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FY 83

BEST AVAILABLE

January 1981

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
WASHINGTON, D.C. 20523

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A Technical Assistance Program to Strengthen

United States - Indonesian Relations

USAID Indonesia's Country Development

Strategy Statement - FY 1983

January 1981

January 31, 1981

Transmittal Letter

Transmitted herewith is the Country Development Strategy Statement (CDSS) for USAID Jakarta for the planning period FY 1983-87.

In preparation of this document, we came to the conclusion that the time had come in United States - Indonesian relations to review our economic assistance program with the aim of ensuring a long-term mutuality of bilateral interests and a maturing of our relationships commensurate with Indonesia's growth. Indonesia desires such a relationship with the United States and can be expected to become increasingly uncomfortable with traditional perceptions of concessional aid as a one-way street.

At the same time, Indonesia desires a continuation of concessional assistance which it believes is important to its development interests. The United States appears to be the only major bilateral donor that has not reconciled Indonesia's improved financial position with its own self-interest in continuing or expanding concessional assistance. Because we believe the United States has a strong mutuality of interests in continuing its assistance, the U.S. program for Indonesia is on sure footing.

Other donors tend to view their concessional assistance to Indonesia as part of larger "packages" of aid-trade-investment interests broadly defined. These "packages" may include technical assistance, development loans, concessional and commercial export credits and foreign investments. These "packages" are quite large and growing and are being used effectively to secure major contracts and commercial advantage to the "donor" as the Indonesian economy grows and actively seeks modern industry and transfer of more advanced technology.

We have come to believe that if future U.S. assistance combines (a) our traditional concern with helping developing nations cope with humanitarian and basic development problems (food, population, health, employment and education) with (b) the need for the U.S. to be more competitive in foreign markets, and (c) a desire to be responsive to Indonesia's increasing need for the transfer of technology, the resulting U.S. contribution will provide a sounder basis for future bilateral relations.

We recognize such identification of U.S. commercial interests with the AID program could distort the traditional image of a disinterested concern by AID with Indonesia's development problems. At the same time, we believe such a melding of interests will be perceived in Indonesia as the foundation for a long-term, more mature relationship.

We are convinced there is a strong rationale for continuing a U.S. Development Assistance program designed to help Indonesia cope with some of its most intractable problems. We believe that despite its substantial foreign exchange holdings, Indonesia remains, in many respects, a poor country that needs and warrants our assistance. While the high reserves could argue for harder terms, we believe it important that our program remain a mix of loans and grants and be perceived by Indonesia as a development assistance program.

Experience has demonstrated that one of the things most needed from the United States is flexible administration of aid and the innovative role played by the AID Mission in development of new programs and approaches to deal with problems of rural poverty. For these roles grant aid is uniquely important. Any trade-off of funds should recognize this fact. Perhaps, the anomaly of a pressing need for grant funds could be dealt with more successfully by AID and the Congress if the AID slice of a total U.S. economic package is viewed as strengthening the whole, and if the whole were perceived to be just as much in the interest of the United States and its relatively rich people as in the interest of Indonesia and its poor. Such a perception would need to be based on strategic and political considerations as well as humanitarian and economic interests. This document deals primarily with the latter set of interests.

The CDSS contains some preliminary ideas for closer coordination of U.S. concessional assistance through AID with other forms of U.S. economic cooperation with Indonesia. Several additions to the current AID program complement other U.S. economic interests as well as the lending programs of the World Bank and the ADB. But, as directed by AID/W, much of the 60 pages of this CDSS (Part I) is devoted to an analysis of Indonesia's macroeconomic situation. The current AID program and proposals for its continuation throughout the planning period, including PL480 Title II, is summarized briefly in Part II. Part II also includes a statement of why emphasis is given to particular activities within the areas AID is authorized to provide assistance. A fuller treatment of program plans by sector was presented in last year's CDSS and was expanded upon in the Annex to the ABS submitted in May 1980. Updated sector plans will be annexed to this year's ABS.

To assure several of AID's most significant contributions to Indonesian development are not obscured in a lengthy and structured presentation they are highlighted as follows:

1. FAA Sec. 103: Food and Nutrition

   a. A major contribution is being made by AID in strengthening Indonesia's national agricultural research system - both in creating a strong central research institution and in establishing a network of modern research stations throughout Sumatra, Kalimantan and Sulawesi. More than $40 million of technical assistance funds have been committed to these programs over the past few years making this one of AID's largest food research programs.

   b. AID is making a major contribution to training of the national leadership for modern agriculture by helping bring into being a center of excellence at the

University of Agriculture at Bogor and by strengthening the faculties of agriculture at more than 20 other universities. A dozen U.S. land grant colleges under Title XII legislation are participating in this key undertaking to which approximately $50 million has been committed over the past few years.

c. The role of local governments in rural development programs has been expanded through AID initiative. The Provincial Development Project (PDP) includes three or four new provinces a year in a program of decentralized planning and implementation of village level projects to deal with rural poverty. A training program supported by AID will extend staff development to the district level. Through FY 81 about $45 million of technical assistance funds had been committed to these activities.

d. Two "integrated area development" projects (Luwu and Citanduy) have reached the point of being models for other donors and successful testing grounds for new concepts and programs of organization, erosion control and watershed management. The comprehensive plans developed with AID assistance are attracting large-scale financing from other donors.

2. FAA Sec. 104: Population and Health

AID has been the major source of technical and material assistance for Indonesia's national family planning program since initiation of the program. This program is thought to be one of the most successsful ever undertaken. This is AID's largest program of family planning, having received in excess of $100 million. It is the first program to fund oral contraceptives by loans. Local manufacture of contraceptives is replacing loan funds.

It is our hope the CDSS will both provide a useful context for reviewing the rationale for continued development aid in face of growing Indonesian foreign exchange resources, and make an effective presentation of the directions and general content of the assistance programs for which funding is proposed.

Thomas C. Niblock
Director

Indonesia, the world's fifth most populous nation, is steadily and voluntarily reducing birth rates and is doing so in advance of large increases in family incomes. National food production is growing at 3 percent each year, faster than the population. This record of progress sets Indonesia apart from other developing countries. Indonesia is a petroleum exporter with foreign exchange reserves that have reached $11 billion. Why should AID use scarce Development Assistance funds in Indonesia?

Indonesia's resources are meager in comparison with the costs of needed development and its large population. Indonesian families are poor. With an annual GNP per capita at $360 in 1978 and a Physical Quality of Life Index (POLI) at 52, Indonesia remains the least developed among ASEAN countries. In comparison, the Philippines has an annual GNP per capita at $510 and POLI at 80. In 1978, life expectancy in Indonesia was only 47 years. Infant and child mortality are very high. Despite rapid growth of investment in primary education, literacy rates are in the 60 percent range. Health services are extremely limited: one physician for 15 thousand persons in 1977; twelve percent of the population has access to safe water. Despite the early success of the family planning program, the population retains tremendous momentum for growth. Land resources are under stress from intense cultivation where populations are densely settled, and from cutting of tropical forests for fuelwood, lumber and more arable land. Java is the most densely settled region in the world. Overriding these problems is the spectre of the vastly underemployed population in need of productive labor and more income.

Indonesia is attempting to transform its financial reserves into effective development activity, especially to increase jobs and income for poor people. Spending these reserves quickly would accelerate inflation without either achieving meaningful economic growth or distributing benefits broadly. Based upon past experience, the government is disciplining the use of its resources through development programs which have been designed and tested in cooperation with donor agencies. The reserves are only a potential resource for solving enormous development problems.

The inability to utilize in the near term the available foreign exchange reserves is a symptom of the limited problem-solving capacity in Indonesia. Because development programs are directed at complex problems of poverty, and because Indonesia's management experience is limited and recent, funds are spent slowly and resources could be more effectively utilized. Scarce administrative talent is concentrated in central government offices in Jakarta; these administrators are far over-extended even within the confines of central government functions. The most serious obstacle to rural development, however, is the lack of capability in the provinces. Indonesia's diversity of ecologies and cultures and the great distances among its islands defy intelligent governing from the center. For example, improvements in health delivery systems cannot be mandated from Jakarta for the health

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problems of the two million people living on the remote islands of Flores and Sumba. Before the central government's funds can be useful, a provincial program must be organized; simply pushing resources out from the center does not work.

The AID program, responding to Indonesian commitment to decentralize development efforts, is:

-- strengthening provincial and district government administrative capacity, allowing the central government to shift resources and program authority to people who can see the problems and devise ways of overcoming them;
-- creating problem-solving capacity in universities and field research institutions and in supporting the private voluntary community;
-- expanding the group of central government managers and experts who, through training and direct experience with AID projects, are able effectively to direct the use of government resources for development;
-- helping plan and launch major village development programs: irrigation, electrification, village family planning services, access roads, and income generating activities for poor people.

The Indonesians are confident but not satisfied with the pace of development efforts. The government recognizes the political necessity of rapid, visible progress. Policy statements and program ideas reflect a growing concern with the underemployment problem. In searching for ways to accelerate development, the government is for example impressed with AID's contribution to its successful family planning program. Confidence in our approach is reflected in the openness of government councils to AID's experts. For example, the Provincial Development Program (PDP), working with the Ministry of Home Affairs, is directly assisting local administrators on the sensitive front line of government functions. The Indonesians are pressing for more rapid expansion of the PDP program. This access to the process of development in Indonesia is unrivaled by other donors.

The World Bank staff is concerned that their own assistance programs are not adequately engaged with the problems of rural poverty in Indonesia. New government positions and regulations discourage World Bank technical assistance. We and the World Bank staff are considering whether AID's technical assistance can more directly complement and support the Bank's lending programs. We are ready to collaborate with the World Bank and other donors.

The Country Development Strategy for Indonesia through 1987 proposes to sustain AID's participation in the government's development programs. Projected budget levels maintain the current value of AID's program and provide a modest increment to explore opportunities for more U.S. private sector involvement in Indonesia's development efforts. We believe this program directly supports the U.S. interest in the development of Indonesia. Indonesia is the most important ASEAN country for the United States:

-- Indonesia is a reliable friend, which has made valuable contributions to problems which concern us most, including the hostage situation in Iran, the invasion of Cambodia and Afghanistan, and the Vietnamese refugee problem.
-- U.S. investments in Indonesia are growing; they total $.6 billion outside the petroleum sector and $1.5 billion per year are currently being expended by U.S. oil companies in Indonesia;
-- Indonesia provides high quality (low sulphur) petroleum to the United States; five percent of U.S. petroleum imports;
-- Indonesia is a major supplier of tin, rubber and wood for the U.S.; Indonesia as a market for U.S. goods and services has already grown to over $1 billion annually.
-- Indonesia's strategic location astride the sea lanes that link the Pacific and Indian Oceans makes it important to U.S. security and economic interests and vital to the interests of our largest Asian ally, Japan, for whom these waters are a lifeline to Europe and the Middle East.
-- As a founder and leading member of the nonaligned movement and the most populous member of the Islamic Conference, Indonesia is destined to play a leading political role in the developing world.

Seeing potential benefits for themselves, other nations -- Japan, Germany, France, Canada, Australia -- are investing in long-term relationships with Indonesia. Indonesia is the first or second largest aid recipient for each of these countries. In addition, each of these countries combines large commercial credits with development assistance to promote exports.

The AID strategy should contribute to a solid, long-term relationship between the United States and Indonesia. No other donor has an in-country advisory staff which communicates so broadly and continuously throughout the Indonesian government. Indonesia's most serious development challenges are in the future. AID is in position to enhance significantly the prospect for success.

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A Technical Assistance Program to Strengthen

United States - Indonesia Relations

Part I The Macroeconomic Framework of Indonesia's Development

1. Macroeconomic Overview of the Economy

A. Introduction: Indonesia's enhanced oil earnings have dramatized the country's vast natural wealth as well as the Indonesian government's frustrations in its efforts to share this endowment with its people. The larger the earnings, the more visible have become the constraints to development. And fortuitously, with this visibility is coming a greater awareness of the need to release the brakes on programs to deal with rural poverty.

The resurgence in oil earnings in this 1979-80 period has refocused attention on monetary stability to ensure that the trade benefits of the November 15, 1978 devaluation and the fruits of development itself are not eroded by inflation. But as pressure on government policy makers to control inflation increases, so too has the pressure on them to share this new income with more groups in society. The commitment to spreading the benefits of economic growth is real, but so are the constraints on economic expansion.

B. The Oil Economy: Oil now drives the Indonesian economy. A second resurgence in oil exploration, international oil prices and export earnings, following the resurgence in 1973 and 1974, has now overtaken the gloomy resource picture originally forecast in the Third Five-Year Plan (1979/80-1983/84). This is the short and mid-term prospect even though the outlook is far less sanguine for the 1990s when domestic petroleum consumption is likely to absorb virtually all domestic production. Even now Indonesia is

pumping at full capacity. And with the Middle East unrest, pressure on the existing companies and fields will increase as exploration money flows to the comparatively difficult and less promising Indonesian terrain.

Nevertheless, large crude oil price increases in 1979 and 1980, and the prospects for modest oil production increases, larger LNG exports, and particularly higher international energy prices, markedly improve the country's short and medium term financial outlook. Foreign exchange reserves grew from $500 million in 1970, to $1 billion in 1975, to $4 billion in 1979, and then jumped to $11 billion by January of 1981 - $75 per capita.[1/] (The notes start on page 61.)

