
**PARTNERSHIP AGREEMENT
ON POVERTY REDUCTION**

between

GOVERNMENT OF INDONESIA

and

ASIAN DEVELOPMENT BANK

2 JULY 2001



Poverty Reduction Partnership Agreement (2001-2004) between Government of Indonesia and Asian Development Bank

I. Introduction

1. During the course of 2000 the Government of Indonesia (the Government) and the Asian Development Bank (ADB) worked together to develop a new Country Operational Strategy (COS) for Indonesia. The new COS places overriding emphasis on achieving the goal of poverty reduction. This goal has been a longstanding objective of both the Government and ADB, but has been given important new emphasis in the Government's PROPENAS or Law 25 Regarding the National Development Program 2000-2004 and in the ADB's Poverty Reduction Strategy adopted in November 1999.

2. Indonesia's record in reducing poverty in the two decades preceding the crisis has been exceptional. From a country with widespread poverty, it rose to the ranks of a middle-income country in two decades. According to the Central Bureau of Statistics, the incidence of poverty fell from 40 percent in 1976 to about 11 percent in February 1996. Indonesia's rapid economic growth thus proved to be effective in reducing poverty, although the crisis in 1997 revealed unsustainable elements in this pattern of development. The crisis in 1997 had an immediate impact on the poor and near poor. Although the sharp increase in the incidence of poverty has receded with the economic recovery, the surge in poverty during the crisis has left a large segment of the population in a vulnerable state.

3. There is, moreover, a wide dispersion of the incidence of poverty across regions. While the largest number of absolute poor live on Java, the incidence of the population below the poverty line is greater in the outer islands. Java has 7 percent of the land and 60 percent of the poor. Another 20 percent are in Sumatra, with the rest spread across the archipelago. While Jakarta has the lowest poverty incidence at 7 percent, Irian Jaya, Maluku, and East Nusa Tenggara are the poorest with the poverty incidence exceeding 35 percent.

4. Poverty is not just the lack of income. Poverty is a matter of a lack of access to basic social services, shelter, social protection, and basic security. In these broader aspects of poverty, Indonesia has also made significant progress. Yet clear challenges remain. The indicators of human development vary by region. They do not always coincide with the incidence of income poverty. There is a need for measures that specifically address the differential provision of public services across regions.

5. In Indonesia, as in many developing countries, open unemployment has always been low, since the poor cannot afford to remain unemployed. Taken as a whole the number of unemployed is large. Unemployment is not directly related to poverty as the highest levels of unemployment are among first-time labor market entrants and the educated. During the crisis, unemployment rose faster among these groups. Underemployment is significantly higher among the poor, especially in rural areas, and among workers in agriculture, and some service sectors. The resumption of growth and macroeconomic stability is key to absorbing school leavers, a source of social instability, into the labor force and promoting income generating opportunities for the poor.

6. Much is said about the relationship between poverty and the environment. It is perceived that the urban poor are more likely to live in environmentally degraded or polluted areas and, the rural poor, because of their poverty are sometimes forced to degrade or pollute the area in which they live. However little research is available on the links between poverty and the environment in Indonesia, and this issue would merit a closer view.

7. Significant advances for women in Indonesia were achieved during the last quarter century of development. Women live longer, are more educated, have more control over their reproductive functions, and have greater choices. However the development has not progressed equally in all areas. Maternal mortality is the highest in ASEAN and half of all pregnant women are anemic. Women are more likely to be in the informal labor market, more likely to be unpaid family workers, and young educated women are more likely to be unemployed than their male counterparts. Investment and productivity in agriculture and the informal sector where women tend to work has stagnated. Women have limited input into and influence over national development programs, policies, and laws. Consequently, women benefited less from the development that did take place and society did not achieve as much as it could have.

8. New forms of poverty are emerging as a result of social tensions and outbreaks of sectarian or political violence. A further complication arises when the victims of unrest attempt to relocate themselves elsewhere. This is a disruptive influence in the receiving area regardless of the goodwill or lack thereof of the inhabitants. Displaced persons and refugees are a new problem in Indonesia and there are many challenges to developing appropriate approaches to deal with this issue.

