

INDONESIA

A STUDY ON SUPPORT TO SMALL AND MEDIUM ENTERPRISES AND SOCIAL SAFETY NET PROGRAMS TO COPE WITH ECONOMIC CRISIS

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List of Abbreviations and Acronyms

ADB	Asian Development Bank
ADWD	Asian Decent Work Decade
AHP	Analytical Hierarchy Process
AIP	Australia Indonesia Partnership
AIPRD	Australia Indonesia Partnership for Reconstruction and Development
APBN	Anggaran Pendapatan dan Belanja Negara (National State Budget)
ASKESKIN	Asuransi Kesehatan untuk Keluarga Miskin (Health Insurance for Poor)
ASKRINDO	Asuransi Kredit Indonesia (Indonesian Credit Insurance)
AUSAID	Australian Aid
BAPPENAS	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
BLK	Balai Latihan Kerja (Training Center)
BLT	Bantuan Langsung Tunai (Unconditional Cash Transfer)
BNI	Bank Negara Indonesia (Indonesia National Bank)
BOP	Bottom of Pyramid
BOS	Bantuan Operasional Sekolah (School Operational Assistance)
BPHTB	Bea Perolehan Hak Atas Tanah dan Bangunan (Property Transfer Tax)
BPS	Biro Pusat Statistik (Statistics Indonesia)
BRI	Bank Rakyat Indonesia (Indonesia People's Bank)
BTN	Bank Tabungan Negara (National Savings Bank)
BULOG	Badan Urusan Logistic (Logistic Affairs Agencies)
CAS	Country Assistance Strategy
CBOs	Community Based Organizations
CDD	Community Driven Development
CERD	Community Empowerment for Rural Development
CGI	Consultative Group on Indonesia
CIDA	Canadian International Development Agency
COBP	Country Operations Business Plan
CPS	Country Program Strategy
CSP	Country Strategy and Program
DAU	Dana Alokasi Umum (General Allocation Fund)
DAK	Dana Alokasi Khusus (Special Allocation Fund)
DBH	Dana Bagi Hasil (Regional Share of Natural Resources Revenue)
DFID	UK Department for International Development
DJSN	Dewan Jaminan Sosial Nasional (National Social Security Council)
DPJ	Democratic Party of Japan
DPRD	Dewan Perwakilan Rakyat Daerah (Regional People's Representatives Council)
DSF	Decentralization Support Facility
EU	European Union
FDI	Foreign Direct Investment
FGD	Focus Group Discussion
FY	Fiscal Year
GDC	German Development Cooperation
GDP	Gross Domestic Product
GOI	Government of Indonesia
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (German Technical Cooperation)
IDB	Islamic Development Bank

IDR	Indonesian Rupiah
IDT	Inpres Desa Tertinggal (President's Instruction for Backward Villages)
IFLS	Indonesia Family Life Survey
IMF	International Monetary Fund
INDOPOV	Indonesia Poverty Analysis Program
JAMKESMAS	Jaminan Kesehatan Masyarakat (Public Health Insurance)
JAMSOSTEK	Jaminan Sosial Tenaga Kerja (Worker's Insurance)
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
JPK-GAKIN	Jaminan Pemeliharaan Kesehatan Keluarga Miskin (Health Insurance for the Poor)
JPS	Jaring Pengaman Sosial (Social Safety Net)
JPS-BK	Jaring Pengaman Sosial Bidang Kesehatan (Health Sector Social Safety Net)
JPY	Japanese Yen
KDP	Kecamatan Development Program
KHR	Cambodia Riel
KKPPI	Komite Kebijakan Percepatan Pembangunan Infrastruktur (National Committee on Policy for Accelerating Infrastructure Provision)
KMK UKM	Kredit Modal Kerja Usaha Kecil dan Menengah (Working Capital Credit for SMEs)
KPEL	Kemitraan Pengembangan Ekonomi Lokal (Partnership for Local Economy Empowerment)
KUR	Kredit Usaha Rakyat (People's Business Credit)
LPG	Liquefied Petroleum Gas
LSE3	Life Skills Education for Employment and Entrepreneurship
MDGs	Millennium Development Goals
MICRA	Microfinance Innovation Center for Resources and Alternatives
MOF	Ministry of Finance
MOH	Ministry of Health
MOHA	Ministry of Home Affairs
MSMEs	Micro, Small and Medium Enterprises
NSSS	National Social Security System
NGO	Non Governmental Organization
ODA	Official Development Aid
OECD	Organisation for Economic Co-operation and Development
OPK	Operasi Pasar Khusus (Special Market Operation)
P3BM	Pro-Poor Planning, Budgeting and Monitoring
P2D	Program Pengembangan Prasarana Desa (Rural Infrastructure Development Program)
P2KP	Program Penanggulangan Kemiskinan Perkotaan (Urban Poverty Project)
P3DT	Proyek Pembangunan Prasarana Pendukung Desa Tertinggal (Infrastructure Development for Backward Villages)
P3T	Proyek Penanggulangan Penanggulan Pekerja Terampil (Unemployment Alleviation and Skilled Labor Project)
P4K	Program Pembinaan Peningkatan Pendapatan Petani Nelayan Kecil (Income Generating Program for Small Farmers and Fishermen)
PBB	Pajak Bumi dan Bangunan (Tax on Land and Buildings)
PDKMK	Program Penanggulangan Dampak Kekeringan dan Masalah Ketenagakerjaan (Drought Impact Mitigation and Labor Force Problem Program)
PDMDKE	Pemberdayaan Daerah untuk Mengatasi Dampak Krisis Ekonomi (Region Empowerment for to Overcome Impact of Economic Crisis)
PERPRES	Peraturan Presiden (Presidential Regulation)