The latest published World Bank projections indicate that the FY 1980/81 current account surplus of the balance of payments will be $2.20 billion (up from $1.99 billion the year before), and that it will decline to $1.5 billion in FY 82, to $0.7-0.8 billion in FY 83, and will turn negative in FY 84 with -$0.5 billion. These 1980 projections of surpluses are sharply higher than those projected by the Bank last year, and because of continuing oil earnings and continuing constraints on the domestic economy, these more recent projections are already dated.[2/] (The Embassy will be reporting more fully using current data from the recent budget. Balance of payments estimates for the years FY 1978/79-1980/81 are included as Annex A.)

Our expectation is that Indonesia's oil and gas earnings will remain large for some years. Beginning in the late 1980s, with the decline in oil exports, LNG earnings may equal those from oil.[3/] Mineral export earnings are also large and growing even though export volume is stable. Agricultural exports of rubber, timber products, coffee, tea and spices are other prominent exchange earners. Because of this bounty, domestic resource mobilization remains a largely untapped national resource. In time, taxation of the domestic economy (and further subsidy reductions) should become prime sources

of public revenue. To date, oil earnings have allowed an unfortunate yet understandable relaxation of the domestic tax effort.[4/] And as we will emphasize later, should there be no large increase in petroleum production, and no corrective action on the consumption side, Indonesia will probably become a net oil importer in the next decade.

C. The Importance of Monetary Stability: Preservation of monetary stability has become a leading macroeconomic concern, and a major issue. The relatively low inflation rates of 10% in 1978, 29% in 1979 and 17% in 1980 in comparison with earlier years are testimony to the government's efforts to maintain monetary discipline.[5/] Because of this policy, and other factors, the government has succeeded in preserving about half of its remaining comparative trade advantage gained at the time of the devaluation.[6/] But the pressures to utilize the oil earnings and to expand domestic expenditures (with the certainty of dissipating the remaining trade advantage) are large and emanate from several sources.

First, domestic tax revenues from oil and gas totalled $6.3 billion in FY 1979/80 and are estimated to be increased to at least $13.7 billion in FY 1980/81. Ninety percent of these earnings are denominated in dollars. But dollars are not used directly to finance the domestic rupiah budget. The domestic budget itself is heavily in deficit because non-oil and gas domestic revenues are small. Because of the imbalance between the foreign and domestic budgets, the government has a heavy responsibility for managing the creation of rupiah for domestic credit and for public expenditures. The government must also manage trade with a careful eye to its effect on domestic liquidity. If the government allowed the full expenditure of all its annual revenues (as tradition requires), the inflation rate would soar because the supply of domestic and normally imported goods is not increasing at a

sufficiently rapid rate. In short, the monetary authorities must decide how and at what rate these foreign exchange earnings can be translated into domestic demand. Because of severe capacity constraints on the domestic economy, reserves are growing faster than they can be spent. This is the first balancing act.

A second balancing act arises from the several competing demands on these earnings. The government has sharply expanded the development budget in FY 80/81 and raised government salaries by 50%, on the one hand, and has increased controlled prices for several basic commodities and public services by as much as 50% on the other. It has resisted other demands, particularly for a rapid expansion of credit for the private sector. On balance however, liquidity has grown at an annual rate of 60% during the first six months of FY 1980/81 which has given rise to the concern that the government is likely to exceed its 15% inflation target by several percentage points.

During the 1970s credit controls have favored the public sector. Between 1973 and 1975 private sector credit declined in real terms at an annual rate of 6% whereas the real growth of credit to public enterprises was approximately 50% a year (excluding Pertamina's debt repayments). Special credit programs for pribumi (Indonesian) business people are relatively new and limited but of increasing importance. The World Bank argues that it is the private sector and not the public that has the capacity for an accelerated supply response to the devaluation and to credit's expansion.[7/]

Despite present concerns about the overall inflation rate however, the record of relative monetary stability during preceding years is important and sustains the hope that the government will monitor the expansion closely.[8/]

D. <u>The Non-oil Economy</u>: Because oil earnings have forced the government to focus on monetary policy, we have started our review at this point. Monetarist issues however tell us little about the economy.

In broad terms the $60 billion ($400 per capita) economy has strengthened somewhat in 1980 following the 1978 devaluation, according to Bank Indonesia. Following a moderate decrease in the GDP growth rate to 4.9% in 1979, the rate has increased again to 7% during 1980, similar to the level sustained during the 1970s.

The non-oil export picture has not been as bright as that for oil. Total non-oil earnings in current prices fell slightly during FY 80/81 over FY 79/80, to a level of $5.8 billion. Raw timber exports have decreased by 5% in volume, and some export commodity prices have softened internationally. Raw timber exports have declined because of a new government provision designed to encourage the export of plywood and timber products.

This falling off in export growth is due to lower world prices, increased domestic demand, termination of fertilizer and cement exports, and capacity constraints in some industries. Part of this decline is also the direct result of government controls on export trade which are aimed at protecting domestic producers and consumers (but at the social cost of causing some erosion in the devaluation's purpose). Although there are signs that the devaluation is paying off within some parts of the industrial sector, continuing business uncertainity and heavy regulation are adversely affecting the export of manufactured goods.

We can tentatively conclude therefore that during the two years following devaluation there has been a limited export volume response among certain traditional and manufactured products.[9/]

Imports have picked up during FY 1980/81 over 1979/80. Food imports remain high, to build stocks in the face of the good 1980 harvest while the cost and volume of imported crude and refined oil products remain high.[10/] (See the reporting cable on the FY 81/82 Budget (Jakarta 0950) and the early February reporting cable and airgram on the Balance of Payments.)

F. Food and Energy: Before turning to a discussion of constraints on the government's development efforts during this period we mention two issues which relate directly to Indonesia's new reserve levels: food and fuel. Despite its considerable success with rice production, Indonesia's dependence on food imports has grown with its population. The food picture is described in Section 4. For our purpose here however, high oil earnings and reserve levels have provided the country with a cushion against extreme food short-falls. This has not led to any relaxation in the country's food production effort but it does remove, for now, the crisis atmosphere surrounding past food shortage periods. In the early 1970s, a crisis food import bill would have, and did, absorb most of the country's reserves. An emergency food import level now, even one as high as 2.0 million M.T., and even when allowance is made for the price effect of such a purchase, would only marginally curtail present reserve levels. Two million tons of rice can be purchased at a cost of a little more than the earnings from only one of the country's agricultural exports; that of coffee.

The country can be considerably less sanguine about its thirst for its own oil resources. Domestic fuel consumption has grown at a 12% annual rate, and now consumes 400,000 barrels of oil a day or one-fourth of all production. Should there be no large increase in petroleum production, and no corrective action on the consumption side, Indonesia will probably become a net oil importer in the next decade.

Indonesia's rate of energy consumption has increased because of its development, and because of fuel's subsidized price, to a level of 21.4% per year during 1974-78, up from an average annual rate of only 4.2% between 1960 and 1974. This growth rate places the country ahead of 45 other, mostly poorer, countries in its level of per capita (coal equivalent) energy consumption.[11/]

The government has attempted to constrain this appetite. But a large domestic price increase in May of 1980, like the one in April of 1979, has not kept pace with the rising international price of oil and gas. As a result the fiscal subsidy for retail oil sales, 90% of which is for kerosene and diesel, has risen from 1.5% of the 1978/79 budget to 13% of the 1980/81 budget, or to nearly $2 billion and will increase further until conservation improves and energy alternatives are found. Furthermore, a preliminary study suggests that the poorest 40% of population enjoys less than 20% of this subsidy.

The total economic subsidy for domestic fuel consumption is around $4 billion a year, and causes an even higher social cost by allowing some disguise of the country's labor-intensive manufacturing and trade opportunities. This occurs because oil earnings finance large energy price subsidies which act to encourage energy-consuming capital-intensive projects.[12/] The government recognized these penalties, and has acted in prior years to raise fuel prices, and has ambitious plans (but not the technical capacity) for the development of non-oil energy sources.

F. Constraints on the Government's Development Program: Constraints to economic progress are a now familiar litany among developing countries and within institutions which assist development. Constraints define underdevelopment. Until Indonesia's present oil boom, these problems were itemized to explain slow project disbursement rates and large donor pipelines. These constraints still range from the mundane, periodic shortages of cement and construction materials, to the more intractable problems such as weak management and limited technical capabilities.

These "routine" constraints on the government's Third Plan have been over-shadowed lately by debates in the central government over basic issues concerning the use of its oil earnings. New "constraints" have appeared.

Trade liberalization remains a major issue. Should the government further liberalize trade (and investment) controls as one way of allowing a non-inflationary liquidity expansion, and to further exploit the purpose of the devaluation? Or are domestic industries and consumers to be protected against international competition and domestic price rises? The liberalization of controls would favor labor-intensive industries over existing, more capital-intensive ones, and would give greater scope for trade. This debate engulfs the Investment Board which is seen as a protector of inefficient industries (in the name of protecting consumers) rather than as an agent to speed investment priorities. Despite the devaluation and other domestic price adjustments, Indonesia's economy is heavily regulated.

Underlying this issue is growing concern for the entrepreneurs of the country's smaller firms. The arrival of Japanese products, increased resentment of the Chinese domination of the country's business world, and the growth in oil earnings have caused the government to initiate programs to channel credit and supportive services to indigenious business people (the pribumi). In 1980, these concerns gave rise to Kepres (Presidential Instruction) numbers 10 and 14a which stipulate respectively that domestic companies must increasingly purchase domestic materials and parts, and that pribumi firms must obtain a "fair share" of all government contracts.[13/] These direct efforts to restructure the economy in favor of broader groups of business people could cause a more widely shared growth pattern in the future.

Although conflicting industrial policies and regulations will continue to co-exist, it remains to be seen how small firms will grow when large firms enjoy energy subsidies and infrastructure, and dominate the opportunities for production and trade.

Paradoxically, another constraint on rapid use of oil earnings is the legacy of financial mismanagement from the Pertamina scandal of 1974-75. The technocratic managers of the economy are determined to avoid an uncontrolled spending spree. Because of this there is increasing evidence the government understands and welcomes the discipline that comes with foreign commercial and concessional financing. This factor may make it possible to explore new forms of assistance which use the government's reserves jointly with bilateral programs, and which may provide for a more complementary relationship between programs of technical assistance and the larger programs of the two development banks. These ideas are discussed further in Part II.

Poor health is another, greater, constraint to the development of the outer islands, and even Java, than is generally recognized. Malaria is a serious curb to greater labor productivity and to the opening of new lands on the outer islands. The level of government support for rural health services does not yet reflect the severity of morbidity. On Java, Madura and Bali, increasing population density is exacerbating environmental sanitation problems and the risk of transmission of infectious diseases is increasing even though treatment is more accessible on these "inner" islands.

For these several reasons, answers to the question "How should Indonesia spend her new found income?" are seriously circumscribed. Easy answers are side-tracked by the necessity of monetary management, the lack of managerial and physical capacity and the debate over developmental direction.

Last year the World Bank staff and the Ford Foundation recommended use of these reserves for an expansion of foreign training to increase the supply of skilled administrators and technicians. AID has programmed an expansion of its overseas participant training program by three fold for 1981 and 1982 but weak English language ability may hold this expansion to a doubling (to 500

trainees) each year. The Bank idea faces the same problem. Although the goverment may not wish for other reasons to endorse a massive overseas training program, it is not reluctant to accept overseas training if grant financed. But the government resists using the Bank's ordinary capital, at 9-1/4 percent interest, for other than carefully scrutinized training.

Some outsiders favor immediate new programs for basic infrastructure, to expand the country's meager and poorly maintained supply of roads and highways, railroads, ports and shipping. Here again the government is said to be wary of the inflationary impact large expenditures for wages would cause at the present time.[14/] These constraints define under-development, and also an independent people.

Few people have asked an obvious question: "Given the government's commitment to equity-oriented goals of the Third Plan, why does it not buy larger social and employment-oriented programs with its new oil earnings?" The government appears to believe it cannot do this for several reasons. Because the country does not have a large middle class of professional people - people imbued with a problem-solving approach to tasks - project studies, designs and often management depend upon outsiders. The government dislikes turning important programs over to foreigners, and suffers political criticism when it does so. For the same reason the government is not likely to undertake many more turn-key projects, certainly not ones designed to reach the people. Another reason may be that because this is a second oil boom, the government is concerned that the same management mistakes not be made twice. In short, development is an evolutionary process which for Indonesia will only be allowed to proceed apace with the rate of social change itself. The real question is one of "how?"

These dilemmas give rise to a sense of restlessness. In the face of the complex, sensitive issues described above, the government has limited its developmental sights. Selected imports and industrial incentives could be tailored to finance the construction of a wide range of physical infrastructure. The brake on such initiatives is as much political as managerial. So while we can understand the government's concern for monetary stability, and support the policies of restructuring economic opportunities, we also share the concern that constraints must be alleviated so that the commitment to equitable growth can be more rapidly implemented. This document is devoted to an analysis of AID's institution building support for this continuing endeavor.

2. The Government's Development Achievements

The accomplishments of the 1970s greatly enhance the possibilities for development in the 1980s. Had the successes enumerated below - a reduction in the birth rate, dramatic increases in rice production and an expansion of primary education - not taken place, the government would now be faced with crises; not options and opportunities. A macroeconomic perspective alone can tend to cloud the opportunities for further growth already made possible by aggressive development programs. (The availability of oil per se bears little explanatory relationship to the developmental successes of the 1970s.)

The first of these successes is the government's family planning program. The percentage of married couples of reproductive age who are current contraceptive users has grown from less than 1% in 1970 to 32.5% in November 1980. In Java and Bali, 43.4% of these couples are current users; in the outer islands, 13.1%. Based in part on these successes, and in part on raising the age of first marriage, the Indonesian crude birth rate has dropped 24% from an estimated 44-46 births per 1,000 population in 1970 to 33-35 births per 1,000 population today.