9. This Partnership Agreement sets out a long-term vision and agreed targets for poverty reduction. It also incorporates mechanisms to review performance and highlights key indicators and institutional milestones necessary to monitor progress. It is envisaged that in the future the allocation of ADB resources will be linked to the achievement of progress agreed upon under the Partnership Agreements with its borrowing member countries.

II. A New Partnership between the Government and ADB

10. The nature, composition and causes of poverty in Indonesia, and the measures that would be needed to address poverty in a comprehensive manner have been discussed with Government, civil society, NGOs, the private sector, and other donors at several forums. These include the High Level Forum organized and led by the Government - the key

stakeholder, in February 2000 at which NGOs and community-based organizations, the private sector, ADB and other donors also participated. During the development of the COS additional consultative meetings were held in 2000 with Civil Society on the directions and focus of the COS. Further discussions have been held with these stakeholders in 2001 including those in the context of developing the Poverty Partnership Agreement. A common agreement has been reached regarding the complexities of poverty and the need for a multi-faceted approach for sustainable reduction of poverty.

11. The Government and ADB have agreed that reducing poverty in Indonesia will need to be addressed in a considered manner. The PROPENAS states that poverty reduction is the Government's highest priority. It envisions (i) a conducive environment for promoting small scale economic activities; (ii) increased supply and improved quality of health and education services to raise productivity and capacities; (iii) the development of a social protection system; (iv) increased access for small business ventures, and support for agriculture and rural development; (v) implementation of decentralization and development of good governance enhances local government transparency, accountability to reflect local aspirations and needs; (vi) strengthening community organizations; and (vii) accelerating development in remote areas.

12. The Government's draft poverty reduction strategy paper tabled at the October 2000 Consultative Group Meeting in Tokyo identifies three pillars for poverty reduction: promoting economic opportunities, empowering the poor, and enhancing social security. In addition, the importance of wide participation and ownership of poverty reduction strategies is highlighted by the Government's establishment of a Agency under the responsibility of the Vice President comprising representatives of relevant ministries and government institutions, civil society groups, NGOs, and academe.

13. The strategic vision for the ADB's operations under this partnership is contained in the ADB COS which was developed based on the Poverty Assessment¹ and in consultation with the government and other donors. It is cognizant of the comparative advantage of ADB and other donors in the support of the poverty reduction thrust of the PROPENAS. ADB operations in Indonesia in the medium-term (2001-2004) will be geared to (i) improve the basic institutions that govern the lives of the poor at the national and local level; (ii) broad-based growth will be stimulated by nurturing competition for private sector led growth; (iii) pro-poor or inclusive growth also requires improvement in regional equity through balanced regional development; (iv) human and social development will be promoted through improved delivery of basic services and social protection; (v) sustainability will be promoted through strengthened environmental management. A summary of the COS strategy is provided in the Appendix.

14. The ADB recognizes three major facts faced by the Government in developing and implementing a poverty reduction strategy. First, the tremendous fiscal constraint facing the Government in the medium term due to, amongst other things, the public debt overhang underscores the need to mainstream poverty reduction through all of its operations to make the best use of existing resources. Second, wide participation of local government, civil society, and poor people is needed to build national ownership of stakeholders and, hence, ensure adoption and implementation. Finally, there exists large variation in the capacity and resources available to local governments for poverty reduction efforts. Targeted support of weaker local governments is required to prevent worsening of regional inequity.

¹ ADB Assessment of Poverty in Indonesia, October 2000

III. Implementing the Agreement

15. The Partnership Agreement between the Government and ADB endorses the analysis and focus of the Government vision and the ADB COS. Based on the inputs of government, civil society and donor institutions, the agreement formalizes a sustainable partnership setting out a long-term vision and agreed targets for poverty reduction. This vision provides for (i) inclusive growth and regional equity; (ii) human resource development enabling people to develop their capacities while protecting the vulnerable such as the young, the aged, and the infirm; (iii) developing a system of governance that is transparent and accountable and thereby; (iv) reducing poverty to minimum levels.

16. In the medium term, it is envisioned that poverty reduction development priorities would focus on three major areas of intervention: pro-poor growth, human resource development, and good governance. Pro-poor growth could be achieved by increasing the productivity of the poor through empowerment, the development of infrastructure especially in rural and remote areas, increasing access to financial and business services and providing a stable macroeconomic environment. Human resource development would be achieved by improving access and quality of basic services for the poor and in remote areas as well as expanding the system of social security. Good governance would be achieved by creating transparent and accountable decentralized institutions responsive to the needs of the poor.

