assistance on one side and the institutionalization of a high-level dialogue between the Government, EC Delegation, *EuroCham* and the Indonesian Chamber of Commerce (*Kadin*) on the other.
- Promoting the **interaction between the EU and Indonesian business communities** in key economic sectors.

The variety of factors affecting the investment climate in Indonesia, and the diverse number of stakeholders (central and local government, legislative and judicial power, labour unions, employers associations, representatives of the business community) make it critical to engage private sector and other civil society actors.

Particular mention should also be made to **decentralisation** and the still unclear definition of the modalities for devolution of political and economic powers to Provinces and Districts. An improved definition of roles could make it worth exploring the possibility to direct co-operation efforts towards selected local authorities.

The main **risks** and **assumptions** related to an uncertain global trading environment. In the case of Indonesia, such uncertainties relate to the outcome of the Doha round of WTO negotiations, the evolution of the Chinese economy, and the impact of the preferential trade agreements. Finally, the EC trade initiatives in the region should also be fully taken on board, the TREATI initiative being completed by other bilateral or regional propositions, such as the proposed Free Trade Area with ASEAN countries.

When promoting trade and investment, due consideration will be given to their impact on **environment** and **social cohesion**. Possible areas of support in the field of environment could include: eco-labelling and certification processes, improvement of environmental standards, improvement of sustainable, reliable and affordable access to, and use of energy, development of energy efficiency and renewable energy technologies. On social issues, areas of cooperation could include: improvement of labour standards, development of vocational training, cooperation on health and safety at the workplace, corporate social responsibility

In view of the signature of an air services agreement between the Community and Indonesia and of the critical importance of maritime transport in this region, the EC is ready to provide technical assistance in these domains and to enhance regulatory convergence in the field of civil aviation

### 6.3. Area 3: Law Enforcement and Justice

**Governance**, in particular law enforcement and judicial reform, remains one of Indonesia's key medium-term development challenges. The Medium Term Development Strategy (MTDS 2005-2009) addresses **combating corruption** and **good governance** reforms including **legal and judicial reform** as critical to the recovery of the Indonesian economy and as a means to attract much needed foreign investment. Improving internal governance is also critical to mobilising domestic investment reserves. Addressing corruption, transnational crime and money laundering is key to a stable environment and combating illegal logging will improve the sustainability of Indonesia's development.

The proposed approach will be based on the dialogue established in the framework of the new Bilateral Cooperation and Partnership Agreement which will include a common commitment to respect human rights, to the fight against terrorism and organised crime. Within the DCI area of cooperation on governance, democracy, human rights and support for institutional reform, in particular related to co-operation and policy reform in the fields of security and justice, the Community will carry out measures which shall fully respect OECD-DAC guidelines, taking also into consideration relevant European Council Conclusions.

The **overall objective** of EC assistance will be an **improved governance and law enforcement** as key to the proper functioning of the financial and corporate sectors and public administration.

Against this background, the **specific objectives** of the EC-Indonesia Law Enforcement and Justice cooperation will be as follows:

- Supporting Indonesia's efforts to tackle **corruption** in line with the National Plan for the Eradication of Corruption as a means to encourage increased inward and domestic investment and underpin long-term sustainable economic development.
- Addressing the specific needs of **law enforcement and judicial authorities** in support of ongoing reform including amongst others, the Judiciary, the Public Prosecution service and the National Police with the aim of supporting the emergence of publicly accountable institutions, committed to improved and effective governance and to combating more effectively **transnational organized crime**.
- Responding to the justice needs of the business and investor community by enhancing the **capacity of the Commercial Courts**, in particular at regional level
- Enhancing the **legal protection of human rights** through support for the implementation of National Human Rights Plan of Action 2004-2009 and in particular the ratification of international human rights instruments.

The proposed approach will be based on the following assumptions:

- Macro-economic and political stability
- Continued political support and commitment to legal, security sector and judicial reform
- Enhanced policy dialogue with Government through political dialogue and in the CGI framework

The main risks identified are the following:

- Fight against corruption does not progress significantly in line with National Plan for Eradication of Corruption
- Weakened commitment to reforms in law enforcement agencies
- Lack of Government capacity to realise better human rights protection
- Insufficient or untimely provision of counterpart funding

Parallel and complementary to the cooperation with Government, and given Indonesia's democratic environment, the role of **civil society** as a co-operation partner has been enhanced considerably and will therefore be taken into account in the design of future support programmes, in particular in the area of human rights.

The EC has also provided an essential support to the democratic transition through **election support**. Based on this successful experience and in the light of political developments in Indonesia, the EC will therefore consider whether such support should be repeated for the next elections scheduled in 2009.

#### 6.4. Cross-cutting issues

Based on the key issues identified in this CSP, a number of **cross-cutting issues** will be addressed as a matter of priority and mainstreamed in the design of all programmes:

**-Environment:** support to the education sector will promote the inclusion of **environmental education** in the school curriculum. The **fight against illegal logging** will be given priority under the support to law enforcement and judicial reform and under the support to trade reform (in particular in the area of certification and customs cooperation). Other areas of support could include the **promotion of environmental standards in the productive sectors**.

**-Governance and human rights** will be another priority issue, in particular as governance issues such as corruption need to be addressed at all levels and in all sectors. Due attention will be paid to the need to reinforce public and private institutions in concerned sectors and to increase **transparency**, in particular as regards **public finance management**. Attention will also be paid to the rights of indigenous peoples (marginalised *adat* and isolated communities). Core labour standards will be taken into account in the design of relevant programmes.<sup>36</sup>

**-HIV/AIDS:** in the response strategy, the risks and opportunities in the proposed focal sectors for combating HIV/AIDS and other diseases will be assessed. This could apply in particular to the education sector.

**-Social Dimension of Globalisation:** the strengthening the social dimension of globalisation, including the international management and governance of globalisation, and the promotion of employment and decent work for all will be taken into account where appropriate in the design of assistance programme.

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<sup>36</sup> Indonesia has ratified all International Labour Organisation Core Conventions relating to the freedom of association and collective bargaining, the abolition of forced labour, non-discrimination and the elimination of child labour

**-Conflict prevention** will remain a major issue to be addressed in the design of programmes. The need to address conflict prevention in particular in the context of the peace process in **Aceh** and of the regional autonomy in **West Papua** will remain. In all sectors, and in particular in education and law enforcement and justice, the needs of areas in post-conflict situation will be given particular attention.

**-Gender:** fullest participation of women and men in all aspects of democratic life will be considered in each and every action foreseen in the framework of the Country Strategy.

## 6.5. Coherence with regional and thematic programmes

In the context of the co-operation with Indonesia and of the priorities set out in the present CSP, and in line with the cross-cutting issues underlined above, the Commission intends to pursue thematic interventions in the following areas:

- **Democracy and Human Rights:** support to governance, rule of law and human rights are among the priorities identified in the CSP. The thematic programme could complement actions directed at public authorities, in particular by directing assistance at civil society and conflict areas (such as Aceh, Papua, Moluccas)
- **Non-State Actors in Development:** NGOs constitute a dynamic element in the political transition and in the social fabric of Indonesia. Specific support to local community-based actions should be supported.
- **Migration and Asylum:** in view of the new Cooperation and Partnership Agreement being negotiated, which will include a comprehensive article on dialogue and co-operation on migration, this issue will become more prominent. Appropriate assistance aimed at enhancing migration management could be considered, in particular in the fields of combating illegal migration and trafficking in human beings, as well as border control management.
- **Human and Social Development:** social development being a priority in the present CSP, complementary actions, as well as pilot actions may be needed to support social reforms or programmes.
- **Environment and Sustainable Management of Natural Resources** (including energy): pilot actions, in particular towards NGOs and local communities, could usefully complement assistance under CSP.
- **Food security:** while needs can be expected to diminish in the future, assistance in poor and disaster/conflict ridden areas may be needed for some time.

These thematic activities are complementary to the strategic objectives pursued by the Commission under the present CSP and form part of the policy dialogue with Indonesia. The financing of these thematic activities will be additional to financial resources provided under the NIP.

In addition, Indonesia can be expected to benefit from activities funded under the “**Instrument for Stability**”, in view of recent conflict history of this country, of the need to provide assistance in the security area (e.g. counter-terrorism), the area of governance and of law enforcement.

Lastly, Indonesia will also benefit from activities funded under the Asia-wide programme (e.g. Asia Invest).

## 7. ANNEXES

### 7.1. Annex 1: EU/EC Cooperation objectives

#### 1/ EC Treaty Objectives for External Cooperation

In accordance with **Article 177** of the Treaty Establishing the European Community, the Community's development cooperation policy shall foster the sustainable economic and social development of the developing countries, the smooth and gradual integration of these countries into the global economy and the fight against poverty. The Community's policy in this area shall contribute to the general objective of developing and consolidating democracy and the rule of law, and to that of respecting human rights and fundamental freedoms.