PISA	Program for International Students Assessment
PK	Padat Karya (Intensive Work)
PKH	Program Keluarga Harapan (Conditional Cash Transfer)
PKPS	Program Kompensasi Pengurangan Subsidi (Compensation Program for Oil Subsidy Reduction)
PKSK	Proyek Padat Karya Sektor Kehutanan (Forestry Intensive Worker Project)
PNPM	Program Nasional Pemberdayaan Masyarakat (National Community Empowerment Program)
POSYANDU	Pos Pelayanan Terpadu (Integrated Health Service)
PPA	Participatory Poverty Assessment
PPLS	Pendataan Program Perlindungan Sosial (Social Protection Program Listing)
PPP	Public-Private Partnerships
PROFI	Promotion of Small Financial Institutions
PROPENAS	Program Pembangunan Nasional (National Development Program)
PRSP	Poverty Reduction Strategy Paper
PSE 2005	Pendataan Sosial Ekonomi 2005 (Socio-Economic Listing 2005)
PSF	PNPM Support Facility
PSM	Private Sector Management
PT ASBRI	PT. Asuransi ABRI (Indonesia Armed Forces Insurance Company)
PT ASKES	PT. Asuransi Kesehatan (Health Insurance Company)
PT TASPEN	PT. Tabungan Pensiun (Pension Savings Company)
PUSKESMAS	Pusat Kesehatan Masyarakat (Public Health Services)
RASKIN	Beras Miskin (Rice for the Poor)
REPELITA	Rencana Pembangunan Lima Tahun (Five Years Development Plan)
RIS	Rural Infrastructure Support
RPJMN	Rencana Pembangunan Jangka Menengah Nasional (National Mid Term Development Plan)
RPJP Nasional	Rencana Pembangunan Jangka Panjang Nasional (National Long Term Development Plan)
SAADP	Sulawesi Agricultural Area Development Project
SEMBAKO	Sembilan Bahan Pokok (Nine Basic Necessities)
SMEs	Small and Medium Enterprises
SMERU	Social Monitoring & Early Response Unit (SMERU) Research Institute
SSN	Social Safety Net
SUSENAS	Survei Sosial Ekonomi Nasional (National Socio-Economic Survey)
TA	Technical Assistance
TKPK	Tim Koordinasi Penanggulangan Kemiskinan (Coordination Team of Poverty Alleviation)
UNDP	United Nation Development Programme
UPP	Urban Poverty Project
USAID	United States Agency for International Development
USD	United States Dollar
VIP	Village Infrastructure Project
WSILC-2	Second Water and Sanitation for Low-Income Communities

Chapter 1 Political, Economic, and Social Conditions of Indonesia

1-1 Post-Crisis Political and Economic Reforms

1-1-1 Overview of Post-Suharto Political and Economic Reforms

1-1-1-1 Transformation of the Political System

Soon after Habibie succeeded Suharto as the third President in 1998, the year following the Asian financial crisis that had been pushing Indonesia into socio-political turmoil, a new democratic legal system replacing the prior authoritarian system was introduced. The political reforms under the Habibie administration included those of political liberalization, the institutionalization of political competition and participation, and the institutionalizing of the separation of powers.