A direct consequence of the family planning program to date has been the government's acceleration of its crude birth rate targets. In 1974, the government set a goal of a 50% reduction in the crude birth rate between 1971 and the year 2000. Once the program expanded in 1976 from a clinic-based to a village-based system, contraceptive user rates have been increasing by over 5 percentage points per year since 1977. Based upon this success, the government brought forward its 50% birth rate reduction target from the year 2000 to 1990 and increased its annual budget for family planning at a rate higher than that for its overall development budget.

The October 1980 population census indicates that the country had a 1980 population of 147.4 million, which means that the average annual rate of growth since the 1971 census has been 2.34%. The present rate of annual population growth is about 2.0%. (Firm census results await further analysis.) The Central Bureau of Statistics had earlier projected a population of 142.3 million for 1980. Much of the difference is tentatively accounted for by West Java and Sumatra where family planning has not progressed as rapidly as in Bali and the other large Java provinces, by an under-estimation of the 1971 population, and by a lower than expected mortality rate.

On the other hand, in the twelve provinces that comprise 60% of the total population, the average annual rate of population growth between 1971 and 1980 has been a low 1.8% and the present rate is likely to be still lower. This 1.8% figure supports the repeated downward adjustment of the population projected for the year 2000, from 250 million people projected earlier in the decade to a present low total population target of 190-200 million.[15/] Assuming the government sustains its commitment, this low projection will

become a reality. Fertility reduction has already spared many women from frequent and often hazardous pregnancies, and reduced family size has already enhanced the potential for better family well-being.

A second major accomplishment is that of rice production; during the period 1969 to 1980, the average annual rate has been a remarkable 3.9%. Because rice is the staple food and the food priority of the government, this is an important event. The real success story of rice is that this high growth rate reflects a strengthening of institutional capabilities to stimulate production and is not a fluke of good weather. This is the conclusion of a recent Australian National University study by Peter Warr on the 1980 rice crop, and by extension, to the trend growth rate which underlies the record harvest of nearly 20.0 million M.T. The factors which explain this growth in production according to Warr are three fold: (1) total fertilizer use has grown at an average annual rate of 20% between 1976 and 1979 (largely because of its low fixed price); 2) the government has given great emphasis to tertiary and quarternary irrigation works since 1978; and 3) IR 36 has been widely adopted because of its yield characteristics, its resistance to the brown leaf hopper (wereng), and because it is early maturing.[16/] Warr's analysis goes on to estimate the contribution of each of these inputs to the total harvest. Even with ample caveats and account for good weather, he concludes that ".... a genuine and impressive increase in Indonesia's rice production capacity has indeed occurred." [17/]

The point here is one of proven capacity. The government has also shown that it has the capability to produce and distribute wereng (brown plant hopper) resistant seed under crisis conditions; further evidence that the government has succeeded in training and motivating staff including plant breeders. AID can take some credit for having helped the government develop

this institutional capacity, one which has released a major constraint on food production. The country's agricultural universities and agricultural research centers on Java as well as on the outer islands, have also long been the focus of AID-financed technical assistance and training.

Again we emphasize that this success does not suggest a relaxation of effort. But the fact of this success, like that of family planning, provides a proven basis on which to expand.

A third accomplishment has been the construction of primary schools, the training of teachers to fill them, and the achievement of an enrollment level of 86% of all eligible primary school children in 1978. Between 1960 and 1978 the enrollment of boys has increased 6% while that for girls has increased by 40%, to a level of 81% of all girls in the primary education age group.[18/] The magnitude of this effort is revealed by the fact that more than 1,000 village schools are being constructed and supplied with teachers each month.

Other developmental accomplishments are reviewed in Part II and in Note number 19. Progress Indicators are included in Annex D.

3. A Review of Selected Poverty Indicators

Underemployment is becoming the leading manifestation of poverty in Indonesia. Because the problem is so pervasive the government is paying greater attention to job creation. As Professor Sumitro has stated in his recent evaluation of the economy: "The creation of productive and remunerative employment opportunities should be an overriding policy objective in order to enable large groups of the community to obtain food and other necessities of life. Productive employment is also the main venue to eradicate poverty and to bring about more equity in income distribution." [20/]

In the first part of this document we have reviewed several of the underlying causes of underemployment and the constraints on employment-creating policies and programs. In this section we are more

specific about the nature of underemployment, and about the quality of public services in rural areas - a factor related to underemployment because the quality of public services has a direct bearing on the well-being of men, women and children. Past CDSS and ABS documents have emphasized several basic poverty indicators; here we will focus on only two of these - underemployment and rural services - and explore their causes and consequence. This discussion in turn helps to explain AID's attention to selected sectors and sub-sectors of rural development activity.

A. Underemployment in Indonesia: The labor force of this large population of 147 million people grew at a rate of over 3.2% per year during the 1970s. This year an additional 1.8 million people seek work; many of them are forced to find it by sharing existing work opportunities with the thirty-eight million workers on Java and the eighteen million workers on the outer islands (1978 data).

New jobs are not being created fast enough. Only one-half of the targeted employment goal of the Second Plan was achieved. Industry was to have created 600,000 jobs for workers over the five year period, but less than half of these numbers of people found work. Many school drop outs have no job prospects. Growing numbers of these semi-educated, jobless, often trouble making youth can be expected in view of Indonesia's population profile.

Agriculture remains the largest employer in Indonesia and must remain so for the foreseeable future. The introduction of new seed varieties, irrigation and a host of related inputs have acted to increase the need for agricultural laborers over the course of a multi-crop year. Although the multicropping of rice and other crops has increased significantly, the opportunities for work on each crop have not increased.[21/] Because of this the direct on-farm employment impact of the green revolution has not been as

large as anticipated, and a few innovations associated in time with the new seeds' introduction have been labor displacing. Women have born the brunt of at least one of these innovations, mechanized rice milling, and may again because of additional agricultural innovations in the offing.[22/]

On Java, real wages of unskilled laborers have remained stagnant and even declined in some areas over the long term.[23/] Changes in tenure relationships on Java also show a deterioration against poor cultivators.[24/] The dominant condition, however, remains that of cultivation by owners of very small plots. (We note that these generalizations are not applicable to most of the outer island where for example real wages have increased.)

Although public data suggest that there is little visible or open unemployment, there is in fact a great deal of underemployment and work-sharing on Java. Many cultivating families must hold multiple off-farm and "off-season" jobs during the year in order to pool an adequate household income. In a recent survey in rural Java, almost 30% of the male respondents claimed they did not earn enough to support themselves, though fully employed, and an additional third of this survey group claimed they could not support their families.[25/] AID also recognizes that the burden of being the poorest of the poor falls disproportionately on women, particularly as they are often heads of households. It is this diversity of employment practices and conditions which makes us appreciate the sterileness of the phrase "landless" and forces us to think in an integrated manner about the causes and solutions to underemployment in the rural economy.

B. <u>The Quality of Public Service Programs in Rural Areas</u>: Nearly seventy million people lived below the Indonesian government's poverty line in 1976 and twenty-seven million people were said to be destitute. This massive group is expected to grow larger in number by the year 2000.[26/]

The lack of adequately remuerative employment is a major contributing factor to this poverty. Other indicators and causes are described in the FY 82 CPSS. Here we review those public service programs which appear not to have been successful in reaching Indonesia's poor people. Public services are all the more important for families not able to purchase basic goods and services in the market and for a population 44% of whom are below the age of 15. In fact, a ranking of such factors as secondary school enrollment, access to clean water and health services places Indonesia in a group of countries poorer than itself, beneath the achievements of other developing countries in the $370 per capita income range.

There are reasons for what would appear to be a serious under-investment in rural services. These include the mitigating circumstances of a poor development record in the 1960s, the country's physical diversity, a colonial policy which provided little by way of qualitative improvements in rural life, and the relative newness of the country's oil income. Nonetheless, major new investments in service programs appear to be in order.

A review of social indicators in the World Bank's World Development Report, 1980 is illustrative. With respect to life expectancy at birth for example, 38th-placed Indonesia with a 1978 per capita income of $360 has a 47 year average life expectancy which places it "behind" ten poorer countries and ahead of five richer ones. With respect to the improvements in life expectancy which have taken place between 1960 and 1978, 27 poorer countries added more years to the average life expectancy than did Indonesia with an improvement of six years.[27/]

With respect to the supply of physicians in 1977 (an admittedly poor proxy for rural health services), Indonesia faces a severe shortage of doctors with only one doctor for 15,000 people. Ten poorer countries have a better

availability of doctors, while only one richer country has a smaller supply in proportion to its population. And as for access to safe water, in 1975, 22 of the 37 countries poorer than Indonesia show a greater availability of safe drinking water. More significantly, only 30-40% of the Indonesian population is said to have an adequate daily consumption level of calories and protein.[28/]

The success with which the government has expanded primary school enrollment will place great pressure on the government's capacity to expand additional educational facilities. At present, school enrollment levels in institutes of higher education are very low. In 1977, only 21% of the eligible secondary school population was in school and only two percent (in 1976) were in post-secondary institutions.[29/]

Our point here is to emphasize that one of the severest constraints on development now and over the longer term is the lack of trained people with managerial experience. Data on the present quality of rural services reveal that there are serious deficiencies in health and nutrition among a population who will need to be educated in coming years. It takes a substantial, sustained educational investment to develop a diverse, qualified labor force. As Western experience has shown, it is this investment which accounts for most of the development in rich countries; the growth of Western economies is explained far more by advances in human than in capital productivity.[30/]

C. The Dynamics of Poverty and Development: Poverty indicators obviously do not stand alone in a mechanistic fashion but are simplified characterizations of complex factors within families, communities and the larger world. Development programs have long recognized this complexity.

Seen in historic terms, the doubling and quadrupling of the population on Java since 1930 must be this island's most significant cause of poverty. It

is this factor which makes the importance of family planning so compelling, and the vastness of the outer islands so appealing.

A poor rate of growth for some major food and estate crops, which have traditionally employed many people, is also a leading cause of poverty for a population which has grown so rapidly. As a result of economic priorities established in the 1960s, GDP growth per se has created relatively few jobs in comparison to the numbers needed, and little purchasing power for day laborers, many cultivators and artisans in the traditional trades and services.

And because of population growth and urban-biased development policies, government programs and services have not been equally available to all. An expectation of access to programs and social services on the part of villagers far out-distances the government's achievements to date, and often runs afoul of the pre-existing distribution of power, assets and income. Even programs designed specifically for landless laborers have not had their full developmental impact.[31/]

These basic determinants of poverty - rapid population increase, a capital consuming growth pattern, and the limited availability of many public programs and services - inter-act with each other in complex ways. Explained simply, equity is not likely to be improved without growth because economic opportunities will not otherwise be made available.[32/]

Over the longer term, the subtle dynamics of change are altering the economic structure. On the heels of a seed revolution is an information revolution made possible by radio, television, the cassette and video. The present investment in primary education will cause a demand for more education. The government is acting to increase the influence of women in government. Policy changes which outsiders may feel should be made with the stroke of a pen will more forcefully and enduringly take place as the

government's staff becomes more developmentally-minded and as the myriad of national and international channels of communication develop. Public and private sector forces are directing the economy's structure to favor broader groups of people. Impatience with the pace of this change should not obscure the fact of its existence.

4. Indonesia's Food Production - Population Growth Equation

A. The Food Production Record: An overview of the food production, consumption, and population picture in Indonesia provides some indication of the country's food situation. A look at rice suggest a highly favorable picture as we have indicated earlier. The major non-rice food crops of corn, cassava, sweet potatoes, peanuts, and soybeans show an overall weighted average rate of growth of 2.2% per year for the 1969-1980 period, or just about the same growth rate as that for population. Cassava's production, because of its size and weak performance, masks the significant increases in three smaller crops which have occurred over the decade: corn (3.5%), peanuts (5.0%) and soybeans (3.0%). (Cassava's importance as food is overstated because 10-15% of each crop is exported.) In summary, the six food crops taken together show an average annual increase of 3.0%, ahead of the population growth rate of 2.3% for the period.[33/]

When account is taken of per capita income growth of about 5% per year and an average income elasticity of demand for basic grains of .3-.4, it is apparent that domestic grain consumption is growing a little faster than domestic production. Consumption is growing at about 4.5% per year, while the production of staple foods is growing by some 3.0%. To meet the growth in market demand, food imports have grown at an average rate of 12.5% per year over the last five years.[34/] Even in the face of large foreign exchange holdings and a leveling off in food import levels, the government is acting to

reduce this dependency by sustaining its emphasis on rice and by increasing attention to crop diversification.

B. Food Distribution: Because the overall growth rate in domestic food production is improving and because of large food import levels, total per capita food availabilities appear favorable when compared with accepted nutritional standards. Based on 1977 data from the Central Bureau of Statistics (CBS), there is more than a sufficient supply of calories per capita and the protein supply is over 97% of the recommended level.[35/]

However, according to John Dixon, a Ford Foundation specialist, these aggregates do not reflect the availability of food for the poorer half of the Indonesian population. He notes that "the poorer groups consume 10% to 25% less rice than the total population averages and this "loss" is not really replaced by increased consumption of other foods." For the three lowest expenditure groups (with 58% of the total population), average consumption of calories in 1977 was 1797 per capita per day (or 87% of the 2100 caloric standard) and average protein intake was 32.2 grams (or 74% of the 45.9 protein standard).[36/]

One cannot conclude however, how many Indonesians are experiencing malnutrition and to what degree. Household surveys and crop production estimates are well known for underestimating family food intake; they do not take account of minor food crops or of the household garden with its fruits, vegetables and poultry which is said to be a very significant source of protein.