On the basis of **Article 179** of the same Treaty, a new Development Cooperation Instrument (DCI) was adopted in December 2006. Indonesia is eligible to participate in cooperation programmes financed under the DCI [European Parliament and Council Regulation (EC) No. ... of ... December 2006 establishing a financial instrument for development cooperation.

#### 2/ Objectives of the EU as laid down in other applicable documents:

- a. Commission Communication COM(2001)469 "[Europe and Asia: A Strategic Framework for enhanced partnerships](#)" with the following 6 objectives: (i) contribute to peace and security in the region (ii) further strengthen our mutual trade and investment flows with the region; (iii) promote the development of the less prosperous countries of the region, addressing the root causes of poverty; (iv) contribute to the protection of human rights and to the spreading of democracy, good governance and the rule of law; (v) build global partnerships and alliances with Asian countries, in appropriate international fora, (vi) and help strengthen the awareness of Europe in Asia (and vice versa).
- b. On 9 July 2003, the European Commission adopted a Communication on a "New Partnership with South East Asia", setting out a comprehensive strategy for future EU relations with the region. The strategic priorities identified in the Communication include (1) Supporting regional stability and the fight against terrorism, (2) Human Rights, democratic principles and good governance, (3) Mainstreaming Justice and Home Affairs issues (4) new dynamism into regional trade and investment relations (5) development of less prosperous countries, and finally (6) intensifying dialogue and cooperation in specific policy areas, such as economic and trade issues, justice and home affairs matters, science and technology, higher education and culture, transport, energy, environment, and information society.
- c. Indonesia is signatory to the 1980 Co-operation Agreement between the European Community and the ASEAN countries. The Agreement covers trade, economic co-operation and development as a basis for institutionalised dialogue. The EU and Indonesia have initiated negotiations for a new Bilateral Cooperation and Partnership Agreement. This agreement aims at establishing a relationship based upon a modern policy agenda, with an appropriate institutional framework and

enabling a policy dialogue on a wider range of issues, including political issues such as human rights and counter-terrorism.

- d. Communication from the European Commission to the European Council and the European Parliament (2 February 2000) "Developing closer relations between Indonesia and the European Union" and the European Council Conclusions.

### **3/ The EU's Development Policy**

On 20 December 2005 the Presidents of the European Commission, the European Parliament and the EU Council signed the joint Development Policy Statement (DPS). This "European consensus" will provide the Union with a common vision of values, objectives, principles and means for development. The revised statement is intended to take account of changes both within the EU and internationally since the first statement on the European Community's development policy was adopted by the Council and Commission in November 2000. The new joint statement is structured in two parts, which set out:

- in the first part, "the EU vision of development", the objectives, principles and methods by which the EU at Community and member state levels implement their development policies;
- in the second, "the European Community's development policy", guidance for implementation at Community level.

In its 12 April 2005 Communication on **Policy Coherence for Development**,<sup>37</sup> the Commission has defined coherence commitments in the overall framework of the EU sustainable development strategy and identified the following priority areas with high potential of attaining synergies with development policy objectives: trade; environment; security; agriculture and fisheries; social dimension of globalisation<sup>38</sup>, employment and decent work; migration; research and innovation; information society; transport and energy. These commitments were endorsed by the Council (GAERC) on 24 May 2005. The Communication further calls on non-development policies to respect development policy objectives and on development cooperation to also contribute, where possible, to reaching the objectives of other EU policies.

### **4/ Aid Effectiveness, harmonisation and co-ordination**

The EC-Indonesia dialogue on co-operation is conducted at the level of Senior Officials, who meet annually with the venue alternating between the EU and Indonesia.<sup>39</sup> The signing of a new Bilateral Cooperation and Partnership Agreement will enhance the dialogue between the EC and Indonesia and will open new areas for such a dialogue.

Assistance activities of all donors are coordinated through the Consultative Group for Indonesia (CGI), chaired by the Government of Indonesia with the support of the World

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<sup>37</sup> COM2005/0134 final

<sup>38</sup> World Commission on the social dimension of globalisation "A Fair Globalisation: Creating Opportunities for All", 24.02.2004; Communication from the Commission "The Social Dimension of Globalisation – the EU's policy contribution on extending the benefits to all", COM(2004) 383 final, 18.05.2004.

<sup>39</sup> Since 2002, the **political dialogue** between the **EU and Indonesia** takes place at Ministerial level, in the Troika format.

Bank, and the underlying sector groups (forestry, investment climate, decentralisation, poverty reduction).

The National Medium-Term Development Strategy 2005–2009 is the core policy document which takes on board the MDGs and will be developed into strategic plans at line ministry level. The MTDS 2005–2009 incorporates the Poverty Reduction Strategy (PRS) as an integral part of the Plan. In March 2003, Indonesia completed its Interim Poverty Reduction Strategy (I-PRSP). The PRSP is being prepared and a final draft was discussed in December 2004.

The Commission is actively contributing to improved donor coordination and aid harmonisation in Indonesia. Beyond the monthly internal EU coordination meetings with Member States and the new annual "Blue Book" on EC and Member States cooperation with Indonesia, the Commission participates in the semi-annual meetings of the CGI, and its various sector groups (forestry, education, poverty reduction, investment climate, decentralisation...), where effective dialogue and discussion between donors, government and civil society on Indonesia's development take place. In addition, the Commission is a member of the monthly "Donor Roundtable", where the main players come together to enhance alignment and information exchange.

Together with Member States missions, the Commission supports harmonisation through the Multi-Donor Trust Fund for the post-tsunami reconstruction of Aceh, and has assumed a leading role as co-chair of the Fund. The Commission is also improving its ability to coordinate on the ground with the establishment since October 2005 of a "Europe House" in Banda Aceh.

A new field of harmonisation is the joint effort to advance towards sector-wide approaches in education, and possibly also water and public finance management, with the EC in a leading role on education.

Regular meetings are also being held at Headquarter and Delegation level with representative of local and international NGOs and the private sector. Specific meetings are being held at Delegation level in the process of preparation of the CSP and NIP. A meeting will be called in Brussels at the end of 2006 ("Indonesia Day") which will gather representatives from Government, civil society, donors, academia among others, allowing further consultations.

Moreover, in particular through local small project facilities in the area of economic cooperation and human rights, regular and structured contacts are established with NGOs and representatives of the private sector (in particular through EUROCHAM).

## 7.2. Annex 2: Economic/Social Indicators – Selected Statistical Data for Indonesia

### Key Indicators, pre-crisis to present

| Indicators                                    | 1996  | 1997   | 1998   | 1999  | 2000  | 2001  | 2002      | 2003  | 2004               | 2005               |
|---|-------|--------|--------|-------|-------|-------|-----------|-------|--------------------|--------------------|
| <b><u>ECONOMIC</u></b>                        |       |        |        |       |       |       |           |       |                    |                    |
| Real GDP growth (% change YOY)                | 8.0   | 4.5    | -13.0  | 0.8   | 4.9   | 3.8   | 4.3       | 4.9   | 5.1                | 5.5                |
| Real GDP per capita (US\$)                    | 1,136 | 1,063  | 464    | 671   | 710   | 659   | 796       | 944   | 1176               | 1270               |
| Inflation %                                   | 9.0   | 13     | 73     | 17    | 3.8   | 11.5  | 11.8      | 6.8   | 6.1                | 10.0               |
| Exports US\$ billions                         | 50.2  | 56.3   | 50.4   | 51.2  | 65.4  | 57.4  | 59.2      | 64.1  | 71.6               | 85.0               |
| Imports US\$ billions                         | 44.2  | 46.2   | 31.9   | 30.6  | 40.4  | 34.7  | 35.6      | 39.5  | 46.5               | 57.0               |
| Private Capital Flows (net) US\$ billions     | 11.5  | -0.3   | -13.8  | -9.9  | -10   | -8.2  | 0.2       | -0.9  | -3.4               | -3.0               |
| External Debt Total US\$ billions             | 128.9 | 136.1  | 151.1  | 148.1 | 141.7 | 133.1 | 131.3     | 134.9 | 137.0<br>(53% GDP) | 131.0<br>(47% GDP) |
| Current account balance (US \$ billions)      | -7.8  | -5.0   | 4.1    | 5.8   | 8.0   | 6.9   | 7.8       | 7.3   | 1.5                | 0.0                |
| Population (millions)                         | -     | 199.87 | 204.42 | 203.6 | 212.6 | 215   | 211.8     | 214.7 | 217.6              | 220.0              |
| <b><u>EDUCATION</u></b>                       |       |        |        |       |       |       |           |       |                    |                    |
| Adult literacy rate over 15s % (male /female) | 90/78 | 90/78  | 90/78  | 91/80 | -     | -     | 92.5/83.4 | -     | 94/87              | -                  |
| Elementary school enrolment (% of group)      | 94.8  | -      | -      | 92.7  | 94.9  | -     | 93        | 95    | 94                 | -                  |
| Junior high school enrolment (% of group)     | 48.6  | -      | -      | 59.2  | 60.8  | -     | -         | -     | 64                 | -                  |
| Senior high school enrolment (% of group)     | -     | -      | -      | 38.5  | 39.8  | -     | -         | -     | -                  | -                  |