This political liberalization involved the abolishment of the power of the Minister of Information to authorize publications such as newspapers and magazines, the legislating of a penalty for the violation of the freedom of press, and the relinquishing of the government's power to manipulate information with an exclusively-authorized press association through the liberalization of the establishment of the press association. The Guidelines for Understanding and Practices of Pancasila (Pedoman Penghayatan Pengamalan Pancasila) enacted in People's Consultative Assembly in 1978, which had set the legal basis for the policy of forcing all the political and social organizations to accept the doctrines of the state, and which Suharto had used as a means of thought control, was similarly repealed. Moreover, the freedom to demonstrate and assemble was codified.

In relation to the institutionalization of political competition and participation, Habibie first implemented the new Law Concerning Political Parties allowing political parties other than those authorized as "political groups" under the Suharto regime to participate in elections. While the privileged dominance of the administration party and the national army within parliament since the Suharto era was eliminated through the limitation of public servant participation in political party activities, the new Law Concerning General Elections, and the establishment of the new Law on the Composition of the Parliament, the administration was deprived of any measures to control parliamentary politics through the maintaining the neutrality of the electoral commission and terminating the rights of President to appoint members of Peoples Representative Council.

The institutionalizing of the separation of power was promoted through the widely shared recognition that the excessive concentration of power in the presidency had allowed the abusive exercise and long monopoly of power during the Sukarno and Suharto eras. Thus, this movement resulted in the amending of the 1945 Constitution, a first since independence. With these amendments the article, which previously provided no limitation on the number of reelections, was revised into one that allowed only a single reelection. The ultimate authority to legislate was correspondingly transferred from President to National Assembly and the President's appointment powers were severely limited.

Under these restructured legal institutions free general elections were conducted in 1999. At the time the People's Consultative Assembly consisted mainly of members who had recently been selected in the 1999 general election and Abdurrahman Wahid became the first elected president in Indonesian history. However, very little progress was made towards the administrations assigned agendas, which included the realization of social justice, maintenance of national integrity, resolution of provincial conflicts, and the stabilization of security and economic recovery. Consequentially, the increasing conflict between the Government and President and the political parties in the parliaments, who had increased their role in decentralization, led quickly to political stagnation.

The National Army reforms also encountered setback after the initial momentum experienced in the post-Suharto transition. With the National Army in the spotlight for reforms soon after the disruption of

Suharto regime with the promotion of decentralization in mind, voices calling for extreme reforms were widely accepted in the beginning. In effect, the voices calling for reform became louder, urging that among the two functions of National Army that had formed during the Suharto era, one of security and defense, and the other of politics and society, the latter should be abandoned and the responsibility for security action be transferred to a civilian police force due to the security actions by National Army leading to human rights violations in the past. In response, National Army initiated and advanced its own self-reforms, however, the deterioration of security in some local provinces, including Aceh, and the continuously increasing social unrest heightened calls among nationalist forces for the necessity of the security function held by the National Army. Eventually, the restructuring of the security and intelligent functions of National Army proceeded once Megawati, who led the nationalist party, was appointed as President in 2001.

1-1-1-2 Reform of the Economic Law

Following the currency crisis of 1997-98, Indonesia began promoting structural reform policies as prescribed by the International Monetary Fund (IMF) in the manner of other crises-affected countries; structural reforms leading to market-oriented institutions and avoiding the promotion of the states direct involvement in the economy. Although the reforming of the economic law was one of the highlights, cannot be said to have necessarily worked with Bankruptcy Law was a quintessential example. The Bankruptcy Law was revised in 1998 under an IMF initiative with the aim of liquidating debt-default domestic companies though it had at the same time the surreptitious purpose of pushing legislation to bail out foreign creditors. In reality, however, creditors continued losing cases within the newly established Commercial Court. Yet debtors did not benefit from this as the Law could not relieve the domestic debts of severely insolvent companies. The major cause of this failure was the fact that the revision of the Law was not conducted through a domestic initiative, but rather coerced through conditional requirements of the IMF.