In summary, Indonesia faces a food distribution problem, but food data alone do not provide an indication of which areas are the poorest, at-risk, regions. For this, nutritional education and direct feeding programs have to rely on kabupaten data, village studies and news reports.

Fortunately, village data are increasing in supply. The President directed CBS a year ago to develop social indicators for village Indonesia. Because of this effort, and earlier work, there is a fairly well documented assessment of the numbers of poor people in 2910 of the country's 3341 kecamatan, and the severity of their poverty. The poorest eight percent of the population, almost 12 million people, has been identified using the CBS standard.[37/] Newspaper reports on famine conditions among villagers, and there are said to be an average of five such reports among village households each year, have given rise to governmental emergency food distributions and to a commitment to establish a famine surveillance program. In short, data do exist to guide the public programs described briefly in a following section.

C. BULOG, and Food Policy Options: The national commodity logistics agency, BULOG, is responsible for supplying basic food commodities at stable prices to urban Indonesia. It does so by selling grain at fixed prices to urban wholesalers, and by supplying rations to the 2.5 million civil servants including the military. Some food is distributed on an emergency basis to such areas as the Eastern Islands.[38/] Public food stocks are maintained by a domestic rice procurement program, which also serves to provide support prices to farmers, and by the import of rice and wheat. Just as the government gives singular emphasis to rice production, so too does it give great emphasis, through BULOG, to stable urban food prices. It has been successful and efficient in fulfilling its mandate.

Because of food import costs, and because Indonesia is such a large buyer in the international rice market, a policy to diversify the nation's mono-crop strategy was announced in Repelita III.

Some experts have argued that much of the effort to diversify food consumption and thereby production can be achieved: a) by allowing the rice price to rise (and so curtail its consumption); b) by encouraging production

of other crops by offering higher prices (as occurred with the 1978 devaluation); and c) by shifting the subsidization of rice towards other lower-cost staples.[39/]

Consideration of these options over the last two years suggests that these prescriptions are basically correct but must be seen in a time span of ten to fifteen years. An appreciation for the narrowness of the urban diet and of the production and marketing constraints facing this island nation inevitably lead to this conclusion. Experts have emphasized that the production and marketing constraints on non-rice food crops are serious, and that promotional efforts are needed to develop new food products and tastes. These recommendations argue for broad-based efforts that give primary emphasis to programs of agricultural research and extension, to supporting physical infrastructure, and to research and promotion of acceptable foods which will help meet the nutritional requirements of poor people. (These are areas of priority attention in the AID program.)

The importance of rice to the national diet is part of the policy dilemma. In urban Java, rice provides over 96% of the staple food calories.[40/] For this reason, a rapid rise in the price of rice would seriously hurt most urban consumers without necessarily stimulating the production and supply of acceptable substitutes. Because rice substitutes are not significant in the urban diet, except for the increasingly important wheat, price changes alone will not induce significant demand and supply adjustment in the short term.[41/]

Still there is much to learn. It is far from clear that the Ministry of Agriculture and BULOG should develop rice-style production programs for the other major crops. Each crop has special problems including ones of marketing and acceptability which will require several years to work out. Crop specific

studies are underway. These include a two-year study on cassava and one for a proposed AID secondary crop project.

D. Food and Nutrition Programs: This brief review provides some perspective on Indonesia's food situation. Although there is a problem of food import dependence and of food distribution, these do not appear to be of crisis proportions nor insurmountable. Nor does it appear that the population - food equation will lead to crises in the future, if the government sustains its commitment to Third Plan goals.

The government is concerned nonetheless about its overall food availability picture and specifically about food distribution. President Suharto has said that "low quality of food not only weakens people today, but will create a weaker generation in the future". The government is acting to diversify its food strategy; it has directed BULOG to promote other crops; public works programs focus on poor areas; special blended food products are being tested in some village nutrition programs; blindness caused by nutritional deficiency is receiving special attention; and an early warning system for famine prevention is being developed. The Ministry of Health is acting to sensitize other line ministries to the importance of nutrition, and is setting standards for the many public and private targetted nutrition programs. CBS is expanding its poverty indicators to guide targetted programs. In short the government is beginning to understand that nutrition programs are not "feeding" programs; they are investments in the future.

Some of this governmental commitment and progress reflects AID's early work and current assistance. The mission's influence has been large through its on-going work in agriculture, health, nutrition, and through the research it continues to support in these areas. AID programs of Nutrition (famine) Surveillance and the Expanded Program of Immunization, our work on vitamin A

deficiency through Helen Keller International, and with the Village Family Planning/Mother Child Welfare Program and the planned Comprehensive Health Improvement Program are increasingly targetted on those with severe health and nutritional deficiencies. (The role of PL480 Title II is discussed in Part II.)

In summary, the macro picture is an encouraging one because the gap between food production and consumption appears to be narrowing, the population growth rate is slowly coming down, foreign exchange reserves are large, and the government is assuming responsibility for assisting those people who are the most malnourished. Should the Third Plan approach its employment targets and as a policy of food diversification is implemented, prevalence of malnutrition can be expected to fall.

5. Program Directions of Other Donors

Concessional assistance "pledges" in support of Indonesia's development plans are made at the annual meetings of the long standing Inter-Governmental Group on Indonesia (IGGI). Annual IGGI commitments have grown over the years from $560 million in IFY 1970 to an estimated $1.9 billion in IFY 80/81 pledged at the May 1980 meeting in The Hague (IGGI-23). The large FY 80/81 ODA pledges were: The IBRD, $800 million; the ADB, $250 million; Japan, $280 million; The United States, $128 million, the Netherlands, $80 million; Germany, $68 million; France, $65 million; and Australia, $45 million. (Data on donor pledges for FY 79, FY 80 and FY 81, and estimates for the bilateral donors for FY 82, are included in Annex B.) In addition to these pledges, a number of donors provide substantial concessional "aid" as part of financial packages for major projects of commercial interest to them.

Since FY 74, the U.S. share of the total annual IGGI pledge has declined from about 30% to about 10% in FY 79 and FY 80, including food aid. For FY

81, the U.S. share decreased to about 7%, including food aid, and to 4% without it.

The Indonesian government now finances most of its development budget. For the FY 79/80 budget of $5.6 billion, 34% was donor financed. During FY 80/81, this percentage falls to 22% for a much larger budget of $8.0 billion.

With respect to the overall developmental direction of the donors, there may be some shift in interest towards rural programs, to training and education and to public services. This shift is explained by the donors' increasing awareness of the constraints on the government's ability to expand development programs for a wide spread rural population. The AID program is distinctive in that it is the only donor program which over the years has been broadly designed to expand absorptive capacity through training and institution building projects.

Because the Japanese have the largest bilateral program in Indonesia, its program directions are important. The Japanese Ambassador recently announced that his government's two main development goals here are to help the country achieve food self-sufficiency and to help the government reduce the population growth rate. In addition to its aid interests, some 210 Japanese companies have invested in joint ventures for the domestic manufacture and sale of consumer goods. (The U.S. has 73 joint ventures in Indonesia.) This approach promises to result in significant growth in medium-scale industrial output and employment.

We may also see greater World Bank interest in human resource development, in part because the resource gap has turned positive and because there is greater awareness of the constraints on development. But, the absence of IDA funding appears to restrict the Bank's ability to provide technical assistance since the government resists acquiring this assistance on near commercial terms. We should also note that it appears that the Bank may be less able to

accommodate itself to changing circumstances and to regulations such as Kepres 14a than other donors; it remains to be seen whether the Bank plays a larger or smaller role as a result.

We also note that the demonstration effect of AID's rural projects has had some impact on other donor perceptions and possibly on their project priorities. Because of AID's focus and its field staff, the AID mission here is viewed by other donors and the government as playing an important role. We have the impression that as the government's oil earnings have increased, making it difficult for donors to justify capital transfers on a "gap" basis, they have shown greater interest in the kinds of projects AID is financing and the ways in which it is implementing them.

Nonetheless, several donors are more interested in the commercial benefits of their assistance than in the development impact of the projects they finance. A few donors "package" their ODA assistance with special project and export credits.

In retrospect, AID's investment in feasibility studies since the 1950s has enabled other donors to commit funds to many projects here. Because of this we have also had some impact on the government's ability to use its own foreign exchange for turn-key infrastructure projects, and on its ability to attract commercial financing for other projects. A few large donors are much more aware of this link than is AID. This issue is discussed again in Part II.

We also point out that as the donors show some "diversification" of their interest towards Indonesia, the government itself is increasingly aware that their international economic relationships should include issues of technological transfer, foreign investment, and access to foreign markets for raw materials and manufactured goods.

At the IGGI-23 meeting last May 1980 the United States was the only donor to announce a decline in its aid. The other donors maintained or increased

their assistance levels. At the upcoming IGGI-24 meeting scheduled for May 1981, we expect the Japanese, the Dutch, the French and the Germans to maintain or increase their real levels. Assistance from a number of donors is rising markedly if one considers the concessional financing provided in addition to their official ODA IGGI pledges to complete commercially competitive packages for major projects.

The Japanese continue to be interested in identifying one or two specific projects in which it can coordinate its technical assistance with AID; family planning and energy are examples. In addition, as indicated earlier, World Bank officials here have indicated that local circumstances (particularly the government's attitude towards Bank loan financing of technical assistance) might lead to increased opportunities for World Bank-AID project level coordination. Unlike the Japanese, who are only interested in coordinating their technical assistance with AID's projects, the Bank appears receptive to coordination involving our technical assistance and their capital financing.

In conclusion, overall ODA assistance levels are steady in nominal terms. In FY 1978/79 bilateral donor commitments through the IGGI were $829 million, in FY 79/80 they fell to $726 million, and in FY 80/81 they increased slightly to $749 million. Because of increased multilateral support, total IGGI - ODA assistance has increased slightly in nominal terms (see Annex B).

PART II The AID Program Strategy to Strengthen United States - Indonesian Relations

1. AID Program Directions

Technical assistance designed to expand capacity for development, e.g. training, institution building, testing of new ideas, effective project implementation and financial discipline, is essential to Indonesia's development effort. There is agreement among all donors and within the government about this need.

Two developments during the past year have had a major impact on the determination of our FY 83-87 program strategy. The first of these deals with the government's approach to AID for technical assistance to help it expand selected rural development programs, e.g. provincial development, watershed management and rural electrification. In effect, the government has indicated a willingness to use its own financial resources to increase the pace of development. However, the government feels constrained in doing so unless it has assurances from AID that we will provide the technical assistance needed for the effective use of the government's funds. Our response to this approach, as it pertains to FY 81 and FY 82, has been guarded and not particularly forthcoming because of funding, particularly grant funding, limitations. For the period FY 83-87 we anticipate increased governmental pressure on us for this kind of assistance and accordingly have included it within our proposed program and funding projections.

Closely related to this matter has been the significant shift during the past year in both the government's attitude toward the World Bank and the Bank's perceptions of its relationship with AID. In recent months the government has advised the Bank that it is reluctant to use Bank loan funds to

finance technical assistance components of Bank assisted (or other) projects. In addition, the Bank staff has expressed some frustration (stemming from both Bank and government circumstances) regarding their technical assistance efforts in the rural development sector. The Bank Mission in Indonesia has advised AID of the Mission's desire to cooperate with AID under circumstances in which we would provide technical assistance in the development and implementation of major projects for which the Bank would provide financial assistance. Indications are that the government would support this kind of cooperative arrangement. Accordingly, it is reflected in our FY 83-87 assistance strategy and budget projections.

To "multiply" the impact of AID's technical assistance, we would operate in three basic and sometimes overlapping modes, the latter two of which are essentially new:

-- assisting the government in the planning and implementation of complete demonstration projects (i.e. the generally used mode in which we provide technical staff, training, limited commodities and increasingly limited local currency);

-- helping the government transform AID-tested project models into national programs; and

-- cooperating with the World Bank (and possibly the ADB and other U.S. international agencies) in formulating, packaging and implementing new projects. (The World Bank has already indicated its interest in this kind of arrangement. Neither the ADB nor, on the USG side, the Export-Import Bank or OPIC, have been approached regarding these matters.)

Another matter which has impinged heavily on our strategy as presented in this CDSS centers on the AID role vis-a-vis both the U.S. private sector and the U.S. government apparatus established to support that sector in its

operations overseas. During the past year a consensus has emerged within the U.S. Mission: there are unexploited opportunities for the U.S. private business sector to contribute more to Indonesia's development while achieving its own business interests. We believe that these two interests are compatible and that AID can perform a useful role, within current legislation, in facilitating and supporting their common pursuit. AID's role in this area must be largely a facilitative and supportive one; it must be carefully coordinated with the interests and capabilities of the EX-IM Bank, OPIC and the Commerce Department and must rely on these organizations and the private business community itself for the financial resources and other inputs required.

2. The Strategy Overview

AID's programs will help the Indonesian government implement a strategy formulated in the government's series of five-year plans, which are aimed at broadening opportunities for the Indonesian people generally and the rural poor specifically. We believe this strategy and its program direction will be continued throughout the 1980s.

The goal of the AID assistance program to Indonesia is a significant expansion by FY 1987 of the institutional capacity of the government and the private community to use more of their own resources and those of development banks, U.S. companies, and other donors to meet the needs of the rural population, particularly in the areas of employment opportunity, food supply, health and family planning services, and energy. These programs are strengthened by and depend on continuing in-country and overseas training programs.

Much has been accomplished as we have illustrated in Part I. Food production, primary education, family planning and institutional development

have received substantial emphasis and have recorded major successes. The government is also planning for the longer term with its support for decentralized development planning and administration, for resource conservation, and for stepped-up training programs for government employees and for universities staff.