|   | 1996   | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|--------|------|------|------|------|------|------|------|------|------|
| <b><u>HEALTH</u></b>                      |        |      |      |      |      |      |      |      |      |      |
| Life expectancy at birth                  | 63.2   | -    | 65   | 65.5 | 68   | 66.2 | 66.7 | 66.9 | 67   |      |
| Children < 5 with good nutrition (%)      | 63.9   |      |      | 69.7 | 71.1 | -    | 75   | -    | -    |      |
| < 5 mortality rate (per 1000 live births) | 70.4   | 56   | 52   | 59.6 | 44.7 | -    | 43   | 41   | 38   |      |
| Fertility rate (births per woman)         | 2.8    | -    | -    | 2.6  | 2.5  | -    | 2.5  | 2.4  | 2.3  |      |
| Children < 5 fully immunised (%)          | 88.2   | -    | -    | 89.9 | 90.1 | 89.9 | 90.6 | -    | -    |      |
| Medical doctors per 100,000               | 10.7   | -    | -    | 10.8 | 16.2 | -    | 20   | -    | -    |      |
| <b><u>POVERTY</u></b>                     |        |      |      |      |      |      |      |      |      |      |
| Number of people under poverty line (%)   | 34.5   |      |      | 48.4 | 37.3 | 37.1 | 38.4 | 37.3 | -    |      |
| Population under poverty line (%)         | 17.7/a |      |      | 23.5 | 19   | 18.4 | 18.2 | 17.4 | -    |      |
|   |        |      |      |      |      |      |      |      |      |      |

Sources:

World Bank (web site – Indonesia Social Indicators)  
Human Development Report 2004 & 2005  
MDG website (World Bank)  
World Bank CGI report 2005 – selected social indicators  
WHO Health workforce database (web)

7.3. **Annex 3: EC cooperation CSP 2002-2006 period** (situation as of June 2006)

In million EURO

| Sector   | Programming   |               |            |             | Before or outside NIP | Total Commitment |                 |              |             |
|--|---------------|---------------|------------|-------------|-----------------------|------------------|-----------------|--------------|-------------|
|  | NIP 2002-2004 | NIP 2005-2006 | Total      | %           |                       | NIP 2002-2004    | NIP 2005-2006   | Total        | %           |
| <b>Programme Aid</b>                                     |               |               |            |             |                       |                  |                 |              |             |
|  |               |               |            |             |                       |                  | <i>underway</i> |              |             |
| <b>Social Sectors</b>                                    | <b>55</b>     | <b>50</b>     | <b>105</b> | <b>49%</b>  |                       | <b>55</b>        | <b>20</b>       | <b>75</b>    | <b>30%</b>  |
| <i>Health</i>  | 35            | -             | 35         |             | -                     | 35               | -               | 35,0         |             |
| <i>Education</i>   | 20            | 50            | 70         |             | -                     | 20               | 20              | 40,0         |             |
| <b>Good Governance</b>                                   | <b>15</b>     | <b>22</b>     | <b>37</b>  | <b>17%</b>  | <b>14</b>             | <b>17</b>        | <b>22</b>       | <b>53</b>    | <b>22%</b>  |
| <i>Partnership for Good Governance/AGO</i>               |               |               |            |             | 14                    |                  |                 | 14           |             |
| - <i>Reform of Judiciary</i>                             | 10            | -             | 10         |             | -                     | 10               | -               | 10           |             |
| - <i>Support for Local Democracy (Electoral Process)</i> | 5             | -             | 5          |             | -                     | 7                | -               | 7            |             |
| - <i>Strengthening the Rule of Law and Security</i>      | -             | 12            | 12         |             | -                     | -                | 12              | 12           |             |
| - <i>Support to Public Finance Management</i>            | -             | 10            | 10         |             | -                     | -                | 10              | 10           |             |
| <b>Sustainable Management of Natural Resources</b>       | <b>56</b>     | <b>0</b>      | <b>56</b>  | <b>26%</b>  | <b>16,6</b>           | <b>42</b>        | <b>0</b>        | <b>58,6</b>  | <b>24%</b>  |
| <b>Natural Resource Management Forestry</b>              | 41            | -             | 41         |             | 16,6                  | 32               | -               | 48,6         |             |
| - <i>East Kalimantan Natural Resource Management</i>     | 15            | -             | 15         |             | -                     | 17               | -               | 17           |             |
| - <i>Directorate of Forest Fire Controll</i>             | 1             | -             | 1          |             | -                     | -                | -               | -            |             |
| - <i>Biodiversity - now FLEGT</i>                        | 15            | -             | 15         |             | -                     | 15               | -               | 15           |             |
| - <i>Social Community Forestry</i>                       | 10            | -             | 10         |             | -                     | -                | -               | -            |             |
| <b>Natural Resources Management Water</b>                | 10            | -             | 10         |             | -                     | 10               | -               | 10,0         |             |
| <b>Ad-hoc Facility for Sust. Man. NRM</b>                | 5             | -             | 5          |             | -                     | -                | -               | -            |             |
| <b>Economic Cooperation</b>                              | <b>18</b>     | <b>0</b>      | <b>18</b>  | <b>8%</b>   | <b>0</b>              | <b>18</b>        | <b>0</b>        | <b>18,0</b>  | <b>7%</b>   |
| <b>Technical cooperation for trade and investment</b>    | 12            | -             | 12         |             | -                     | 12               | -               | 12           |             |
| - <i>Trade Support Programme</i>                         | -             | -             | -          |             | -                     | 8,5              | -               | 8,5          |             |
| - <i>Customs Programme</i>                               | -             | -             | -          |             | -                     | 3,5              | -               | 3,5          |             |
| <b>Economic Cooperation Small Project Facility</b>       | 6             | -             | 6          |             | -                     | 6                | -               | 6            |             |
| <b>Total Programmable Aid</b>                            | <b>144</b>    | <b>72</b>     | <b>216</b> | <b>100%</b> | <b>31</b>             | <b>132</b>       | <b>42</b>       | <b>204,6</b> | <b>83%</b>  |
| <b>Thematic Budget Line</b>                              |               |               |            |             |                       |                  |                 |              |             |
| European Initiative for Dem.& Human Rights - IND         | N/A           | N/A           | N/A        |             | 1,6                   | -                | -               | 1,6          |             |
| European Initiative for Dem.& Human Rights - REG         | N/A           | N/A           | N/A        |             | 5,3                   | -                | -               | 5,3          |             |
| NGO Co-financing   | N/A           | N/A           | N/A        |             | 4,5                   | -                | -               | 4,5          |             |
| Aid to Uprooted People                                   | N/A           | N/A           | N/A        |             | 15,7                  | -                | 4               | 19,7         |             |
| Tropical Forest  | N/A           | N/A           | N/A        |             | 10,3                  | -                | -               | 10,3         |             |
| <b>Total Thematic Budget Line</b>                        |               |               |            |             | <b>37,4</b>           | <b>0</b>         | <b>4</b>        | <b>41,4</b>  | <b>17%</b>  |
| <b>GRAND TOTAL</b>                                       | <b>144</b>    | <b>72</b>     | <b>216</b> | <b>100%</b> | <b>68</b>             | <b>132</b>       | <b>46</b>       | <b>246,0</b> | <b>100%</b> |

## 7.4. Annex 4: Country Environmental Profile - Summary

### 1/ State of the environment:

Environmental degradation is on the rise in Indonesia. The main reasons include the rapid development of the population (from 147 million in 1980 up to approximately 215 million in 2005), rapid industrialization (real GDP increased an average of 3.3% per year between 1980 and 2001), the Asian financial crisis, and the poor management of key sectors such as natural resources or urban transport. Issues of poor governance exacerbate these problems.

The extent of damage to the environment in Indonesia is considerable, and the following issues have been identified as the main challenges facing Indonesia's environment:

- Issues of governance;
- Air pollution and atmosphere damage;
- Water pollution and water requirements;
- Coastal and marine damage and pollution; and
- Biodiversity degradation;

Air pollution has become a major environmental issue in Indonesia with air quality in the large urban centres (such as Jakarta, Surabaya, Semarang, Bandung and Medan) being the worst affected. Monitoring results for particulate matter (SO<sub>2</sub>, No<sub>x</sub>, CO, HC and Pb) is well above internationally recognised acceptable levels.