Indonesia's Prohibition of Monopolistic Practices and Unfair Business Competition Law, enacted in 1999, and Commission for the Supervision of Business Competition (Komisi Pengawasan Persaingan Usaha-KPPU), established in 2000, which were other highlighted results of the economic law reforms, have also failed to perform their functions of meeting the requirements of the society itself. Although these reforms were also initiated by IMF, Indonesian society welcomed them as they were expected to redress monopolistic practices widespread under the Suharto regime. The new law based on international standards, however, shared common characteristics with the competition law that mainly regulated industrial monopolies, a characteristic common in laws adopted by developed countries. As a result Indonesia's peculiar monopolistic practices implemented through governmental authorization were not seen as illegal so long as the practices retained their legal foundation.

Economic law reforms during this period might not have been effective due to the fact that there were no sufficient arrangements to address problems unique to Indonesia and emphasis was placed on substantive law reform alone, which lacked domestic level coordination in the reform of implementation process, especially judicial institution reforms.

1-1-1-3 Bank reform and Reform of the Financial Institutions

In the economic restructuring process following the currency crisis of 1997-98, one of the sectors experiencing the severest amount of change was the financial sector, in particular commercial banks. Institutional reforms at the time made some progress with the restructuring of sector actors and the banking supervision as one of the three major policies with IMF support. The Indonesian banking sector had originally formed its foundation of government-owned businesses during the Sukarno era, and then the Suharto administration embraced and reinitiated the practice, as state-owned businesses were able to play an important role in the economic development regime through the renovating of the legal system.

Following the 1988 financial liberalization, banks were easy to establish. Prior to the currency crisis, a general banking supervision system had been established, but an institutional environment in which various regulations could be effective in terms of their original intent, such as a clear rule for pushing banks out of the market, was in actuality lacking. Prudential banking principles are not generally practiced in this business of trust. Most banks were affiliated with the group of major conglomerate; the legal lending limits were easily violated. It is under these circumstances that banks' non-performing loan liabilities expanded and several big scandals occurred¹.

Post-crisis financial restructuring, including bank closures and nationalization, enterprise integration and public capital infusion, and then sell-off of Government's shares in the infused banks, was pursued for seven years prior to 2003. Through this restructuring process, while no public banks were closed and their assets were expanded, 41% of private banks (31% of all combined assets of private banks) were closed and 4% (46%) were nationalized or infused with capital. More importantly, these nationalization and capital infusions were concentrated in banks existing within company groups. In time with this, foreign private banks also began appearing on the scene as new actors. In the end, the biggest change in the private banking sector brought about by the restructuring process after the currency crisis was the disruption of the banks existing within company groups and the entry of foreign banks.

The reform of the institutions regarding banking supervision was another implementation of the financial institutions reform at that time. The reform process just after the crisis had included the independence of the central bank in monetary policies and, in 2004, the check-and-balance mechanism was established among the president, parliament, and central bank. With the aim of the advancement of competition and the soundness of the banking sector through the building of trust with depositors of banks and then directing depositors selectively to quality banks, the Government had introduced the time-limited debt guarantee system for all deposits that transited to deposit payoff systems in a phased manner, leading to the complete implementation of the deposit insurance system in March 2007.

During this drastic reform, provincial development banks, which had been originally public banks financed by local governments, showed high performance in terms of efficiency and profit rates as early as 2002 even on a micro scale, and the rates of non-performing debt was lower than other types of banks. In the process of decentralization as will be explained below, almost all the provincial development banks have progressively turned into ordinary banks. Therefore, if the traditional problem of the collusion with local governments and corruption is eliminated, they may play a more positive role as local-centered bank, which would contribute to some extent to the economy of each province.

1-1-1-4 The Yudhoyono Administration I (2004-2009)

In 2004, the newly elected President Yudhoyono prepared the National Mid-Term Development Plan (Rencana Pembangunan Jangka Menengah Nasional-RPJMN) for the 2004-2009 period, which outlines the development problems and challenges including:

- (1) low level of economic growth, people's welfare, and various other social issues;
- (2) the quality of Indonesian human resources is still low as access to quality education is limited;
- (3) the issue of environmental protection and use of natural resources, which often creates tension between economic interests, exploitation of natural resources (mining, forestry) and environmental protection;
- (4) the disparities in inter-regional development is very wide, such as between Java and outside Java, between the western and eastern regions of Indonesia, and between cities and villages;
- (5) decrease in quality of services and the delays in implementation of infrastructure projects has

¹ Starting with the Bank Duta's huge corrupt practice discovered in September 1990, there were at least nine bank-scandals up until 1998. For details, see Tabalujan (1999).