Although government resource levels are not a constraint now, the general problems of underdevelopment, the absence of adequate numbers of tested program concepts, and a weakly developed cadre of managers and technicians limit the rate at which financial resources can be utilized and therefore the rate at which Plan goals can be achieved.

We propose to continue to concentrate our activities on helping the government: eliminate constraints on agricultural and rural development; reduce fertility rates; improve the provision of public services to the rural areas; and upgrade development-oriented institutions and personnel at central and lower levels of government. We propose to use all resources available to us - grants, loans and PL480 - in a coordinated manner to assure high developmental pay-off.

The mission's priority is the agricultural and rural development sector with special focus on food production (particularly secondary crops), non-farm job creation and stabilizing the environment. Between two-thirds and three-fourths of our annual development assistance resources would be allocated to programs in this sector. While the basic purpose and direction of the program in this sector remain constant, we plan some changes: 1) a discontinuation where possible of local cost financing for rural infrastructure; 2) an intensification of technical services and training, particularly at the provincial and kabupatan levels, to improve management; 3) increased geographic concentration, primarily within the context of our PDP

program; and 4) an incorporation of multiple objectives into programs, e.g. nutrition and family planning; or environmental control, agriculture research and energy.

Beyond this, we would attempt to work with various government and private sector entities and perhaps other donors to stimulate activities designed to increase off-farm employment. We also plan a special effort to explore ways by which we can facilitate and support U.S. private sector involvement in Indonesia's development efforts. At present we have no firm proposals to make in either of these areas but are pursuing several promising ideas

Family planning, along with agriculture and rural development, would continue to be ranked as our highest priority. We plan to provide about 10% of our annual budget to this sector. In sectoral terms, the remaining 15-20% of our funds will be directed to education and training, health and energy. While funding levels in each of these areas are low (see Annex F), the development pay-off is substantial.

3. Sectoral Strategy Statements

A. Agriculture and Rural Development: Our rural and agricultural development strategy will concentrate on four main areas: increasing agricultural productivity to attain self sufficiency in food crops production; promoting improved environmental management of the upland areas in the densely populated regions; strengthening the capabilities of local government and promoting regional development; and promoting off-farm employment through rural enterprise development.

1. Agricultural Productivity: AID's past and projected assistance for the agriculture sector is designed to support ongoing government efforts to attain food self-sufficiency, and generate employment opportunities. AID support can be broadly differentiated between those programs designed to

directly impact on production, productivity and employment within the sector and those programs designed to increase the technical, planning and management capability and manpower base of the various institutions serving the agriculture sector.

a. Institutional Capability: The pace of agricultural development in Indonesia is severely restricted by the limited professional manpower base and the equally limited scope and capability of various agricultural institutions to conduct research, and plan and administer development programs. For these reasons, the development of institutional capability in the agricultural sector must continue to be a primary concern of AID during the CDSS period. Our institutional support efforts are focused on three discrete areas: agricultural research, agricultural education and agricultural planning and administration.

(1) Agricultural Research: During the past decade, AID assistance for agricultural research has focused on building Indonesia's central research capability, largely in support of rice production. During the late 1970s, this assistance shifted to developing regional capacities for applied research; this focus will be continued in the 1980s. Under two separate projects we will continue to help develop facilities and professional capabilities in a network of research stations to conduct applied agricultural research on the islands of Sumatra, Kalimantan, Sulawesi, Maluku, Bali, the islands of the Eastern Timor and the province of West Java. Therefore, during the planning period, AID plans to assist the government in developing regional research capabilities largely for the outer islands where a great long-term food crop production potential may exist. These programs will also support the government's broader efforts to promote regional development in the outer island areas as appropriate cropping systems are developed for the varying agro-climatic and ecological zones found in these locations.

Because the unemployment problem facing the country is so severe, AID's support for agriculture research, as in all of its activities as appropriate, will stress labor-using products and processes in agriculture (and industry) to improve employment opportunities. Here, special attention needs to be paid to projects which create productive opportunities for rural women.

(2) Agricultural Education: In this area AID will continue to follow a strategy of working with regional associations of public universities to upgrade agricultural faculties. To date, about one-half of the 27 universities of the country with agricultural programs have participated. Through this program several hundred faculty members will be trained at the graduate level to provide them with the analytical, research and management skills crucial to agricultural sector leadership. Both short and long-term technical assistance will be used to assist with the reformulation of curricula and the setting up of research and public service outreach programs. Overall, this fifteen-year effort, initiated in 1977, will help to engage the agricultural structure within the Indonesian university system in rural development problem solving. Closer relationships between the resarch centers of the Ministry of Agriculture and the university agricultural programs would enable both to contribute more effectively to resolving the country's food and nutrition problems.

We expect to launch in FY 81 a new project with the Western Islands Association of Universities. The government with AID financed Title XII assistance is designing a project to develop the capabilities of agricultural universities on Sumatra and Kalimantan in a manner similar to the Eastern Islands effort. The final component of this program proposed for AID financing is planned to start in FY 83. The Nusa Tenggara Agriculture Education Project will address institution-building challenges in approximately six universities in the Southeastern quadrant of the country.

(3) Agricultural Planning and Administration: The Ministry of Agriculture's planning and management capability, both from a national and sectoral perspective, has been hampered by the absence of a coordinated planning and management system, by a shortage of qualified personnel, and the absence of an adequate data base. The negative impact of this situation on the agricultural sector specifically and the entire economy generally remains great. The Ministry recognizes these deficiencies and is in the process of taking remedial action. In support of this effort AID and other donors have funded the training of substantial numbers of long and short-term participants. In FY 77 we and the government initiated a project to assist the Ministry to improve its planning and management capability by strengthening its data collection and processing center through training and automation; by providing consultant assistance to coordinate macro-level agricultural policy research efforts; and by providing long and short-term training for planners and programmers located throughout the different central and field planning offices. In FY 83 or FY 84 we expect the majority of these participants sent to the U.S. for professional training will occupy key positions within the Ministry. At that time the scope for additional AID assistance will be explored.

AID is further contributing to the development of the agriculture sector planning capability through introduction of improved field data generation techniques and a pilot land mapping and titling project. If successful both of these programs could be extended during the CDSS period.

b. Production Impact: During the CDSS period AID would continue to support the government's efforts to achieve food self-sufficiency through an assistance program which places balanced emphasis on continued development of irrigated agriculture and the promotion of secondary crops on rain-fed, non-irrigated lands.

For irrigated agriculture we plan to move away from supporting a centrally administered approach to irrigation development. Regional and provincial water resources institutional capabilities are better able to promote participation by local decision makers and farmers in system operation and maintenance. Sustained participation by the local community in all aspects of project design and implementation is important if farmers are to accept responsibility for maintaining the infrastructure once it is in place.

Two projects are being developed which would directly support the effort to decentralize responsibility for planning and implementing water resources programs. The first would build on the experience acquired during implementation of the Sederhana Irrigation program; the major distinction being that individual irrigation sub-projects would be designed and implemented entirely at the provincial or district level in a few selected provinces. Given its decentralized and experimental nature, the project would be financed with concessional grant and loan funds. The second project would focus on upgrading regional water resources planning and implementation capability on one of the major outer islands and would focus on construction of medium to large-scale water resources projects. The scale of individual component projects and the large capital investment that would be necessary to carry out the program, require that it be developed in a manner that would package concessionally financed technical assistance with either international development bank funds or a commercial line of credit to purchase heavy equipment and construction supervision expertise.

To date little effort has been given to exploiting the potential complementarities that may exist between rural electrification and pump irrigation. For the government's rural electrification program, the inclusion of a World Bank-financed pump irrigation component could generate demand for

electricity within the rural electric service areas. From the irrigation perspective the availability of reliable power from a central source for pump operation may decrease operating costs and minimize the serious operation and maintenance problems inherent in any pump irrigation program. If this concept proves feasible, Indonesia would have a new model for promoting intensive agricultural development in surface water-deficit and densely populated areas. AID plans to explore with the World Bank and the government the possibility of ground water irrigation by the use of electric pumps.

With respect to rain-fed agriculture we plan to develop pilot programs focused on secondary food crops. A project scheduled to commence in 1982 would concentrate on 1) the drying, storage and marketing of secondary crops, and 2) the extension of on-going cropping systems research to farming systems research to determine the optimum crop-livestock combinations appropriate to various agro-climatic zones. Since secondary crops historically have received only limited attention from the government and the donor community the early years of the CDSS period will be spent developing the empirical foundation which could provide the basis for follow-on activities in 1984 or 1985.

A complementary activity supporting both irrigated and rain-fed agriculture assistance programs will be undertaken to reduce the major annual losses due to pests and improper crop handling. Pest management in Indonesia is a relatively neglected functional area, by both the government and donor agencies, although plant pests alone reduce crop yields by 15-20%.

2. Environmental Management: Perhaps the most serious issue confronting government policy makers with respect to long term agricultural development on the islands of Java, Bali, Madura and Lombok is the prospect of irreversible environmental deterioration of vital watersheds due to extreme population pressure and the consequent introduction of sedentary agricultural practices

on increasingly steep slopes. The problem is of such dimensions now that unless corrective measures are taken soon the fundamental character and productivity of inner island agriculture, both upland and lowland, could be seriously impaired within the time span of one or two generations.

The government, with AID assistance, has pioneered the development of an ecologically stable and privately profitable upland technology package which holds promise for dramatically reducing soil erosion in watershed areas, while at the same time increasing upland productivity and farm income. Also within the context of the Citanduy River Basin Project, AID has been instrumental in assisting the government develop and test a decentralized, interagency framework for disseminating this upland package of technology to farmers throughout the watershed areas of the Citanduy Basin. Building on this experience, the government, AID and the World Bank are exploring the possibility of formulating a multi-donor technical assistance and capital financing package which would enable the government to systematically expand the Citanduy technology package and institutional framework to five other critical watershed areas.

The urgency and dimensions of the problem, coupled with the availability of a technological package, a workable management framework, and wide interest in undertaking a collaborative multi-donor initiative including AID, highlight this activity as one of our most important development themes in coming years. This proposed program is illustrative of how AID can leverage our technical assistance resources to address a major problem on a national scale through collaborative arrangements with the multilateral banks.

3. Local Government and Regional Development: Perhaps our most significant rural development achievement over the preceeding five-year period has been our institutional support for bringing local government more fully

into the development process. This assistance has placed us in a leading role among the foreign donors in promoting the development of local government capability and is in line with the decentralized direction of development sought by the government.

The Provincial Area Development Program (PDP), which is currently operating in eight Provinces, will begin a national expansion (starting in FY 82) into five additional Provinces. Under a separate but closely related activity, Local Government Training, AID will assist the government in implementing a training strategy which will upgrade provincial and kabupaten level officials in planning and management skills. AID will also build local government components into our rural development efforts, both to capitalize on the institutional advantages inherent in decentralized administration of public programs as well as to upgrade the capabilities of the local agencies.

With respect to regional development AID will continue to assist in the development of appropriate institutional mechanisms for both the inner and outer islands. Implementation of Phase II of Citanduy River Basin Development Project mentioned above has only recently begun in conjunction with the Asian Development Bank. We expect it to pioneer institutional mechanisms for national planning and development of inner island river basins which includes a major role for local government. Phase II will concentrate on the basin wide extension of the successful upland agriculture and erosion control pilot activity developed and tested under Phase I. Given the importance of environmental management and erosion control especially on Java, Bali, Madura and Lombok, AID plans to extend this particular component more broadly as proposed above.

The Luwu Area and Transmigration Development Project I has also become a model after which several donor assisted transmigration and area development

programs are patterened. This model involves the creation of an area project office with responsibility for coordinating the investments of several national sectoral agencies in a defined geographic area. AID believes that a principal task should be to further strengthen the capability of local governments so they can increasingly assume and effectively discharge their responsibilities for guiding and coordinating regional development. This task is and will continue to be the focus of the PDP program in its work with provincial and district level government.

An important lesson learned from the Luwu, Aceh Road and other location-centered projects and from the growing literature on development needs and priorities for the outer islands is the importance of transport and water resources infrastructure to the development of these outlying regions. We have concluded, as have others, that the creation of this infrastructure base, and the employment generated in the process of its creation, could serve as the central stimulus to the pace of outer island economic development. Investment in infrastructure could also have a greater influence on stimulating spontaneous out migration from the heavily populated inner islands than government efforts at directed transmigration.

Accordingly, we plan early in the CDSS period to explore with the government and the EX-IM Bank, the collaborative undertaking of two projects that would link concessional technical assistance from AID with commercial credits from the EX-IM Bank to be used by the government to purchase engineering supervision services and heavy equipment necessary to implement the proposed projects. One possibility would be development of a major transport planning and investment program on one of the major outer islands (e.g. Sumatra, Sulawesi or Kalimantan). The element financed by AID on a

concessional basis would involve technical assistance focused on institutional development, transport planning (including feasibility study preparation), training and project implementation supervision.

The second project idea, also focused on one major outer island, would develop a comprehensive plan and investment program for the water resources sector. Concessional technical assistance financed by AID would focus on developing the institutional and management capability of regional water resource agencies, water resources planning including preparation of project specific feasibility studies, training and construction supervision if necessary. The EX-IM Bank could negotiate a credit with the government for the purchase of required, U.S. source, equipment and construction contract financing.

In both of these projects we wish to emphasize the importance of linking our concessional financing for technical assistance from the outset with commitments for follow-on capital financing from sources such as the EX-IM Bank or multilateral sources or the government itself. It is the mission's judgment that given the limited administrative capability within the government for packaging programs of the magnitude suggested above, the government would be receptive to this approach.