The transportation sector contributes the most to air pollution with an estimated 80% of air pollution caused by motor vehicle emissions with the remaining 20% contributed by other sources such as industry, forest fires and domestic activities.

Smoke from forest fires is a major contributor to air pollution on a local, national and regional scale.

Groundwater resources are currently exploited by industry and the service sectors particularly in areas such as Jakarta, Bandung, Samarang, Mojokerto and Denpasar where there is concern that the groundwater resources are being exploited in an unsustainable manner. Monitoring has indicated that the industrial exploitation of groundwater resources in Jakarta has resulted in seawater intrusion into the aquifers. Additionally the lack of wastewater treatment has led to contamination of aquifers in the Jakarta region.

Waste is predominantly disposed of directly to the receiving environment and river monitoring results in Indonesia have shown that even during the increased flows of the wet season there is no reduction in the levels of pollution in the rivers despite the increased flows and therefore dilution of pollutants.

The agriculture sector is a significant water polluter especially with Persistent Organic Pollutants (POPs). Despite a ban on the use of DDT monitoring results throughout Indonesia show that DDT is still present in many of the surface water bodies.

Unsustainable development in the coastal regions such as the reclamation of low lying coastline north of Jakarta and elsewhere for housing and industrial developments has led to destruction of coastal and marine resources and can lead to further degradation of the resources from pollution.

Indonesian forests and oceans are the home to several charismatic species in danger of extinction such as the rhinoceros, orang utans, tigers, elephants and turtles and the country is one of the ten “megadiversity” centres, so called for their exceptionally rich biodiversity.

Indonesia’s forests cover two-thirds of the country’s land area (approximately 120 million ha). Over the last 50 years, Indonesia has lost over 40% of its forest cover. Despite growing concern about the environmental, social and economic consequences of widespread tropical deforestation, the rate of forest loss has been accelerating. The forest ecosystem is threatened by logging, fire and agricultural clearance that results in total loss of the resource or fragmentation into forest islands.

Indonesia’s coastal waters are internationally recognised hotspots of marine biodiversity. The marine ecosystems and their functions are threatened by unsustainable coastal and economic development as well as destructive fishing practices and illegal, unauthorised and unregulated (IUU) fishing.

Indonesia has developed the Indonesia Biodiversity Strategy and Action Plan (IBSAP) which will guide the implementation of the national biodiversity programme through to 2020.

Indonesia recognises the need for public participation in the successful protection of biodiversity. Bioforum is a network of non-governmental organisations with a network covering the whole of Indonesia that endeavours to ensure the interests of traditional society and local communities in decision making linked to biodiversity.

The use of non-renewable sources of energy is the norm in Indonesia. The Ministry of the Environment recognise the potential of renewable energy sources such as bio-energy sources, hydro-electricity, geo-thermal power, solar and wind energy.

The Indonesian population has more than doubled since 1970 to over 215 million people and is estimated to grow to 262 million by 2020. The average waste production in 1995 was 800g/person/day and this is expected to rise to 910g/person/day by 2020 (Min of Env. 2004). There are inadequate sites for the proper disposal of this waste and there is little waste management undertaken.

The rapid increase in population particularly in urban areas has created a wastewater disposal problem. The density of population does not allow for the construction of even the most basic waste water treatment facilities and what facilities do exist are below standard or simply stretched beyond their design capacity. The total quantity of wastewater dumped directly into waterbodies in Jakarta alone is estimated to be over 1 316 000m<sup>3</sup>/day.

Historic use of Persistent Organic Pollutants (POPs) in Indonesia has led to a legacy of contaminated land particularly from POPs such as DDT and PCBs. Indonesia is a

signatory to the Rotterdam Convention concerning the import and export of hazardous and toxic materials and the Stockholm Convention on the eradication of POPs. As such ten POPs including DDT and PCBs are now banned in Indonesia and are not legally sold although some may be found in home made products.

Illegal gold mining is a significant polluter of the environment as it discharges considerable quantities of mercury from the gold acquisition process. Other illegal mining activities particularly coal mining are responsible for loss of forest land with the resultant loss of habitat, species, genetic diversity, and environmental protection.

Large scale mining concessions within conservation land have long been a contentious issue within Indonesia and one that involves not only central and local government but also a number of Ministries, Agencies, NGOS, and local communities. As such, it has become a national concern to which there is no clear answer.

In Indonesia land slides are caused by over- or inappropriate development in areas prone to instability. This development can be in the form of either forest clearance or the development of human habitation. In 2003 178 people were killed, 3292 houses badly damaged or destroyed, 120 ha of agricultural land lost, and 245 km of road destroyed in landslides.

Floods are becoming more common in Indonesia and are predominantly caused by inappropriate development in the upstream and midstream areas of river basins. Excessive logging and land clearance, as well as stockpiling of logs and crowded human habitation along river banks all have the potential to cause floods.

## **2/ Environmental policies and institutions:**

Indonesia has experienced thorough political and administrative changes over the past decade, beginning with the fall of the New Order Regime under President Suharto. During the same period, direct elections have been introduced for presidents, provincial governors and heads of districts. Decentralisation in early 2002 has transferred substantial powers from the central government to the districts.

Customary law, or *adat*, continues to pose a challenge in Indonesian legislation, especially when it comes to traditional claims of tenure or user rights. In all cases national legislation supersedes adat but local regulations are to a large extent built directly on local adat and associated user rights.

Indonesia issues periodic 5-year development plans within which strategic plans for the environment should be established. The first such strategic plan for the environment was issued for the period 1995-1999. No such plan was issued for the 1999-2003 period for internal reasons and the 2004-2009 is presently (2005) being finalised and launched at provincial and district level.

As a result of dialogues with and within the Consultative Group on Indonesia and the Donor Forestry Forum, five priority areas for forestry development have been identified: 1) Fighting Illegal Logging; 2) Controlling Forest Fire; 3) Restructuring the Forestry

Sector; 4) Rehabilitation and Conservation of Forest Resources; and 5) Decentralisation of the Forestry Sector.

A development plan for marine resources to be implemented in 2004 identifies areas that require urgent action in order to manage the resources sustainably. A number of these recommendations have a direct bearing on the management of Indonesian fisheries including Development of fish catch management strategies; Development of fish cultivation management strategies; Supervision of fishery resources; Research into fishery resources; Internal control; and Administrative support.

The national energy policy is focused on the utilisation of non-renewable energy efficiently, effectively and productively whilst encouraging the use of renewable energy and new technology that helps reduce the demand for energy.

One program for environmental management of industries that enjoys increasing support is the Industrial Performance Rating Program (PROPER) under the Ministry of Environment, which rates individual industries and businesses into 5 categories (Gold, Green, Blue, Red and Black) according to their efforts in pollution control.

Indonesian legislation within the environmental and natural resources management fields is extensive and detailed but lacks common vision and established policies. The legislative framework is often incoherent, overlapping and contradictory. These problems have been exacerbated by the incoherent interpretation and subsequent implementation of decentralised authority, with provinces and districts issuing regulations, which at times directly contradict central national legislation, or the regulations issued by the national government.

The Ministry of Environment has established national guidelines and standards for environmental impact assessments. However, the implementation of environmental impact assessments are under the jurisdiction of the provincial and district agencies for environmental impact assessments (Bappedalda), which are directly responsible to the governors and district heads only.

Protection of biodiversity or of geographical areas, e.g. establishment of national parks, sanctuaries and other conservation areas, are all under the jurisdiction of the Ministry of Forestry's Directorate General of Forest Protection. Traditionally, this has not posed any problems as most conservation areas have been within lands classified as 'forest land'. With the increased attention paid to marine issues and transboundary cooperation, this exclusive set-up may not be optimal for the future.

Presently (2004) 21,510,452 ha or 11.7% of the Republic's land area have been declared protected areas, either as national parks, nature reserves, wildlife reserves, nature recreational parks, grand forest parks and game reserves. This is to compare with the UNEP's global goal of 10 %. An additional 4,734,564 ha (2004) have been declared marine parks.

Limited access to land and natural resources continue to pose a threat to the development of rural communities. Overlapping licenses are issued by un-related government authorities and the cadastral records are not centralised. In other words, there are often no clear boundaries around forestry or mining concessions and traditional land use patterns

are interrupted causing a decline of livelihoods. With a lack of effective government support to solve these issues, the concessions normally revert to making either payments to the affected communities or, increasingly, make arrangements for joint management in the areas of conflicting claims.

Indonesia has been through a very rapid period of governmental decentralisation .