- hampered national development;
- (6) social and political instability which has potential of disturbing the stability of Republic of Indonesia;
 - (7) increase in both domestic and transnational crime;
 - (8) considering that the country is spread out, the threat of security, both domestic and external, along with all the challenges of managing the diversity in social, economic, and culture aspects across the country;
 - (9) legislations that have not yet resulted in promoting justice, equity, respect and protection of human rights;
 - (10) low level of public services provided to the community resulting from misusing authority as well as a number of legislations which no longer reflect the current situation; and
 - (11) weak political institutions and state implementing agencies.

In order to respond to these challenges, in the 2004-2009 RPJMN, the Government of Indonesia (GOI) set three main targets, which were: (i) creating a peaceful and safe Indonesia; (ii) promoting equity and democracy; as well as (iii) increasing people's welfare. Related to the third target, the priorities and policy direction puts emphasis on:

- Poverty eradication and reduction of unemployment;
- Increasing investment;
- Agricultural revitalization;
- Development of fisheries and forestry;
- Rural development and the reduction of inter-regional disparities;
- Increasing people's access to education and quality health services;
- Improving social protection and social welfare;
- Promoting citizenry; and
- Acceleration of infrastructure development

Years from 2004 to 2008 were marked by a period for consolidating democratic institutions and returning to political and macroeconomic stability, most notable in Indonesia's first direct presidential elections in 2004 and with its debt levels falling to below 35 % of Gross Domestic Product (GDP). As a result, Indonesia has resumed a higher level of growth and has now re-emerged as a confident middle-income country. However, though poverty levels fell quickly in the years after the crisis, they have been almost stagnant since 2002.

Decentralization policies still contributed to the calming of separatist sentiments and regional conflicts, and the Government received international praise for signing a peace agreement in mid-2005 with separatist rebels in Aceh, ending a three-decade conflict. There has also been a marked reduction in tensions in Central Sulawesi, Maluku, and Papua. A number of sub-national governments have undertaken major reforms of their public sector systems, introducing others performance-based budgeting and one-stop services for the investment licenses and permits.

The government has been investing additional resources in public service provision to address capacity weaknesses and the resulting poor development outcomes. Infant and child mortality rates have been falling steadily, and there has been good progress in primary and secondary enrollment rates. There is also some recent evidence of improvements in the learning achievements of children as recorded in the 2003 and 2006 Program for International Students Assessment (PISA) mathematics assessments.

Much effort is still required to ensure that Indonesia meets all Millennium Development Goals (MDGs) targets. Since 2002, child malnutrition rates have not seen a major improvement and in some provinces increased. Maternal mortality rates, already the highest in the region, have not significantly improved either. Sewerage coverage (estimated at 1.3 %) is the lowest in Southeast Asia. The Government is in the middle of the decentralization of public services. Many of the gaps in the provision of basic services are

due to the difficulties in rebalancing the roles of provincial and district level governments in service provision, and shifting the public sector's role from a provider to a regulator and monitor of private health services.

Investment rates are recovering, but are still below pre-crisis levels and in certain key sectors such as mining, as well as in policy areas, such as labor reforms, much progress is still needed. Indonesia ranks low in several global comparative indicators on the investment climate². The Government has taken steps to address different aspects of the investment climate through policy reform packages covering the key areas that private investors concern, such as taxes, customs, investment frameworks, and the financial sector, and has promulgated Law No. 25 of 2007 for improving the investment climate; but several challenges remain. Institutional capture is a major obstacle in this area, with many reforms still necessary to be implemented effectively and evenly on the ground.

Improving the quality of Indonesia's infrastructure is another essential aspect of strengthening Indonesia's competitiveness. Road congestion is expected to pose significant challenges and the electricity system capacity has been unable to meet growing demands. The retail tariff levels remain below cost in almost all infrastructure sectors, discouraging investment in critical sectors such as power and water and there continue to be considerable operational and financial problems to overcome with the land acquisition procedures for infrastructure projects remain cumbersome and often inequitable.