17. To fulfill this vision the government will promote macroeconomic stability for inclusive growth and poverty reduction. The process of decentralization and institutional reforms will be assigned highest priority to achieve transparent and accountable institutions capable of supporting poverty reduction. To enable men and women to participate fully in the poverty reduction process, gender equity will be mainstreamed. To provide guidance for central and local government coordinated efforts, a Poverty Reduction Coordination Agency is being established. The Agency will coordinate the formulation of poverty reduction policies, plans, and delivery mechanisms at national and local level. It will be responsible for coordinating and guiding implementation of a poverty reduction program, and monitor and evaluate poverty reduction efforts. Poverty reduction interventions will take into consideration the trade-off between a focus on Java where the bulk of the poor are located and the need to reduce poverty in the rest of Indonesia. The government will stimulate expansion and improvement of the quality of key basic services such as health, education, water supply, and sanitation through public and private investment and expand a system for social protection that ensures the vulnerable are protected. To enhance the complementarity and synergy of resources from the international community, the Government will play an active role in coordinating both bilateral and multilateral assistance programs.

18. To facilitate monitoring of the implementation of this Partnership Agreement to achieve a long term vision of poverty reduction in Indonesia, some key indicators and targets have been selected. In the long run, these are:

- (i) A stable or declining Gini coefficient which will help ensure that the benefits to growth are pro-poor;
- (ii) Progress in human resource development which will be marked by achievement of the International Development Goals² related to human development;
- (iii) Good governance to be indicated by measures such as the adoption of best principles for procurement and audit standards and the involvement of professional groups, private sector, and the community in decision-making in the provision of public services.

The cumulative impact of these efforts should result in the achievement of the International Development Goal of a 50 percent decline in the level of absolute poverty over the 1990 base by 2015.

19. Progress towards the long term vision in the medium term will be measured through achievement of targets set out in the PROPENAS (2001-2004). These are:

- (i) Pro-poor growth will be indicated achieving 6 percent GDP growth with increasing real wages for unskilled workers³;
- (ii) Achieving a gross enrollment rate of junior secondary education of 78.9 percent and eliminating the gender gap, improvement in human resource development will be marked by lowering the incidence of malnutrition in under-five children to 20 percent, and reducing unmet contraceptive needs to 6.5 percent. Reduced vulnerability to poverty will be demonstrated by the development of systems to deliver comprehensive social security;
- (iii) Progress in governance will be marked by improvements in the measures for governance indicated in the long term targets mentioned in paragraph 18 (iii) above and by an increase in the tax effort to 16 percent of GDP and the institutionalization of a poverty public expenditure review.

In the medium term, progress in these areas should result in a 4 percent reduction in the incidence of poverty over 1999 levels.

20. To support the Government's commitment to reduce poverty, the ADB COS envisions a program of loan assistance between \$0.6 billion-1.2 billion annually. A TA program of \$10 million-15 million per year is expected to support lending and policy advice activities. A limited amount of Asian Development Fund support will be provided while per capita income remains low and will be evaluated on an annual basis. The ADB will allocate a minimum of 40 percent of loan resources for poverty reduction for the period 2001 to 2004. The actual lending levels will be contingent upon two broad factors: (i) performance and absorptive capacity and (ii) the nature of the financing needs⁴. To promote the efficiency of ADB resource allocation and poverty reduction, a geographic focus will be

² Enroll all children in primary school by 2015; Make progress towards gender equality and empowering women, by eliminating gender disparities in primary and secondary education by 2005; Reduce infant and child mortality rates by two-thirds between 1990 and 2015; Reduce maternal mortality ratios by three-quarters between 1990 and 2015; Provide access for all that need reproductive health services by 2015

³ Changes in the real wages of unskilled workers are an indicators of welfare for the lowest income class.

⁴ Further details regarding lending levels is provided in the ADB COS.

developed taking to consideration sectoral characteristics and regional capacity, resources and local aspiration and needs.