The new focus for governmental power is the district (Kabupaten), which is responsible for environmental management and most land related issues. Each district head makes his own institutional set-up but some restrictions are now being enforced on the number of district agencies permitted. Some agencies will therefore have to be merged at district level. The agencies report directly to the head of the district and are therefore not in a direct hierarchical relationship with similar institutions at province or central level. This can create difficulties in coherent implementation of environmental legislation.

The provinces have lost much of their earlier responsibilities. However, they are still responsible for environmental issues that involve more than one district. As in the districts, provincial institutions are responsible to the provincial governor and are not directly in a line of command with the central ministries.

As a result of the decentralisation, there are now three major levels of public administration: 1) The national level with ministries and departments; 2) provincial level headed by a governor, who is supported by provincial agencies; and 3) District agencies, which refer to the district head. These three levels are not in a hierarchical linear relationship.

The Ministry of Environment is a coordinating ministry, i.e. it has no department and thus no direct responsibility for implementation. It is responsible for general environmental legislation, which provides guidance and national minimum standards. Other ministries, such as Forestry, Agriculture, Fisheries are each responsible for sector environmental legislation, based on the general environmental legislation. The associated ministerial departments are responsible for implementation of the national legislation but constrained by very strict limits. Outside these limits, the national legislation represents guidance and minimum standards for provincial and district regulations. This leaves most implementation and subsequent monitoring to the provincial and district agencies. As a principle, issues contained within one single district are under the jurisdiction of that district. Issues covering more than one district but which are within one province are dealt with at provincial level while issues crossing provincial borders are the responsibility of the central departments.

There has been a proliferation of NGOs in Indonesia, for some of which the label of 'NGO' may be questionable as these basically act as consulting firms profiting from the Western donors' policies of involving NGOs in the implementation of projects. In order to counter this image some NGOs have established independent consulting companies.

The Ministry of Environment has identified twelve themes to be monitored (Air, Water, etc.) through a system where the districts and provinces should provide data to the Ministry's five regional offices who should compile the data before sending them to the central ministry for final, national compilation. As the data collection at district and

province level is at the discretion of district heads and governors, the system still lacks coherent implementation as well as accuracy and compatibility.

As a result of the low level of government law enforcement and the low respect within society for the honesty of government enforcers, there has been a growing movement towards formal as well as informal monitoring and reporting of environmental issues.

It is generally accepted that while the legal instruments are more than adequate for sustainable environmental management there is a serious weakness in both implementation and enforcement of the laws. Government Departments and agencies are in general responsible for the primary steps of law enforcement and prosecution. However, the inherited tradition of on-the-spot settlement of offences has given government agencies the reputation for being involved in extortion and corruption. This is exacerbated by the view that the authority to issue licences and permits is a opportunity to receive gifts of gratitude and that similar gifts may pave the way for a waiver of environmental requirements.

There is international focus on the Indonesian judiciary, which does not have a reputation of actually meting out justice according to the law. This has seriously hampered the creation of a healthy investment climate and does not safeguard environmental values as the perpetrators are normally in a position to swing justice their way with unofficial contributions deemed beneficent to members of the judiciary.

It is the expressed government policy to increasingly include the civil society in the political process, planning and in particular in the monitoring and reporting of environmental issues. In the rural areas, village councils are established and trained by donor projects and NGOs in environmental planning, management and reporting of environmental degradation caused by activities such as mining and forestry.

The Ministry of Environment has seen this as the basis of its real power and involves civil society in a variety of ways. The cash-strapped environmental administration of Jakarta has even come to the conclusion that through public participation it has access to an enormous wealth of free advisory services from the public as among the public there are several specialists willing to give advice as and when needed.

There is in both government services and in civil society an expressed optimism in this field and a sense that things are developing in the right direction.

Only 1.13% of the national budget was allocated to environmental institutions and activities for 2005. Of this allocation, only 13% is allocated directly to the Ministry of Environment, the remaining amount to environmental activities implemented by other institutions. While this may be seen as a lack of emphasis on the Ministry of Environment, it may equally be seen as a sign that environmental issues are seen as cross cutting issues that needs to be addressed by all sectors of the society.

Table 1: Development expenses for the Environmental sector, 1998-2004

| Sector                                     | 1998   | 1999   | 2000   | 2001   | 2002   | 2003   | 2004   |
|--|--------|--------|--------|--------|--------|--------|--------|
| Environment and Spatial Planning (Bil IDR) | 780    | 933    | 551    | 650    | 652    | 508    | 778    |
| National Budget (Bil IDR)                  | 71,600 | 61,740 | 41,600 | 33,360 | 52,290 | 61,140 | 70,870 |
| Environment and Spatial Planning (%)       | 1.09   | 1.51   | 1.32   | 1.95   | 1.25   | 0.83   | 1.10   |

Source: Ministry of Environment

### **3/ Conclusions and recommendations:**

At government level, resource security and sustainable utilisation becomes the main issue, turning the attention towards illegal mining, logging, fisheries into focus, lack of precise knowledge of the state of the resources or of the environment at local as well as at national level.

Most stakeholders have concluded that while there are some technical issues to be solved and certain areas, where technical training is highly desirable, most environmental issues should be seen as symptoms rather than the primary problem to be solved. The underlying cause for these environmental symptoms concern good governance issues and lack of an ethical attitude among stakeholders.

However, there is a clearly expressed optimism both within the government services as well as within the civil society that things are increasingly moving in the right direction. The uppermost levels of government are seen as sincere in its policies of combating the social ills, most people see as the root of environmental degradation in Indonesia. These views are supported by the donor community.

The role of trade incentives and global dialogue is increasingly acknowledged as a central tool for correcting bad environmental management practices. Market pressure, international esteem, foreign investment and partnerships etc. are all seen as important and even voluntary tools in this respect.

#### **Key recommendations:**

Recommended fields of support with particular environmental focus are:

- Governance and judicial reform to ensure environmental law enforcement
- Adult education and formation of attitudes and opinions
- Institutional integration and synchronization
- Enabling business environment
- Ensure that environment concerns are taken into account in trade and investment
- National level inventories and monitoring
- Integrated planning

No environmental issues are seen as clearly within one single technical or economic sector. It is therefore recommended all initiatives are cross sectoral, based on improved planning and policy making and includes issues of good governance. It is believed, that international exposure, dialogue and trade are essential to successful development. It is

further believed that addressing these issues will lead to increased focus on sound environmental management and should therefore be built into assistance where possible.

It is strongly recommended all environmental issues in future assistance to Indonesia be linked to economic development, poverty alleviation or similar major issues that form the basis for human prosperity and national progress.

Traditional project approach has so far not been successful in contributing to a balanced utilisation of the natural resources or a safeguarding of the environment at a national level. This issue should be better incorporated into future project design. Site specific projects may still be necessary, but sufficient time should be allocated to secure national impact.

In the wake of ongoing emergency assistance to Aceh there have been reports of a rapid assault on the resources within the Leuser eco-system. It is recommended, the EC takes a firm stand and presses for a continued protection of the eco-system, where a substantial amount of EC investment has been made.

It is also recommended, the EC maintains an advisory and supporting role directly with the private, commercial forestry sector using especially trade incentives, support to joint ventures and other forms of foreign investments as a tool in order to safeguard the investment and goodwill invested in the past decades through the Berau Forest Management Project and the South and Central Kalimantan Production Forest Project. It is, however, recommended utmost care is exercised in the selection of voluntary partners in all forestry related activities.

## **7.5. Annex 5: Economic Co-operation Actions under CSP 2002-2006**

The first intervention of the EC was the launch in March 2003 of the **Small Projects Facility** in Economic Co-operation (SPF). SPF was designed as a grant programme to promote EU-Indonesia economic co-operation (trade and investment) and support the economic reform process of Indonesia through an involvement of civil society. Indonesian and European business associations have been the priority targets of the programme. SPF is the response to the need to increase the dialogue between the EU and Indonesian business communities, an area of focus defined in the 2002-2006 CSP.

The mid-term review of the programme showed the success it had achieved in terms of number of projects funded (30 as of May 2005), amount of funds invested (4.1 million euro out of a 6.1 million budget), high visibility obtained among the Indonesian and European business communities, and overall management of the Facility. The emphasis of SPF for its remaining life is on building on the relationships created with key economic policy makers, strengthening monitoring of remaining projects and analysing the impact of projects completed.

The **EU-Indonesia Trade Support Programme** is a major trade related technical assistance intervention (8.5 million euro EC Contribution) that started activities in March 2005. This programme tackles technical barriers to trade broadly identified in the CSP (EU, standards, quality control of Indonesian technical laboratories in different sectors, including fisheries, WTO capacity building). The programme is the first one of its kind in Indonesia which applies the decentralized management approach, where responsibility for implementation lies with the Executing Authority, in this case the Ministry of Trade. Internal debate about the definition of the exact conditions for the application of this approach has resulted in a delay in the launching of the programme.