4. Enterprise Development and Off-Farm Employment Generation: The mission plans to continue to support programs wherever possible to generate new employment opportunities and increase labor productivity in rural Indonesia. As described earlier, we view this as perhaps the most pressing problem facing the country, particularly for the overcrowded inner islands. We expect that many elements of our assistance for agricultural and rural development will continue to contribute to increased labor productivity and employment but recognize the need for additional measures to deal with

non-agriculture employment. Therefore during the CDSS period we plan to move from our involvement with labor-intensive, public works project activity (via Rural Works) towards more self-generating and sustainable employment creation via enterprise development, focusing on cottage industries, small scale manufacturing and processing, and commerce and trade. In line with our efforts to provide geographic and program concentration, AID plans to undertake this activity in Central Java where we have gained some experience through our association with the Rural Electrification and Provincial Area Development programs. We plan to initiate a pilot Central Java enterprise development activity early in the CDSS period. Opportunities may present themselves during implementation of this project to increase the role of the U.S. private sector in this effort.

B. Population and Family Planning: Indonesia's population in 1980 was 147 million. The average annual population growth rate during the 1970s was 2.34%, with annual rates apparently declining from 2.7% in 1970 to about 2.0% in 1980. Some two thirds of the population live on Java which has a population density of 1800 persons per square mile, one of the highest in the world. Despite good agricultural sector performance during the 1970s, Indonesia remains a large net food importer; and despite increased per capita food consumption, malnutrition is widespread. Its population size, growth and distribution are directly related, as both cause and effect, to Indonesia's major development problems of unemployment, food supplies, poor health, illiteracy, landlessness, energy, erosion and deforestation.

Government policy emphasizes family planning and promotes the concept of the small, healthy, and prosperous family. The national goal is to reduce the crude birth rate to 22-23 births per 1,000 population by the year 1990, a 50% reduction from the 1971 rate. To achieve this goal and promote greater social

equity, the government is extending its family planning service delivery network throughout the country, improving existing services and broadening the range of available contraceptives.

During the past decade the national family planning program moved from the traditional clinical approach to a village family planning approach which seeks to make the villagers themselves directly responsible for the program. By late 1980, seven million couples, or one-third of the eligible couples in Indonesia were using modern contraceptives under the national program. On Java-Bali 43.4% of the eligible couples currently use modern contraceptives.

Three organizations (AID, UNFPA, and the World Bank) provide most of the donor resources for family planning. Each donor organization has a special area of assistance with only marginal overlap. In 1970 about 75% of the family planning budget came from foreign donors, almost entirely AID. However, as the total family planning budget has expanded rapidly over the decade, so too has the government's share: by 1977 the government was providing over 50% of the budget, and by 1980, 66%. The cost of program implementation will rise as family planning services are provided to the more remote islands, and as new activities are initiated to reach the hard core of non-acceptors and to maintain higher levels of current users.

During the 1980s, AID plans to continue as the largest foreign supporter of family planning with a strong team of population specialists. The nature of this assistance will shift however. Loans for large purchases of oral contraceptive are now scheduled to end during FY 82. Domestic production of pills began in early 1980 and will be expanded in mid-1981. The government can either expand domestic production further or begin to purchase additional supplies, perhaps through the AID/W centralized procurement system. Large scale national training programs are now in place. AID will continue as the

main source of overseas training, concentrating on graduate training for persons who will staff research and training institutions in Indonesia and key operating units. The most important AID program activity will continue to be support for the expansion and strengthening of village family planning activities, focusing on the low acceptor areas of Java and on the ten large other island provinces. We will support the expansion of voluntary sterilization services to assure that couples have a full range of family planning method choices, including the most effective means. A new effort will be made to initiate a program for subsidized commercial retail sales of contraceptives starting with the largest cities. Finally, AID will continue to support the integration of other development activities, especially health, nutrition and income generating schemes, with family planning so long as the momentum of the family planning program is not adversely affected.

We believe we must continue to support the national family planning program throughout the 1983-87 period. Reducing rapid population growth will continue to be a major governmental concern during the 1980s because the number of fertile age women will continue to increase for several decades. Until birth rates are in the low 20s, or in the teens, population growth will still hinder advances in other development sectors. The numbers of people to be reached, informed, served, and maintained in the family planning program are staggering. To reach its 1990 goal, the government must more than double the number of contraceptive users from seven million at present to at least 15 million. The number of paid and volunteer workers required to extend the family planning program nation wide must also double or triple in the 1980's. Yet the administrative capacity of the National Family Planning Coordinating Board and implementating agencies is already severely strained. Requests are expected to increase for specialized technical assistance, development of more

training institutions in Indonesia, program related commodities, and flexible funds for new activities to extend family planning services in less developed areas of the country. AID assistance is preferred by the government because of its flexibility, responsiveness and our willingness to be creative.

C. Health and Nutrition: Public and private health and nutrition services remain among the weakest of all human services in Indonesia. The need for improvement and assistance in the public sector is enormous; yet the government's absorptive capacity in the health field is limited. Under these circumstances and given AID resource limitations we will focus our limited health and nutrition program during the CDSS period on four areas which can most directly reduce infant and child mortality and morbidity: maternal and child health, nutrition, province-level primary health care delivery systems, and malaria control. In all of these areas our assistance will employ a demonstration approach integrated where feasible with government and other donor operations.

The communicable disease burden on Indonesia's children is enormous. Some of these diseases and illnesses can be combated by immunization and others not. It is estimated that by the end of this CDSS period the AID-assisted immunization program against tetanus, whooping cough, diphtheria and tuberculosis will save 150,000 children's lives per year. Many more lives could be saved or improved if the program could expand effective coverage for these diseases, especially if immunization against measles and polio were added to the program. Toward this end we plan to continue our assistance in the immunization area during the CDSS period.

Despite progress made against immunizable diseases, children will remain excessively vulnerable to other health hazards during the remainder of this century. Diarrheas, respiratory diseases and malnutrition, the major causes

of infant and child mortality, are not preventable by immunization. The general level of sanitation is unlikely to improve greatly due to increasing population density, staff constraints and inaequate investment; potable water will still be unavailable to the majority of Indonesians; and breast feeding will probably decline. In view of these negative factors, the government must reach children's parents to improve their knowledge, attitudes and practices toward child care, and thereby help them to reduce their children's disease burden in spite of the poor environmental conditions.

Based on experience in other countries and early indicators in Indonesia, it appears inevitable that DDT resistance among mosquitos and chloroquine resistance in the malaria parasites will spread during the 1980s. Under those circumstances, the related morbidity and mortality as well as the costs, technical and managerial demands and risks of malaria control operations are likely to increase. This is likely to be the case even in the Java-Bali program areas where malaria is under adequate control. Malaria control is not yet established in any of the other major islands in Indonesia where malaria serves as a major constraint to agricultural and general development. The AID assisted Timor Malaria Control Program is the first systematic outer island control operation. If successful, this program's systematic approach may be replicated on other islands - probably Flores, Sumba, Sumbawa and Lombok at first - with larger programs later for Sumatra, Kalimantan, Sulawesi, and Irian Jaya. We propose to provide limited but critical technical assistance.

Regarding nutrition, despite improving rice production, per capita caloric consumption for the majority of Indonesians may remain below adequate levels (much less desirable ones) due to the high population growth rate, inadequate purchasing power, lack of secondary food crops, and inadequate nutrition education. Most of the factors that cause about 50,000 children a year to

become blind from Vitamin A deficiency, that cause millions to suffer from goiter (some of whom then suffer debilitation and produce cretinous children) and that cause tens of millions to suffer debilitating but reversible nutritional anemias, can be changed only over the long term. Nevertheless, specific interventions can be undertaken and pursued during the 1983-87 planning period. Coordinated food-agriculture-nutrition policies and programs are essential and have barely begun; this will be a focus of AID efforts in the 1980s. AID has been assisting with several nutrition interventions including Vitamin A deficiency prevention, delivery of family nutrition services directly to villages, and nutrition surveillance.

The government is currently striving to define primary health care in the Indonesian context; even after definitions and principles are agreed upon, many years will pass before an adequate health care system is established. Although more than 4,000 health centers have been opened in nearly all areas of the country, the harsh realities are that their services affect less than one-fifth of the population. Special attention will have to be paid to the choice of services that reach the people and to the managerial, logistic and epidemiologic support provided, especially at provincial level and below. We plan to initiate assistance in this area soon and to sustain it during the CDSS period.

D. Education and Training: The AID strategy in the area of education and training is designed to support Indonesian goals for the improvement and expansion of selected elements of the Indonesian educational system. Given the heavy involvement of other donors in this sector and AID's concentration in other areas we will continue to confine our efforts to those government priority areas in which we have a comparative advantage. These efforts will be closely coordinated with those of other donors and will stress Indonesian

objectives of improving education for the poor and increasing the education system's staff and institutional capability for planning and directing an expanding national development program. Our assistance stresses the provision of technical advisory services, educational software and training. These three elements complement the government's and other donor concentration on construction and physical expansion; in a sense, our "specialization" allows us to optimize our development investment by concentrating efforts and resources in three areas in which we have special capabilities and interests:

-- the upgrading of agricultural training;

-- the provision of leadership training for key personnel at various levels of government; and

-- the introduction of new and effective instructional methodologies into the educational system.

The first, involving several U.S. universities under Title XII arrangements working with 25 Indonesian Agricultural Colleges throughout Indonesia, represents one of our major areas of assistance. In conceptualizing and planning our proposes five-year program we include this area of effort within our Agriculture and Rural Development sector.

There is wide agreement in Indonesia that many current, traditional approaches to educational techniques and methodologies represent relatively high cost and ineffective ways to expand and improve educational opportunities for large segments of the population, particularly the rural poor. Accordingly, the government places high priority on experimenting with new ideas and approaches to the delivery of instruction, largely at the primary levels and for the benefit of the rural poor, both in and out of school. AID is currently involved in two projects to assist the government in this area.

The first project develops and demonstrates, on a pilot basis, effective self-instructional approaches to primary education which could be implemented by the government on a nation wide basis, starting at about mid-point in our 1983-87 planning period. We are also currently involved in efforts to establish a governmental institutional capability to develop, test and apply new educational technologies at all grade levels.

The provision of leadership training has long been an AID priority in Indonesia. Virtually every AID project has a training component to assist the government at the central and lower administrative levels in developing both the technical and managerial capabilities needed to plan, implement and manage the country's steadily growing portfolio of development programs.

In the past, it was necessary to send most AID assisted trainees to the U.S. or third countries. In order to expand our range of coverage, we and the government have moved increasingly to in-country training, particularly in the field of middle-level management. As witnessed by the extent of the training now being conducted here by our Office of Development Administration, the effectiveness of this training is widely sought and appreciated within the government. During the CDSS period we will continue to provide technical assistance which stresses in-country development management training with major attention being given to the ministries of Agriculture, Education, Planning, Finance, and Public Works. Beyond this both we and the government recognize a need for substantial levels of training abroad for both the public and private sectors. Several other aid donors also recognize this need and are aggressively moving to help meet it by financing training in their respective countries, e.g. France, Japan and Germany. There are many top echelon government officials and private sector personnel with important roles in Indonesia's development who would benefit from training and experience in

the United States. Despite this, we are not always able to train them within the confines of specific projects. Therefore, we need a small, carefully planned training program for selected Indonesian managers and officials, especially for short-term training. We plan to undertake such an effort during the CDSS period; we believe the ancillary benefits for U.S. and Indonesian relations will be significant and long lasting.

We are also exploring other ways AID might assist the government in its expansion of the quantity and quality of education to the rural areas. A strong possibility is to help with the establishment of an Indonesian National Educational Assessment Center. Testing and measurement is a field in which U.S. experts are preeminent, and AID investments can have a powerful impact on the development of a system which has the potential to vastly improve the quality of Indonesian education. A second area we are considering is the development of an Indonesian English Language Academy. English proficiency is a perennial problem faced by most trainees, whether supported by the U.S. or other agencies.

E. Energy and the Role of Science and Technology in Development: Development entails the increasing use of energy and the application of science and technology to accomplish fundamental societal objectives. Perhaps no other sector combines as well as energy U.S. strategic, commercial, and development interests. Because conventional resources such as oil and gas need to be reserved largely as foreign currency earners, and because the government faces hard choices between a rapidly growing domestic market and an equally demanding international one for its oil and gas, energy planning is beginning to seek and encompass alternative energy sources for domestic needs. Based on our experience in several pilot activities, we are now prepared to increase our emphasis in this sector. Our emerging strategy seeks to help Indonesia

maintain its vital oil exports by supporting efforts to plan and mobilize investments in alternative energy resources (i.e. coal, hydro, geothermal, biomass, and solar) and to improve the efficiency of energy use. Within this context, our program will focus on approaches and technologies for meeting the growing needs of rural areas for both commercial and traditional energy. Future project development will emphasize increasing the capabilities of Indonesian institutions in energy planning; resources assessment, project management; technology assessment, research, demonstration, and application; and energy manpower development. A major planned activity will be support for the new natural energy laboratory at the PUSPIPTEK Science Center.

In the area of science and technology we plan to assist Indonesia primarily by supporting applications which supplement our other mission projects and strategies. For example, the further development and marketing of the products of the appropriate technology project complement our efforts to assist in the area of employment generation through small industry development. The pyrolytic converter (of agricultural waste into charcoal, oil and gas) and the variety of ferrocement and fibercement products already designed and proven for village use, may best be disseminated through the PDP and other AID assisted rural development programs. Assistance for the development of specific technological policies will be continued as requested by the government. The further development of rural fisheries and the marine sector will also be considered. In summary, the main purpose throughout AID's energy program will be manpower and institutional development.