The Government recognizes the importance of essential infrastructure for the promoting of private sector activity, both through public sector investments and Public-Private Partnerships (PPP), and has set up a National Committee on Policy for Accelerating Infrastructure Provision (Komite Kebijakan Percepatan Pembangunan Infrastruktur-KKPPI) in 2005. While KKPPI has been successful in preventing non-compliant projects from materializing, it has yet to make a significant breakthrough in developing transparent and competitive PPP projects.

The Government is now drafting its PRJMN 2010-2014, under the new administration led by President Yudhoyono and Vice President Boediono. Based on its administrative strategies of improving welfare, implementation of good government and good corporate governance, continuing the democratization process, establishing law and order, and inclusive development with development priorities supposed to be put on:

- (1) accelerating the provision of physical infrastructure;
- (2) improving soft infrastructure (e.g. institutional capacity building);
- (3) building new social infrastructure (e.g., education and health); and
- (4) developing creativity for medium-term development.

Among those, soft infrastructure will be improved through the enhanced investment climate by regulatory reform with a special focus on implementation levels and local regulation, and further bureaucratic reforms. For the purpose of building a new soft and social infrastructure, the PRJMN will set its priorities on: (i) implementing effective/targeted program intervention, such as an integrated family-based protection program, expanding the community empowerment program and focusing on poor-rural sub-districts, and increased spending on health and social protection; and (ii) revitalizing a high level inter-ministerial committee for poverty reduction in order to boost three cluster programs – social protection, community empowerment, and micro and small scale credit.

² Indonesia ranks 129 from 183 economies in 2010 Index of Ease of Doing Business (<http://www.doingbusiness.org/EconomyRankings/>). The improvement overtime is not very convincing. In 2007 Indonesia was in rank 122 of 181 economies.

1-1-2 Impacts of the Global Crisis 2008 and PRJMN 2010-2014

1-1-2-1 Impacts of the Global Crisis 2008

This section considers impacts of the global crisis, beginning in September 2008 in Indonesia's economy. Unlike in the previous crisis 1997-98, the impacts of the global crisis have been minimal. In the previous crisis, which was locally originated unlike the current crisis, there was both macroeconomic and socio-political turmoil. Economically, exchange rates dropped from USD 1 = IDR 2,350 in July 1997 to USD 1 = IDR 16,800 in January 1998, inflation rate jumped from 11.1% to 78% in a year, economic growth dropped from 5.8% to -13.5% per annum, income per capita dropped from USD 1184 to USD 485, foreign debt increased from 24% of GDP in 1996 to 97% of GDP in 1999, and poverty rate jumped from 17.3% in 1996 to 23.4% in 1999.

During the crisis 1997-98, socio-economic conditions deteriorated with high urban unemployment, the "informalization" of the formal economy, shortages of food, worsening infant malnutrition, lack of access to health facility among pregnant women, increased school drop-outs, and a rise in insecurity and crime rates. Under these conditions, the economic crisis in Indonesia became a multifaceted crisis, resulting in social and political crises, which eventually ended the 30 year long Suharto period.

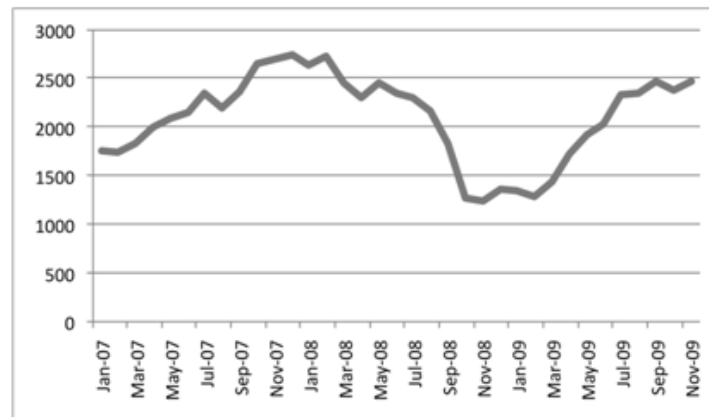


Figure 1-1 Indonesia Stock Index 2-Year Fluctuations

Source: Indonesia Stock Exchange

In the current global crisis that originated from Wall Street, there have been adverse effects on the stock exchange in Indonesia; however, there has been a recovery since around March 2009, and as of November 2009, the stock exchange market has recovered to pre-crisis levels.