The **EU-Indonesia Customs Improvement Project** also addresses a topic reflected in the CSP: support for the Indonesian customs administration in particular in its capacity to raise tax revenue and facilitate international trade. Technical assistance will be provided in the areas of post-clearance auditing, risk analysis, customs intelligence, anti-corruption measures and human resources development. The total EC contribution to the project is 3.5 million euro, and activities are expected to start in October 2005. This EC intervention is integrated into the overall World Bank-assisted programme to improve Indonesian public finance management (GFMRAP)

Support to improvement of investment conditions was an additional activity suggested in the previous CSP. Continuous uncertainty about the investment regulation and lack of clarity between central and local responsibilities has prevented the EC to address the specific issue of investment licensing. The NIP 2004-2006 redefined this priority by allocating 10 million euro to the support of public finance management, through partnering with the World Bank. The joint effort will support improvements in macro-economic stability (budget and treasury management), customs and tax administration, all areas consistently mentioned as critical for the improvement of investment climate. The implementation is based on the mechanism of a Trust Fund set up with the World Bank, and the expectation is that it will be set up by the end of 2005.

To the extent possible, the actions implemented have been co-ordinated with other donors. This is particularly the case in the area of public finance management and customs, where an important partnership has been developed with the World Bank and IMF. In the case of bilateral technical assistance, there has been continuous communication with EU member states in order to ensure co-ordination of activities, mainly through regular monthly meetings at economic and development counsellor level. However, due to the bilateral nature of the assistance it has been more difficult to monitor similar co-operation actions conducted by non-EU countries. Clearly, the government maintains a parallel dialogue with many donors, and this may result in duplication of assistance. The delay in the launch of the Trade Support Programme has not helped in this respect. More co-ordination with other donors has also been recommended for the Small Projects Facility, especially for the improvement of the knowledge about the local economic and business context, and about the capacity of potential applicants from the business community.

In terms of activities of other donors, Annex 9 provides a detailed picture. Co-operation in the field of Public Finance Management has been led mainly by the multilateral donors, especially WB and IMF at the central level and ADB at the regional level. The EC is the most important bilateral player in this area. Through the Trade Support Programme and the Customs Project, the EC is also the lead donor in the field of Trade Facilitation assistance, while Australia and Japan are also active in trade negotiation training. The support to SME development, including the improvement of export skills, is well covered by multilateral donors (IFC), Japan, USA, and Germany through its agency GTZ. The EC does not play an important role here, and a further involvement beyond the Small Projects Facility, is not recommended. Specific support to investment climate improvement, despite its importance, has not really been an area of focus of donors in the past, probably due to the uncertainty surrounding this subject. The Netherlands, through a Trust Fund with the WB for the value of 2.5 million euro, and most recently Japan and USAID are the most important players.

## 7.6. Annex 6: Good Governance actions under CSP 2002-2006

While not strictly covered by the CSP, a small but significant short-term TA project **“Institutional Support to the Office of the Attorney General”** (€ 775,000) was implemented in 2004/5. Its **overall objective** was to support the Attorney General’s Office (AGO) to develop a long-term strategy for developing prosecutors’ skills and formal qualifications in the investigation and prosecution of financial crime. More specifically it provided technical training to enhance the capacity of the AGO to investigate and prosecute of financial crime including fraud and money-laundering. While assistance provided was immediately relevant, it exposed the problem of pioneering innovative training approaches in an institution not yet fully subject to comprehensive reform. The ADB audit of the Public Prosecution Service (AGO) of 2001 remains as yet, unimplemented. As soon as a viable reform plan for the AGO is presented, it would be important for the EC to extend assistance in the context of improving the effectiveness of this central law enforcement agency and enhancing public governance in general.

A €7 million programme of **assistance to the 2004 elections** was provided through a UNDP-led Election Trust Fund. Specific support was provided to the management of the electoral process through enhancing the capacity of the National Election Commission (KPU), to enhance voter information and awareness through targeted civil society based actions as well as to build election administration and civil society capacity to monitor and report on election results. While the programme proved very effective in training KPU staff , poll-workers and election monitors, the level of assistance allocated to the NGO-led voter information and education campaign could have been less and more effectively deployed to support KPU capacity building and general EU visibility.

The EC is currently providing €13.3 million to the UNDP-led **Partnership for Governance Reform** programme. This project started in 2002 and will be implemented over a period of 4 years. The Partnership is a co-operation initiative between the Indonesian government, CSOs, the private sector and Indonesia's international development partners to facilitate and support governance reform. It aims to develop programmes and support projects in the areas of (1) anti-corruption, (2) decentralisation and regional autonomy, (3) legal and judicial reform, (4) security/police reform, (5) electoral and legislative reform, and (6) civil service reform. The project is highly relevant within the current context of political and social reform in Indonesia and of the CSP 2002/6. Projects supported under its auspices have succeeded in articulating new approaches to enhancing local democratic accountability, prioritizing gender in governance, particularly in the context of the 2004 elections and supporting the public fight against corruption.. While the Partnership is very well embedded in local institutional structures, CSOs/ NGOs and contributes to capacity building and governance reform, it remains to be seen whether the EC assistance provided will be sustainable in terms of creating a context favourable to ongoing reform within and between Government Ministries, agencies, public bodies and civil society .Its establishment as a legal entity as well improved technical and managerial capacities will assist it in carrying out its role as an independent donor and reform advocacy organization.

A more recent project on **Good Governance in the Indonesian Judiciary** (€10 million) will be implemented over 3 years from 2005. Its overall objective is to support good governance and democratisation by strengthening the institutional capacity of the judiciary in Indonesia.It will specifically focus on education and training of candidate and serving judges, improving case management as well as public access to justice and provision of legal aid particularly to

women and the poor. It will be challenge to coordinate this major project as it brings together different elements and actors of the judicial system as it undergoes reform. In response to a specific request by the Government of Indonesia, a €12 million project in the area of **Law and Security** will be launched by early 2006. This project will focus on supporting the National Plan of Action for Corruption Eradication, the National Plan of Action for Human Rights (RanHam) as well as providing technical assistance to JCLEC in the context of the fight against serious international crime. This project will require enhanced coordination to be provided by an effective international organization as it aims to deliver tailor-made assistance to the KPK, the National Police and JCLEC, in line with the Government's immediate priorities in this area. While election support proved very successful, assistance to law enforcement agencies needs to take better account of the pace and context of reform within individual institutions as well as their interaction with civil society. An evaluation of EC assistance on governance took place in June 2005 and its recommendations will be incorporated into the design of all future actions.

### **Other donors assistance**

AusAID has provided significant support and developed effective cooperation between the Supreme Court and the Australian judiciary while Japan provided infrastructural support and additional technical assistance. The Partnership for Governance Reform in its own right, has also supported assistance to both the Supreme and Anti-Corruption Courts as well as facilitating donor coordination and contact with government departments and agencies. USAID is supporting the development of economic and commercial law while the IMF and the Netherlands have promoted judicial reform in particular the Blueprint for Supreme Court Reform. In turn, ADB and the World Bank support governance and legal reforms in decentralization, water resource and, electric power management as well as in finance. In 2004, the ADB implemented a TA programme to strengthen the administration and case load management of the Supreme Court which will be fully complimentary to EC support..

Given the intensity of donor activities and the multiplicity of complementary interventions, the issue of donor coordination will be critical for future EC assistance. Indonesia's development partners co-ordinate their support for judicial reform and law enforcement through the Partnership as well as through a working group on legal and judicial reform within the framework of the Consultative Group on Indonesia (CGI) process.

## 7.7. Annex 7: Actions in education and health under CSP 2002-2006

In the **education sector**, the preparation of EC assistance has been characterised by an emphasis on donor coordination and collaboration from the outset, and programming has been complementary to the efforts of other donors. This approach was underpinned by the 2003 *Education Sector Review* (ESR), a joint effort between the government and the donor community in Indonesia. It reflects on, and contributes to, the on-going discussions within the country about how the decentralisation reform can be shaped and managed as it applies to the education sector. The review focused on several critical issues that relate to themes chosen in part because they correspond to the principal roles that governments generally play—as regulator, manager, and provider; as standard-setter and monitor; as employer; and as founder. The Review's *four themes of governance and management, finance and spending, standards and school quality, and teacher management and performance* are discussed in the context of understanding the new roles of the different levels of government and of local communities in the delivery of education services.