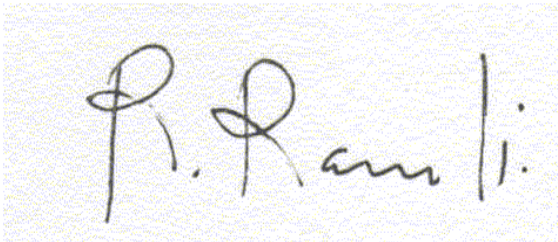
IV. Monitoring Performance with Regard to Poverty Reduction

21. The Partnership Agreement also incorporates mechanisms to review performance, highlighting key indicators and institutional milestones necessary to monitor progress. ADB's Country Strategy and Program (CSP) will translate the underlying thrusts of the Partnership Agreements into specific activities. The CSP Update, prepared annually, will identify, on a three-year rolling basis, the program of loans and assistance. Progress in implementing the Agreement will be reviewed each year. The review will also include changes in government policy or other new information and relevance of monitoring target indicators. In addition the review will identify measures needed by the Government and ADB to ensure progress towards achieving medium term targets and long term objectives. It is understood that in the first year of implementation of the agreement, the medium targets and long term objectives may be refined in accordance with the strategy developed in consultation with stakeholders by the Poverty Reduction Coordination Agency.

22. The Government and ADB will monitor the indicators and targets described in paragraphs 18 and 19 and will jointly undertake consultations with stakeholders and civil society organizations on progress in meeting the agreed poverty reduction targets. ADB will provide support for improvement of poverty monitoring systems to facilitate this process. For identifying core poverty interventions as defined by the ADB Poverty Reduction Strategy⁵, the prevailing national and regional poverty lines published by the Central Bureau of Statistics will be adopted.

Signed in Jakarta on 5 April 2001

On behalf of the Government
of Indonesia



Dr. Rizal Ramli
Coordinating Minister of the Economy

On behalf of the Asian Development Bank



Joseph B. Eichenberger
Vice President (East)

⁵ Approved by the Board in November 1999

Highlights of the ADB Country Operational Strategy

The ADB's Country Operational Strategy (2001-2004) was formulated on the basis of the priorities emerging from the poverty analysis and the high level forum. The five focal points of ADB's Strategy described below follow closely the lessons of poverty assessment, the Government's development priorities, and the emerging programs of other international funding agencies:

- (i) Creating and strengthening basic institutions through improving the many relevant dimensions of governance. ADB will continue to support anticorruption efforts, assist in reviewing and revising laws to promote legal and judicial reform, and widen the involvement of stakeholders.
- (ii) Supporting sustainable recovery and pro-poor growth by enabling and encouraging private sector development. Enabling private sector-led growth entails multifaceted tasks and tools. In addition to enhancing the still tentative recovery and investing in the potential for long-term growth, this will demand focusing support for infrastructure, continuing ADB's lead efforts in strengthening the nonbank financial sector, supporting competition through privatization of State-owned enterprises (SOEs) and support of small- and medium-size enterprises (SMEs), promoting good corporate governance, and strengthening the economy to benefit from changing information technology.
- (iii) Improving regional equity through balanced regional development, especially targeting the rural areas and less developed islands. This will demand (a) supporting decentralization; (b) enhancing rural and urban sector development; and (c) expanding transport systems, particularly to link isolated areas to markets. Pro-poor investments contributing to economic growth are essential to bring about social stability. Infrastructure programs will emphasize providing essential services, utilizing the opportunities to revitalize local labor markets, offsetting the hardships faced by poor households, and expanding the potential for less developed regions. Regional programs that reflect the specific needs and opportunities of the different localities will be developed.
- (iv) Investing in human and social development and enhancing the role of women. Effective poverty reduction includes improved access to basic social services such as education, health and nutrition, safe drinking water, and sanitation. Activities must specifically address access to and quality of public services available to the poor. One lesson of the recent crisis is that social protection mechanisms providing concrete support to the most vulnerable in an efficient and fiscally sustainable fashion must be developed. In addition, conscious action to establish institutions and processes that genuinely mainstream women is required.
- (v) Strengthening environment management to ensure sustainable use of natural resources and prevent adverse environmental impacts associated with development. ADB operations in Indonesia will focus on improved governance in managing natural resources, particularly with decentralization of responsibility. ADB's efforts should focus on (a) sustainable management of coastal and marine resources, biodiversity conservation, and inland water resources; and (b) reducing urban and industrial pollution.