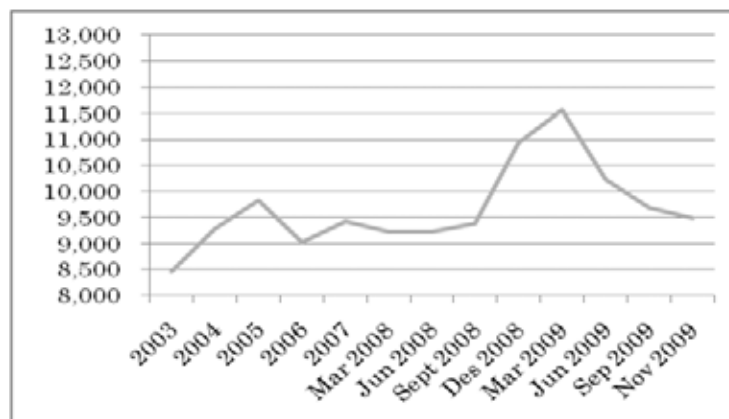


Figure 1-2 IDR / USD Exchange Rates 2003 - 2009

Source: Bank Indonesia

Foreign exchange rates initially experienced depreciation as in the past crisis. However, it started to appreciate once more beginning around March until it was nearly at pre-crisis levels in September 2009.

The macro-economy overall remains strong, however, there are areas of concern. Indonesia's economic growth accelerated to a 10-year high of 6.3% in 2007; thereafter declined to 6.1% in 2008 and 4.0% in the second quarter of 2009. Domestic demand, particularly private investment, has been the main driver of recent growth rates, but after the crisis its growth sharply fell down from 11.7 % in 2008 to forecasted rate of 3.6% in 2009. Real GDP has been growing at 5 to 6% annually since 2002 and, in 2005 per-capita real GDP, for the first time exceeded the level reached in 1997 immediately before the past crisis. To date, inflation has achieved year-to-year increases of 11% in June 2008 due in part to the increase of fuel prices averaging over 125% in 2005, and has continued to decline after the crisis; to date it appears to be at its trough, reaching a low of 2.7% in July and picking up to 2.8% in August 2009 and declining to 2.41% in November 2009. With fiscal consolidation, public investment has steadily increased over the past five years. Public finances in 2009 have been more stimulatory than in recent years. Since 2006, private investment has started to have a positive trend, although it still remains below pre-crisis levels at this moment. Following the 1997 crisis, investment rates fell from more than 30% before the crisis to a low of 19% of GDP in 2003. In 2009, preliminary data on the third quarter shows that Indonesia's investment rate is 23.54% of GDP.