Building on the ESR, under the **NIP 2002-2004**, the €20 million BE-SCSP programme starting in 2005 provides the preparatory stage for a Sector-wide Approach (SWAP), building on the relatively advanced state of developments between donors and MONE, the importance placed on education by the new government and the steps taken already to develop a sector financial framework along with other key policy documents. BE-SCSP will address education management capacity issues from school to national level, and will seek to improve service delivery in line with GoI Minimum Service Standards (MSS) based on:

- § Strategic reforms and capacity which contribute to a more equitable, cost-efficient and quality-driven decentralized education system, and
- § Improved district and provincial plans and budgets for basic education which emulate good practice and help fulfill MSS.

This will pave the way for a sector approach from 2007 onwards. Measures taken within this programme to achieve this will include:

- § Establishment of a Policy Dialogue Board which will engage MONE and donors starting in April 2005.
- § Production of a series of papers to inform education strategy development and functional realignment within MONE, in August-September 2005, including (a) Discussion of performance review processes based on Minimum Service Standards, (b) Focus on education partnership development processes, (c) Knowledge and information management strategy papers.
- § Production of a feasibility study by December 2005, with participation from an inter-ministerial team and key donors. This will then lead to the production of a 'Road Map' for a SWAP.

Under the **NIP 2005/06**, the planned €50 million sector programme has been scaled down to €20 million in order to provide rapid funding for reconstruction activities in the tsunami-affected province of Aceh. Thus, it has been agreed with the GOI to phase in additional funding for sectoral support in education under the NIP 2007-2010 to compensate for this. In addition, the GOI/MONE sector blueprint or policy on education, initially planned for September 2004, had to be revised for a new parliamentary approval in summer 2005, following the change in government in November 2004.

While it is too early to draw detailed lessons from these projects, it is already clear that the education sector, with the basic education sub-sector in a lead role, offers the best prospects for developing a SWAP that would present the best alternative to traditional project approaches or implementation through multilateral agencies, thus enhancing impact, direct EC-GOI policy dialogue, visibility, and also delivery time and responsiveness.

In the **health sector**, EC interventions before the CSP 2002-2006 had been limited to alleviate the effect of the socio-economic crisis (1997-98) through **contraceptive supplies** (15 MEUR) and a small TA project '**Social Health Insurance Policy Development**' (500,000 EUR). The SHI project contributed to the development of a draft bill on social security. The bill was approved by the DPR and signed into law in October 2004. The CSP 2002-06 emphasised the role of support to basic health services as part of good governance, and as a result the project '**Support to Community Health Services**' (€35 million) started in 2003 and will be implemented over a period of 54 months. The **Overall objective** is to improve population health and nutrition status particularly in relation to the socially deprived and those living in poverty, through community health system development at the district and sub-district levels.

However, the traditional, but in this case very ambitious, PMU-based, project design, and other challenges have led to delays in implementation. Problems have been exacerbated following the big-bang decentralisation in force since 2001. Numerous districts, many of them recently established, are not up to the tasks that come with their newly acquired responsibility and lack the capacity that is needed to organise and manage health services, particularly in outer provinces. The CHS project may have to be redesigned to take full advantage of working at district level, within the context of decentralisation and in line with a 'sector approach' at district level. Unless these elements will come into place on a national level, further interventions in the sector would not offer the desired impact, and should thus be put on a back-burner for the new NIP.

Health is further supported through thematic budget lines, such as **Reproductive and Sexual Health and Rights in Developing Countries** and **Poverty-Related Diseases**.

As regards in particular HIV/AIDS, the EC Delegation, on behalf of the EU, is a member of the **Global Fund For HIV/AIDS, TB and Malaria's (GFATM) Country Co-ordination Mechanism (CCM)** in Indonesia. The European Commission is a major donor to the Global Fund, which provides around €150 million in funding to Indonesia (with over €30 million allocated to HIV/AIDS).

## 7.8. Annex 8: Actions in environment under CSP 2002-2006

The EC has been a major supporter of joint efforts with the Government of Indonesia to support environmental issues principally in the forestry and water sectors. These efforts have started before the CSP 2002-2006, which has mainly continued, but also partly modified, the approach to assistance in this area.

Through the **EC-Indonesia Forest Programme (ECIFP)**, a series of projects totalling some **€150 million** over the past 10 years have helped strengthen the capacity of the Ministry of Forestry and provincial Forestry Departments in the following areas:

- Biodiversity conservation in Aceh and North Sumatra
- Sustainable forest management in East, Central and South Kalimantan
- Forest fire prevention and management, in South Sumatra
- Policy dialogue and co-ordination at the national level.

In addition, in the water sector, the EC has supported irrigation developments and river basin management including upper watershed conservation in Sumatra and Java.

Efforts by the EC and Government of Indonesia to improve **sustainable forest management** have been hindered by the continued **illegal logging** and associated trade on both domestic and external levels. Illegal logging does not just impact on sustainable forest management but has a direct effect on protected areas and more widely by degrading the forest resource and undermining the livelihoods of those who depend on the forest. A review of the ECIFP and other recently closed projects such as Leuser Development programme, Berau Forest Management Project and the South and Central Kalimantan Production forest Project, all confirm the negative effects of illegal logging on sustainable forest management.<sup>40</sup>

In addition, **past activities have focused on area-based projects working in specific projects**, drawing heavily on European technical assistance, and in partnership with a single government department (usually the Ministry of Forestry). This project model presents a risk of marginalisation. The Ministry of Forestry isolates donors in particular provinces, the focus on technical assistance renders the projects quickly irrelevant in a fast-moving political environment, and the reliance on a single project partner prevents the diffusion of impacts into the wider political process.

As a consequence of this, the EC and Government of Indonesia have responded by developing the **EC-Indonesia FLEGT Support Project** (€15 million) under the NIP 2002-2004 to be implemented from 2005-2009. This initiative will focus on law enforcement, governance and trade issues to put in place the conditions that will allow for sustainable forest management over the medium to longer term.

This project is part of a broader approach by the EC (EU FLEGT Action Plan) and other donors to acknowledge the demand side of the problem of illegal logging. The action plan aims to address the corruption which drives illegal logging, and the associated trade. The action plan will be implemented through voluntary partnership agreements with badly affected countries. The partnership agreements will embrace development co-operation for governance reform on the one hand, and measures to control the trade in illegal timber on the

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<sup>40</sup> Review of EC-Indonesia Forest Programme 2004, Provides review of several projects and lessons-learned as a basis for future interventions.

other hand. Indonesia is a key country in the context of the FLEGT action plan, and has repeatedly indicated a desire to enter into a voluntary partnership agreement with the EU. It is intended that Indonesia will be amongst the first countries to sign a partnership agreement.

On the civil society side, the **Tropical Forests Budget Line** has become a very effective instrument with currently **seven projects** for **€10.5 million** active in Indonesia.

## **7.9. Annex 9: Projects under horizontal and regional budget lines**

### **1/ Horizontal and Thematic budget lines operational in Indonesia:**

***Aid to Uprooted people in Asian countries:*** the “Aid to uprooted people” budget line has supported economic and social recovery in Maluku, North Maluku, Central Sulawesi, West Timor (14 projects for 21 million euro) à *these projects have significantly contributed to stability in West Timor through continued support since 2001 to the East Timorese former refugees ( through UNHCR for 9 million euro in total)*

***Co-financing with European NGOs, operations in developing countries:*** 5 projects in specific support to NGO’s in development look at economic empowerment, health and gender issues at community level in poor regions, for EUR 4.3 million.

***Environment in the developing countries and tropical forests:*** the Tropical Forest budget line addresses various complementary forestry issues such as illegal logging, certification, governance, and community forestry and funds 7 projects for a total 13.2 million euro. Indonesia also benefits from 6 regional/global projects. à *support is provided to sometimes very marginalized parts of the country often overlooked such as the poorer parts of Bali, Kalimantan and the remote Tanimbar Islands.*

***European Initiative for Democracy and Human rights:*** the European Initiative for Democracy and Human Rights is providing support for 8 million euro (18 micro-projects for 2.2 million euro and 8 macro- projects for 6.5 million euro). à *support to many local initiatives through small grants which although very labour intensive really supports local capacity*

***Aid for poverty-related diseases (HIV/AIDS, malaria and tuberculosis) in developing countries and Reproductive health:*** a) reproductive health and b) poverty related diseases (2 projects) and c) the Global Fund for HIV/AIDS, TB and Malaria (4 projects); à *health is also a priority for international scientific research cooperation under the 6<sup>th</sup> Framework Programme DG RTD and Indonesia benefits from 2 such projects*

***Humanitarian and disaster preparedness (ECHO, DIPECHO):*** Humanitarian and disaster preparedness: ECHO and DIPECHO programmes à *specific needs are nutrition, food security and disaster risk reduction.*

### **2/ Regional projects and programmes:**

EU-Indonesia cooperation has also been complemented by a number of **regional initiatives at the Asia-wide and ASEAN level**. Indonesia has increased its participation in the Asia Wide Programmes such as **Asia Link** (15 projects in the period), **Asia Invest** (7 projects), **Asia Pro Eco** (3 projects), **Asia IT & C** (2 projects) and **Asia Urbs** (2 projects). These programmes have started to build visibility among the target audience (especially Asia Link, among the 10 most active Indonesian universities). However, relevant Indonesian civil organizations, with the exception of universities, have in general difficulties in establishing contacts with potential EU partners for these projects. The programmes also lack sufficient resources for dissemination and training of potential applicants.