F. The PL480 Title II Program: Our current strategy for PL480 Title II is based on the proposed FY 82 level of $17.0 million (including shipping costs). PL480 Title II resources will support the mission's on-going program of collaboration with PVOs in development and humanitarian programs. Title II

commoditios will increasingly be used for Food for Work (FFW) to serve government and mission objectives in rural employment and income generation. Secondary emphasis will be on the use of Title II for Mother and Child Health (MCH) projects. CRS and CWS, and their Indonesian PVO and governmental counterparts, will continue to implement the program.

The mission and PVOs, with AID/W assistance plan to conduct an evaluation of the Title II program in FY 81. The FY 81 evaluation is being taken as an opportunity to more thoroughly assess the Title II program, and to support either a maintenance of current directions or a redirection.

FFW programs to date have increased rural employment and incomes primarily through projects for irrigation canals, land reclamation, and village to market roads (which together comprise 90% of FFW projects). In FY 77, 45% of all Title II recipients were on FFW projects; their share increased to 55% in FY 81; and is projected to increase further to about 65% in FY 83 and FY 84.

Mother and Child Health programs for preschool children and lactating and pregnant mothers also use local foods with Title II commodities, and integrate nutrition, health, and family planning education with their distribution. In FY 77, MCH recipients were 55% of all Title II recipients; their share decreased to 45% in FY 81; and the MCH component is planned to decrease further to about 35% in FY 83 and FY 84.

Title II projects complement AID's strategy in Indonesia. Some examples are:

-- AID's Citanduy River Basin project supports flood control, land reclamation, and irrigation. Since FY 78 about 7,000 hectares have been reclaimed and irrigated in this basin through CRS FFW projects. Approximately 50,000 FFW recipients are employed in these projects annually.

-- Food distribution within MCH programs is used to encourage nutrition and health education, and also to encourage acceptance of family planning information. The largest MCH program is in several districts of East Java. Approximately 25,000 mothers participate in this MCH program monthly.

-- Currently, about 15% of Title II is implemented in the government's outer island transmigration land clearing and cultivation programs, and, depending on the evaluation's findings, and governmental and PVO interest, may be increased in FY 83 or FY 84. In the past three years, 25,000 hectares have been cleared in transmigration areas with FFW projects.

-- The mission's PVO Co-Financing project both assists, and is assisted by, the Title II program. Each frequently fulfills a need of the other, and the pattern will be encouraged in future PVO programs.

-- To begin even closer integration of Title II into some AID programs, the mission and CRS have held discussions to plan a joint project for erosion control and reforestation in Nusa Tenggara Timur (NTT). In a program proposed for FY 82, mission technical assistance and support funds will be combined with CRS Title II FFW and government administrative support for a reforestation project based on CRS' previous successful experience with erosion control and regreening on Flores and West Timor.

G. Private and Voluntary Organizations: There are approximately 80 U.S. PVOs which currently make available some assistance to Indonesia; about 35 of those have some established legal and physical in-country presence in Indonesia. The mission has a well-established, on-going capacity for working with this PVO community. It maintains a separate Office of Voluntary and Humanitarian Programs, and originated the "PVO Co-Financing" concept -- a highly decentralized and flexible umbrella project which allows the mission and local PVO representatives to move relatively quickly and efficiently to review,

approve, fund, implement, and monitor a full range of development projects in-country. Since FY 74, the mission has provided $8 million to co-finance 80 development projects with 17 U.S. PVOs and their Indonesian counterparts. The mission also relies heavily on the PVOs for implementation of the PL480 Title II and Disaster Relief Programs. In cooperation with AID/W, the mission and the PVOs plan to conduct an FY 81 evaluation of their eight-year experience with "co-financing". The results will assist in the design of a new Project Paper for an expanded PVO Co-Financing program in FY 82 and beyond. It is anticipated that funding will be established at $2 million in FY 82, and expanded at about $500,000 annually thereafter.

4. Summary of the AID Program Strategy

We believe the AID program strategy presented above represents a realistic means for promoting Indonesian and U.S. government and U.S. private interests. Implementation of the proposes program will require a positive and forward-looking approach by both the Indonesian government and ourselves. Implementation will also require substantial staff and a sustained grant funding level.

Our proposed program is staff intensive. The program will continue to rely heavily on contract personnel (Americans, predominantly and Indonesian and third country personnel to a lesser extent) from the private business sector and university community. In addition, the participation of U.S. private voluntary organizations (PVOs) will continue to be encouraged to the extent feasible within the limits of their demonstrated capabilities and AID funding availabilities. Ultimately, the success of the program in terms of successfully planning new joint programs and implementing those already in place will depend critically on AID direct hire staff. Over the years the AID staff has evolved good working relationships with Indonesian staff at all

levels in key development ministries and agencies. These relationships have enabled the AID staff to work closely with their governmental counterparts in identifying specific problems and designing and managing well-focused projects. These relationships and the results which flow from them are dependent on the availability of experienced AID technical and managerial personnel. No other donor has this resource in-country; and virtually all recognize its importance. The Indonesian government also has become increasingly aware of the value of the continuous interaction between the AID staff and government managers at both the central and lower levels. We estimate staffing requirements during the CDSS period will remain at about current levels.

Regarding grant funds, we recognize the constraints faced by the Agency in grant availabilities. Accordingly, we are limiting our annual need for grant funds during the CDSS period to $30 million for the continuing program. We believe there will be "costs" involved in this level in terms of reduced contractor effectiveness and project implementation progress as well as administrative difficulties for both the government and ourselves and increased incidents of friction. In the past we have justified the need for grant funds on the basis of their being an incentive and catalyst for attracting government support for high-risk projects. We have also argued the importance of grant funds in providing AID with the flexibility needed to help implement projects in a dynamic and more timely manner than either government or loan funds would permit. (The Family Planning program is an excellent example in this regard.) In our view these arguments remain valid and are independent of the government's financial resources. Our proposed sector planning levels for the CDSS period are included in Annex F.

PART III AID Assistance Levels for Indonesia

The United States and Indonesia have a mutual interest in Indonesia's achieving its objectives of expanding food production, strengthening its family planning program, improving rural services, and of expanding the numbers of trained technicians and managers. With relatively modest financial resources AID has made important and recognized contributions in dealing with each of these basic problems. This valuable work should be continued, and can be at a relatively modest cost to the United States. The share of total concessional aid being provided to Indonesia by the United States in 1981 is down to seven percent, and is about one-third that provided by Japan.

The Government of Indonesia and the World Bank have concluded that AID's technical assistance capability is an essential complement to the financial resources which they can bring to bear on rural development problems. We intend to respond to the government's desires that we continue our technical assistance and project development role, and to respond to World Bank staff suggestions that we engage in more complementary program planning and project financing in coming years.

To support our continuing program we propose to maintain the current level of AID funding in real terms, at around $85 million in FY 83 (see Annex E). During the planning period, we will continue projects in agriculture, health and education, family planning and training, and will seek ways to stimulate on and off-farm employment.

Another consideration in proposing future U.S. assistance to Indonesia is recognition that if AID is to be relevant in helping Indonesia cope with its looming problem of underemployment, a wider range of U.S. resources will need to be coordinated and applied to this end. Moreover, AID's existing program

largely by-passes the special interest the United States has in being both competitive and actively involved in a broader range of commercial and investment opportunities.

AID in coordination with other USG agencies could be helpful in furthering Indonesia's development and in achieving a strengthened overall U.S. economic position. Several forms of financing and financial coordination are possible under existing authorities if Washington concurs that these proposals are timely and feasible; the program budget we propose could be carried out under existing authorities. Other possibilities suggested in Part II could be developed in full if Washington determines that the USG agencies should propose legislative changes. New authorities may be necessary to strengthen USG overseas financial institutions and to match the coordination practiced by other aid donor governments.

We have therefore suggested as a separate component of bilateral assistance an initial $15 million for these activities to complement U.S. trade and commercial interests. We visualize that this increment of concessional funds, in addition to our basic rural development program, will provide a small part of a much larger amount of financing from U.S. non-AID sources such as EXIM, OPIC, CCC, and others. These incremental AID funds would have two purposes: 1) preparation of grant funded feasibility studies and engineering plans for development projects of commercial interest to the U.S. as contractors and equipment suppliers; and 2) facilitation of financial "packaging" for major projects, perhaps through provision of technical assistance by AID for projects receiving loans from the Export-Import Bank.

In coming months AID and other offices of the U.S. mission in Jakarta plan to explore various possibilities for using AID resources to complement the trade and commercial objectives of other U.S. agencies and the U.S. private

sector. Because AID Jakarta has had successful experience with one of these ideas, namely feasibility studies, we recommend an initial $5 million grant level in FY 83 for U.S. conducted feasibility studies and engineering plans. These projects would include Indonesian government and development bank funded projects, which would be of commercial interest to U.S. companies. The involvement of U.S. consulting and design firms in the planning of such projects and the familiarity of their staffs with Indonesia would enhance the prospects for follow-on business.

The program outlined above would combine the best elements of AID practice and experience and American humanitarian concerns with a broadened base of activity reflective of the full range of U.S. interests in Indonesia. With time we could expect to see the integration of these program ideas into a cohesive package to strengthen our bilateral interests.

We propose to continue a modest PL480 Title II program administered by the Catholic Relief Services and Church World Services. The program meets humanitarian needs and consists of food for work and maternal and child feeding. Special efforts will be made to assure that food for work, which is now 55% of the program, is used for development projects such as restoration of tree cover on denuded hillsides. The PL480 Title II level for FY 82 and FY 83 is proposed at $17 million each year (including shipping) pending a review of the program which could see either an increase or decrease in this amount.

The Title I program is proposed for continuation at the level now approved for FY 1982 - $20 million. This is being done upon recommendation of the Country Team which attaches special importance for political and U.S. trade interests of continuing even such a modest program. All of the sales proceeds from the program would accrue to the Government of Indonesia's development budget and would be used for self-help projects designed to increase

Indonesia's domestic food production. Indonesia is expected to continue to be a food importing country throughout the 1980s in spite of much better than average food production increases compared to most other LDCs. The primary justification for Indonesia's Title I program lies with the Department of State and Department of Agriculture.

Last year's FY 1982 CDSS proposed an FY 1982 level of $110 million in development assistance, $50 million in Title I, and $17 million in Title II, for a total of $177 million. AID/W has apparently approved the FY 82 level at $75 million in development assistance, $20 million for Title I, and $17 million for Title II, for a total of $112 million. This is almost one half the FY 79 level. Assistance levels for the years FY 79-FY 83 are included in Annex C, and the overall proposed assistance planning levels for the CDSS period are included in Annex E.

Notes

1. Official reserves grew from $4.2 billion in January 1980, to $6.7 billion in September, and to $7.0 billion as of January 1, 1981. In the text we use total, not official, reserves which include the official reserve amounts as well as changes in net foreign assets of deposit banks and in the government's gold holdings. Because of identification and valuation problems, the reserve data from official sources should be treated as being approximate. These total reserves, equal to $11 billion as of February 1, 1981, belong to the government and are unobligated. Present commitments for large projects, among other liabilities, will draw down reserves at the rate of about $.5 billion a year for the next 15 years.

2. This assessment is based on a November 1980 meeting with a World Bank team and their February 20, 1980 General Economic Report for Indonesia.

3. The Long Term Perspective...to the Year 2000 Study (August 1980) by Profs. Arsjad and Sumitro projects an even more favorable picture for oil and gas production and export. The results of the recent resurgence in oil and gas exploration may confirm favorable projections.

4. At the beginning of Pelita I, the corporate oil tax contributed 53% of total direct taxes; with the start of Pelita II, 79%; and with Pelita III, 83%. Correspondingly, the ratio of public savings to GDP has grown from 2.2% in 1971 to 8.6% in 1979. (Sumitro, Structure, Performance and Prospects of the Indonesian Economy, October 1980, page 19). However, direct taxes from non-oil domestic sources have remained stable or declined in real terms (estimated from World Bank, February 20, 1980 pages 36 and 71).

5. Official data from the Central Bureau of Statistics (CBS). The CPI incorporates controlled prices for several consumer goods.

6. IMF Staff Paper, October 1980, page 8.

7. See World Bank, February 20, 1980, page 28. The brunt of the burden of liquidity control during the 1970s has been borne by the private sector: see Sumitro, October 1980, page 5, and World Bank, February 20, 1980, pages 23-24, and 28.

8. A third interrelated problem of balance relates to the relative prices of traded and non-traded goods; the government has attempted to allow adjustment of traded good prices (the purpose of the devaluation) while at the same time trying to protect consumers from changes in prices for non-traded goods.

9. For a discussion of the country's recent manufacturing and trade performance see Peter Warr, "The Indonesian Economy: Survey of Recent Developments" Bulletin of Indonesian Economic Studies, November 1980.

10. With respect to trade relations between Indonesia and the United States, Indonesia supplies the U.S. with 5% of its oil imports. As for total

trade in 1979, 20% ($3.6 billion) of Indonesia's exports were sold to the U.S., and about 14% ($1.0 billion) of Indonesia's imports were purchased from us; the U.S. has a trade deficit of about $2.6 billion. The book value of private U.S. capital investment in Indonesia totals about $1 billion, in addition to the several billions that U.S. oil companies have expended in the Indonesian oil sector. See U.S. Embassy, Jakarta, Economic Trade Report, October 21, 1980.

11. IBRD, World Development Report 1980, page 122.

12. The impact of a few of these large-scale subsidized industries on traditional industries such as soft drinks, cigarettes and textiles has been to drive many small traditional firms out of business, which has prompted William Collier to comment that a policy of import substitution has also been one of rural (or traditional) substitution.