As regards **research**, Indonesia has participated in the different **EC-ASEAN economic co-operation programmes**. Some of these programmes, particularly on standards, effectively complement the bilateral actions already being implemented. A number of regional programmes have been developed, to which Indonesia has been able to participate, in particular:

- § EC-ASEAN Standards and Quality Co-operation Programme
- § EC-ASEAN Intellectual Property Rights Co-operation Programme
- § EC-ASEAN Energy Facility Programme (EAEF)
- § ASEAN Programme for Regional Integration Support (APRIS)
- § ASEAN-EC University Network Programme (AUNP)
- § ASEAN Regional Centre for Biodiversity Conservation (ARCBC)

## 7.10. Annex 10: Donors matrix (2003 figures)

In thousand euro

| Donoar / Sector         | Monetary Policy | Rural Development | Energy    | Transport | Education | Health  | Water and Sanitation | Governance | Urban Development | Gender | Agriculture, Forestry, Environment | Decentralisation |
|-------------------------|-----------------|-------------------|-----------|-----------|-----------|---------|----------------------|------------|-------------------|--------|------------------------------------|------------------|
| <b>DAC CODE</b>         | 15010           | 920               | 230       | 210       | 110       | 120     | 140                  | 15040      | 430               | 420    | 310/410                            | 15040            |
| <b>Multilateral</b>     |                 |                   |           |           |           |         |                      |            |                   |        |                                    |                  |
| <b>IBRD / WB</b>        | -               | -                 | 141,000   | 641,500   | 534,400   | 296,900 | 70,000               | 146,300    | 74,000            | -      | 103,100                            | 604,500          |
| <b>ADB</b>              | 275,000         | 97,000            | 592,000   | 2,090     | 3,370     | 196,000 | 222,000              | -          | 160,000           | -      | 281,000                            | 36,000           |
| <b>UNDP</b>             | -               | -                 | -         | -         | -         | 6,706   | -                    | 16,695     | -                 | -      | 2,919                              | -                |
| <b>Bilateral EC+MS</b>  |                 |                   |           |           |           |         |                      |            |                   |        |                                    |                  |
| <b>Austria</b>          | -               | -                 | -         | -         | 282       | 1       | 8                    | 5          | -                 | -      | -                                  | -                |
| <b>Belgium</b>          | -               | 573               | 7,187     | -         | -         | -       | -                    | -          | -                 | -      | -                                  | -                |
| <b>Czech</b>            | -               | -                 | -         | -         | -         | -       | -                    | -          | -                 | -      | 62                                 | -                |
| <b>Denmark</b>          | -               | -                 | -         | -         | 35        | -       | -                    | 2,300      | -                 | 268    | 281                                | -                |
| <b>Finland</b>          | -               | 627               | -         | -         | -         | 23      | -                    | 268        | -                 | -      | -                                  | -                |
| <b>France</b>           | -               | -                 | -         | -         | 381       | -       | -                    | 131        | -                 | -      | 165                                | -                |
| <b>Germany</b>          | -               | -                 | 1,589     | 465,580   | 81,860    | 90,238  | 47,224               | 27,460     | -                 | -      | 41,147                             | -                |
| <b>Italy</b>            | -               | -                 | -         | -         | -         | -       | -                    | -          | -                 | -      | -                                  | -                |
| <b>Netherlands</b>      | -               | -                 | -         | -         | 108,456   | -       | 46,013               | 2,764      | -                 | 21,301 | -                                  | -                |
| <b>Spain</b>            | 5,774           | -                 | -         | -         | 63        | 247     | -                    | 20         | -                 | -      | 785                                | -                |
| <b>Sweden</b>           | -               | 678               | -         | 1,542     | -         | -       | -                    | -          | -                 | 171    | -                                  | -                |
| <b>United Kingdom</b>   | -               | 207               | -         | -         | -         | -       | -                    | 71,997     | -                 | -      | 36,089                             | -                |
| <b>EC</b>               | -               | 3,541             | -         | -         | 20,000    | 35,500  | 20,025               | 34,867     | -                 | -      | 82,048                             | -                |
| <b>Bilateral Others</b> |                 |                   |           |           |           |         |                      |            |                   |        |                                    |                  |
| <b>Australia</b>        | 3,000           | -                 | -         | -         | 166,000   | 74,000  | 18,000               | 50,000     | -                 | -      | 16,000                             | -                |
| <b>Canada</b>           | -               | 467               | -         | -         | 7,332     | 7,086   | 7,450                | 29,988     | -                 | -      | 4,819                              | -                |
| <b>JICA</b>             | -               | -                 | 2,320     | 4,410     | 13,000    | -       | 5,460                | -          | -                 | -      | 21,360                             | -                |
| <b>JBIC</b>             | 8,863           | 34,590            | 243,605   | 169,402   | 6,157     | -       | 102,032              | -          | -                 | -      | 2,822                              | -                |
| <b>USA</b>              | -               | -                 | 16,430    | -         | 103,491   | 23,770  | -                    | -          | -                 | -      | 4,270                              | 50,360           |
| <b>Total Loan</b>       | 283,863         | 131,590           | 976,605   | 812,992   | 543,927   | 492,900 | 394,032              | 146,300    | 234,000           | -      | 386,922                            | 640,500          |
| <b>Total Grant</b>      | 8,774           | 6,093             | 27,526    | 471,532   | 500,900   | 237,571 | 144,180              | 236,495    | -                 | 21,740 | 209,945                            | 50,360           |
| <b>T O T A L</b>        | 292,637         | 137,683           | 1,004,131 | 1,284,524 | 1,044,827 | 730,471 | 538,212              | 382,795    | 234,000           | 21,740 | 596,867                            | 690,860          |
| <b>%</b>                | 3.6             | 1.7               | 12.4      | 15.9      | 12.9      | 9.1     | 6.7                  | 4.7        | 2.9               | 0.3    | 7.4                                | 8.6              |

Source:

- 1 WB (Loan)
- 2 BAPPENAS (Loan projects)
- 3 UNDP (Grant)
- 4 EU Blue Book 2003
- 5 BAPPENAS (Grant projects)
- 6 CIDA (grant)

## 7.11. Country at a glance: Millennium Development Goals

The status of the country as to the likely achievement of the Millennium Development Goals at a glance

In October 2006, *United Nations Economic and Social Commission for Asia and the Pacific UNESCAP*, the *United Nations Development Programme UNDP* and the *Asian Development Bank ADP* have issued a report “Millennium Development Goals: Progress in Asia and the Pacific 2006”. This report is the latest update on the progress towards MDGs in Asia and the Pacific. It highlights the region's achievements and exposes issues on which much work remains to be done. The report looks in a more holistic way at overall country progress by assessing absolute MDG indicators in addition to MDG targets.

The report classifies the progress made by each country into 4 categories

- *Early achiever* — Has already met the target
- ▲ *On track* — Expected to hit the target by 2015
- *Off track – Slow* — Expected to hit the target, but after 2015
- ▼ *Off track – Regressing* — Slipping backwards, or stagnating

| Goal      | 1               | 2                    | 3                 | 4                | 6                       | 7              |                  |                 |                   |                  |                |                |                |              |                |                           |                     |             |             |                  |                  |
|-----------|-----------------|----------------------|-------------------|------------------|-------------------------|----------------|------------------|-----------------|-------------------|------------------|----------------|----------------|----------------|--------------|----------------|---------------------------|---------------------|-------------|-------------|------------------|------------------|
|           | \$1/day poverty | Underweight children | Primary enrolment | Reaching grade 5 | Primary completion rate | Gender primary | Gender secondary | Gender tertiary | Under-5 mortality | Infant mortality | HIV prevalence | TBC prevalence | TBC death rate | Forest cover | Protected area | CO <sub>2</sub> emissions | ODP/CFC consumption | Water urban | Water rural | Sanitation urban | Sanitation rural |
| Indonesia | ●               | ▼                    | ■                 | ▼                | ●                       | ●              | ●                | ▼               | ●                 | ●                | ▲              | ●              | ●              | ▼            | ●              | ▼                         | ●                   | ▼           | ■           | ■                | ■                |