    The total economic subsidy estimate of $4 billion is derived from the fact that Pertamina obtains half of its crude under production sharing contracts with foreign oil companies (under which oil is valued at cost plus 20 cents per barrel, i.e., at around 50 cents a barrel at present). This accounts for a loss in foreign exchange foregone of about $2.0 billion in FY 80/81. The budgeted domestic revenue foregone because of subsidized domestic consumption also equals about $2.0 billion in FY 80/81. The original budgeted subsidy has already had to be increased from $1.3 billion to $1.9 billion.

13. Kepres 10, 1980 directs that government tenders of Rp 500 million ($800,000) or more be open for products made in Indonesia. During 1980, tenders are open for completely built-up products; in 1981, for only semi-knocked down products; and in 1982, for only completely knocked-down products. In following years, procurement will be directed to local-component products only.

    Kepres 14a classifies and reserves progressively smaller rupiah government contract amounts exclusively for pribumi business people. For Kepres 10, a special central government review and approval committee has been established.

14. Although it has been suggested that the government use some of its reserves to retire foreign debt, it has no incentive to do so. The debt service ratio has declined from 18% in 1978 to 10% in 1980, well below the "danger-limit" of 20%. Most of the country's $13-14 billion foreign debt is on terms of 17 year maturities at interest rates varying around 5%, (Warr, page 26, and Sumitro, page 16).

15. Alan Strout cites in a Prisma article (September 1977) a year 2000 population as high as 240-260 million. Sumitro's recent study (October 1980) uses 207 million. The 1980 Population Census adjusts the country's year 2000 population upwards from 189 million to approximately 190-200 million.

16. Rusli Hakim and Hidayat Nataatmadja, "Targeting Research for Critical Problems", 1980, pages 18-22.

17. Warr, pages 7-19. He discounts the role of agricultural extension and gives little heed to price except for the effect of the large fertilizer subsidy which he does describe at length. See pages 10-14.

18. Sumitro, October 1980, Table II.26. The World Bank's recent World Development Report 1980 emphasizes that the social return to primary education is a high 25% for developing countries (page 49) and that much of the benefit appears to derive from school attendance and bears little relationship to class size (page 52). See also Table 23.

19. Other government achievements include an increase in the real per capita GDP growth rate to 5.7% between 1971 and 1978; well above the 1.0-1.5% per capita rate achieved during the 1960s. The country's economic growth compares favorably with achievements of the other ASEAN nations during the 1970-78 period. Indonesia's 7.8% rate for GDP equals that of Malaysia, is above the rates for Thailand (7.6%) and the Philippines (6.3%) and only falls below that of Singapore (8.5%). (Sumitro, October 1980, pages 3 and 6.)

    With regard to development implementation, in the past two years the government has taken steps to streamline administration at the national level. These measures include simplification and integration of the DUP-DIP project approval and authorization process, release of full-year funds to line ministries, a switch to a post audit system, and greater authority for project officers. As a result, the SIAPs, the end of year development project carry-overs recorded at the national level declined for the first semester of FY 1980/81 following a rapid rate of increase in previous years. One price for this improved efficiency is the feeling on the part of BAPPENAS and Finance that they have lost some of their control and knowledge as to the status of actual project implementation within line ministries.

20. Sumitro, October 1980, page 23.

21. See Handoko, Hart, Papanek and Partadiredja, "The Indonesian Agricultural Surveys: Summary of Initial Results", (draft) May 1980, page 58, and William Collier, "Policy Implications of Declining Labor Absorption in Javanese Rice Production", November 1979.

22. See C. Peter Timmer (with reply by Collier), "Choice of Technique in Rice Milling on Java", Agricultural Development Council reprint, September 1974.

23. See World Bank staff study (December 1979) of wages for INPRES kabupaten workers for 1978-1980 period. Benjamin White and Makali conclude that real agricultural wages on Java appear to have been rising, starting in the late 1960s or very early 1970s, and then peaked between 1972/3-1974/5 after which there has been a general and rather steady decline. See their "Wage Labour and Wage Relations in Javanese Agriculture: Some Preliminary Notes from the Agro-Economic Survey", The Hague, May 1979, page 23.

24. See Soentors, Collier and Hidoyat, "Land Markets in Rural Java", (draft) Agro-Economic Survey, August 1980.

25. USAID Jakarta, FY 82 CDSS, page 7.

26. Sajogyo defines poverty thresholds in terms of annual per capita consumption levels in rice equivalents below which people are classified as poor, very poor and destitute. The thresholds are 320, 240 and 180 kg. of rice respectively in rural areas. See Sajogyo and World Bank analyses in the Bank's "Employment and Income Distribution in Indonesia", 2/20/79, pages 75-81.

27. AID's Poor Majority criteria include an average life expectancy of 55 years, an infant mortality rate of 33 per 1000, a birth rate of 25 per 1000, and 60% of the population having access to health services.

28. USAID Jakarta, "Health and Nutrition Strategy Statement". October 1979, page 2.

29. Sumitro, October 1980, Table II.26.

30. Edward Denison, in The Sources of Economic Growth in the United States, (1962), has calculated that 70-80% of the growth in the United States is explained by qualitative improvements in labor's productivity.

31. Government advisors have commented that INPRES and Padat Karya contractors seldom recruit workers or invest their profits in local areas.

32. In a recent article, Leipzeger and Lewis argue that for developing countries with less than $540 in per capita income, growth and not programs of redistribution appear to have contributed more clearly towards improvements in basic-needs indicators. See their "Social Indicators, Growth and Distribution", World Development, Vol. 8, pages 299-302. For further discussion of this "Kuznets" phenomenon see pages 40 and 41 of the IBRD's World Development Report 1980. Sri Lanka is an important exception to these studies, one which dramatizes the importance of political will for redistributive programs.

33. Official CBS and BULOG production data. These annual growth rates are sensitive to the first and end years selected. For rice for example, the 1969-1980 annual growth rate of 3.9% "falls" to 3.5% for the 1970-1979 period.

34. BULOG data for rice, wheat and wheat flour equivalent.

35. Using adjusted minimum daily requirements of 2100 calories and 45.9 grams of protein, Indonesia's aggregate per capita food consumption position is illustrated as follows:

Per Capita Daily Consumption, 1974-1977

	1974	1975	1976	1977
Calories	2248	2150	2231	2214
Protein	45.8	45.3	43.7	44.5

See John Dixon, "The Staple Food System in Indonesia", Ford Foundation, August 1980, page 3.

36. Based on Susenas V, 1976 Expenditure Data, Dixon, page 17-18.

37. Summary by F. E. Okada, USAID/Jakarta of data collected by Directorate of Land Use, Department of Home Affairs, April 15, 1980.

38. Between 1969/70 and 1978/79, BULOG distributed between 2 and 12% of its total grain releases for emergency needs.

39. These options have been suggested by Falcon, Timmer and Dixon in various draft papers.

40. Dixon, page 21.

41. Corn and cassava are important foods in many rural areas, but since the devaluation, the relatively lower prices of these and other non-rice staples have increased towards that of rice. This is an important comparative shift in food prices against the poor consumer because the income elasticity of demand for rice, corn and cassava among the very poor is as high as .8. But in this dilemma is a prescription. While a food price increase harms poor consumers, any growth in their incomes, through employment creating policies and programs, is almost entirely consumed in better diets. See C. Peter Timmer "Food Policy Analysis in a Multi-Staple Food Economy", (draft) November 1978, pages 8-9.

ANNEX A

Balance of Payments
FY 1978/79-1980/81,
in $ Millions

	1978/79 Actual	1979/80 Actual	1980/81 Mission Est.
Exports, f.o.b.	11,353	17,489	21,000
Non oil and gas	3,979	6,165	5,500
Oil (gross)	6,858	9,979	15,500
LNG (gross)	516	1,345	
Imports, f.o.b.	- 8,443	- 9,962	-12,500
Non oil and gas	- 6,732	- 8,230	-10,500
Oil	- 1,664	- 1,646	- 2,000
LNG	- 47	- 86	
Services (net)	- 4,065	- 5,537	- 5,000
Current Account	- 1,555	1,990	3,500
Official Transfers & Capitals	2,101	2,495	2,637
IGGI (ODA & non ODA)	1,625	2,008	2,036
Non IGGI	376	425	601
Bonds	100	62	--
Debt Repayments (excludes state enterprises)	- 632	- 692	- 700
Miscellaneous Capital	392	- 1,315	- 149
SDRs	64	65	65
Overall Balance (- equals increase)	- 708	- 1,690	- 5,353[1/]
Errors and Omissions	- 62	- 853	0

1/For FY 80/81 only the overall balance includes reserves held by the state deposit banks.

Source: Ministry of Finance, October 1980

ANNEX B

Indonesia:

IGGI Member ODA Loan and Grant Pledges,
in $ Millions

	1978/79	1979/80	1980/81	1981/82 (est.)
A. Bilateral Donors				
Australia	40.0	40.0	45.0	45.0
Belgium	17.0	15.0	12.0	12.0
Canada*	13.0	12.0	24.0	30.0
Denmark	0	8.2	8.0	8.0
France	41.8	46.2	65.2	70.0
Germany	150.0	73.0	68.0	70.0
Italy	0	0	5.0	5.0
Japan	272.0	235.0	280.0	287.0
New Zealand	5.0	4.2	4.2	4.2
Netherlands	75.0	75.0	80.0	90.0
Switzerland	0	2.0	4.0	4.0
United Kingdom*	13.0	22.0	22.0	22.0
United States	202.2	193.7	127.6	112.0
Sub-Total	829.0	726.3	745.0	759.2
B. Multilateral Donors				
ADB	204.0	235.4	250.0	
IBRD	650.0	726.0	800.0	
IDA	0	89.0	0	
UN Family	15.0	48.0	55.0	
EEC	0	0	10.0	
Sub-Total	869.0	1,098.4	1,115.0	
TOTAL	1,698.0	1,824.7	1,860.0	

*Disbursement estimate. Commitments are expected to be higher in the case of Canada.

ANNEX C

U.S. Bilateral Development Assistance Levels,
in $ Millions

	FY 79	FY 80	FY 81	Proposed FY 82	FY 83/CDSS Proposed FY 83
Loans	70.6	54.6	33.4	42.3	64.0
Grants	20.6	28.1	33.2	32.8	36.0
Sub-Total	91.2	82.7	66.6	75.0	100.0
Title I	104.3	101.0	50.0	20.0	20.0
Title II*	6.7	10.0	11.0	17.0	17.0
Sub-Total	111.0	111.0	61.0	37.0	37.0
TOTAL	202.2	193.7	127.6	112.0	137.0

*includes shipping costs

ANNEX D

Progress Indicators - Indonesia

AID Mission comments and corrections are noted on this AID/W table in footnotes and in the right column.

		AID/W	1980 Mission est.
I. Economic Growth			
A. Growth of Per Capita Income	(1969-1974)	6.5	
	(1974-1978)	5.3	
	(1979)[1/]		2.9
	(1980)[1/]		5.0
II. Income Distribution (based on 1977 data)[2/]			
A. Rural Poverty Line (US$)		107	
B. Urban Poverty Line (US$)		150	
C. Rural Population Below Poverty Line		65%	
D. Urban Population Below Poverty Line		59%	
E. Income going to bottom 40% of Population		17.3%	
F. Income going to bottom 20% of Population		6.8%	

III. Human Resource Development

	1960	1965	1970	1975	latest	1980
A. Infant Mortality Rate	--	--	126	114	--	100±
B. Child Mortality Rate	31	--	22	--	20	18±
C. Life Expectancy	41	--	46	--	47	48±
D. Literacy Rate	39	--	56	--	62	64
E. Primary Enrollment Rates	60	--	71	--	86	86
F. Female Primary Enrollment Rates	55	63	70	75	81	81
G. Gross Reproduction Rate	2.8	--	3.2	--	2.4	2.4

IV. Reference Data	1978	1979	
A. Per Capita Income (US $)	360	370	400±
B. Per Capita Income - Kravis Adjustment (US $)	1,021[3/]		
C. Population (millions)	136.0		147.4

1/Assumes a population growth rate of 2.0% a year.
2/Mission has not updated these 1977 data, but we believe they overstate the absolute degree of poverty.
3/Calculated at the pre-1978 devaluation rupiah rate.

ANNEX F

Proposed Assistance Planning Levels

		FY 83	FY 84	FY 85	FY 86	FY 87
1.	Continued Program: Loans	55	65	70	80	90
	Grants	30	30	30	30	30
	Sub-Total	85	95	100	110	120
2.	Incremental Program: Loans	10	10	20	20	20
	Grants	5	10	10	10	10
	Sub-Total	15	20	30	30	30
	Total Loans:	64	75	90	100	110
	Total Grants:	36	40	40	40	40
3.	Total AID	100	115	130	140	150
4.	PL480 Title I	20	20	20	20	20
	PL480 Title II	17	17	17	17	17
	Sub-Total	37	37	37	37	37
5.	Grand Total:	137	152	167	177	187

ANNEX F

Proposed Sector Planning Levels,
in $ Millions

Categories	FY 83	FY 84	FY 85	FY 86	FY 87	TOTAL
Agr., Rural Dev. & Nutrition						
Project Loans	50	60	65	70	80	325
Project Grants	20	22	22	22	25	108
Population Planning						
Loans						
Grants	10	10	10	10	10	50
Health						
Loans	7	8	10	13	13	51
Grants	3	3	3	3	3	15
Education & Human Resources						
Loans	7	7	10	12	12	48
Grants	2	3	3	3	3	14
Selected Development Problems						
Loans			5	5	5	15
Grants	1	2	2	2	2	9
Grand Total	100	115	130	140	150	635
Total Loans	64	75	90	100	110	439
Total Grants	36	40	40	40	40	196
PL480 Title II*	17	17	17	17	17	85

*Including cost of ocean freight