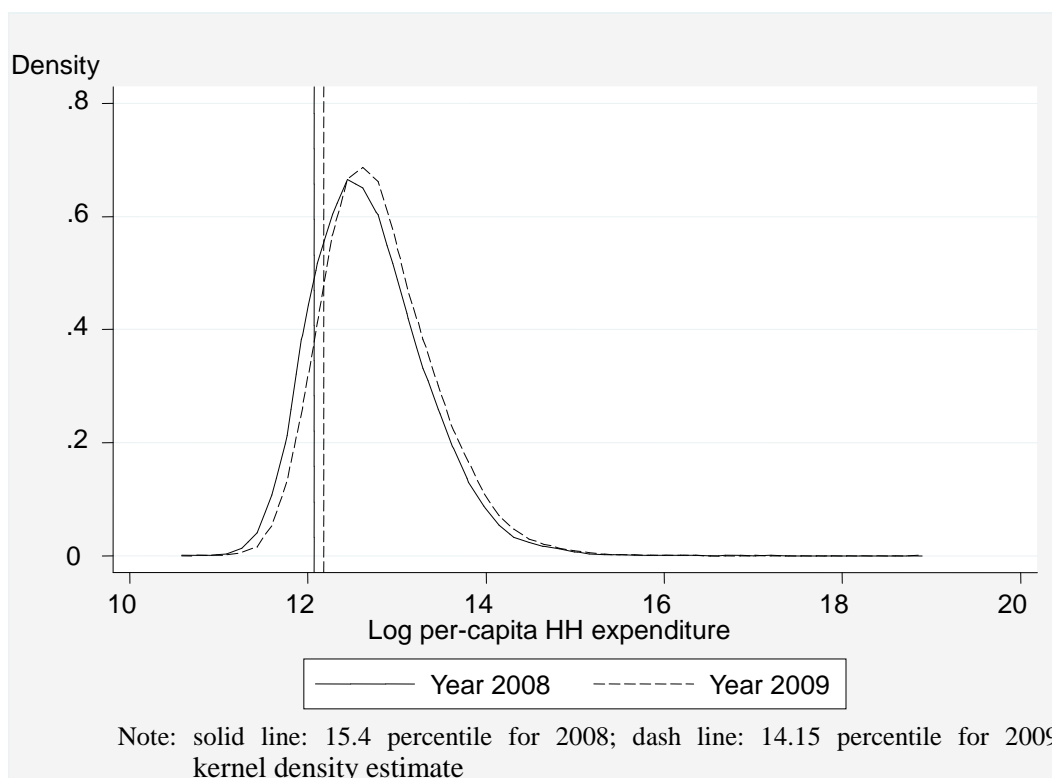


Figure 1-3 Distribution of Per-capita Household Consumption (log) before and after the 2008 Crisis (aggregate)

Source: JICA Study Team

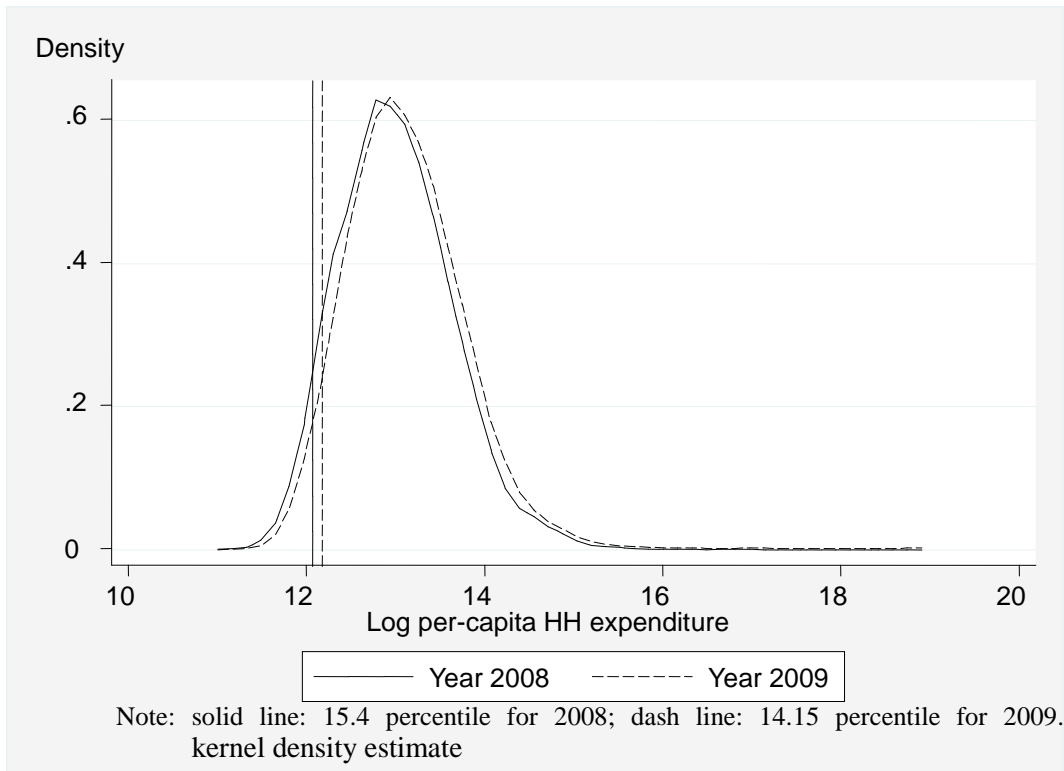


Figure 1-4 Distribution of Per-capita Household Consumption (log) before and after the 2008 Crisis (urban)

Source: JICA Study Team

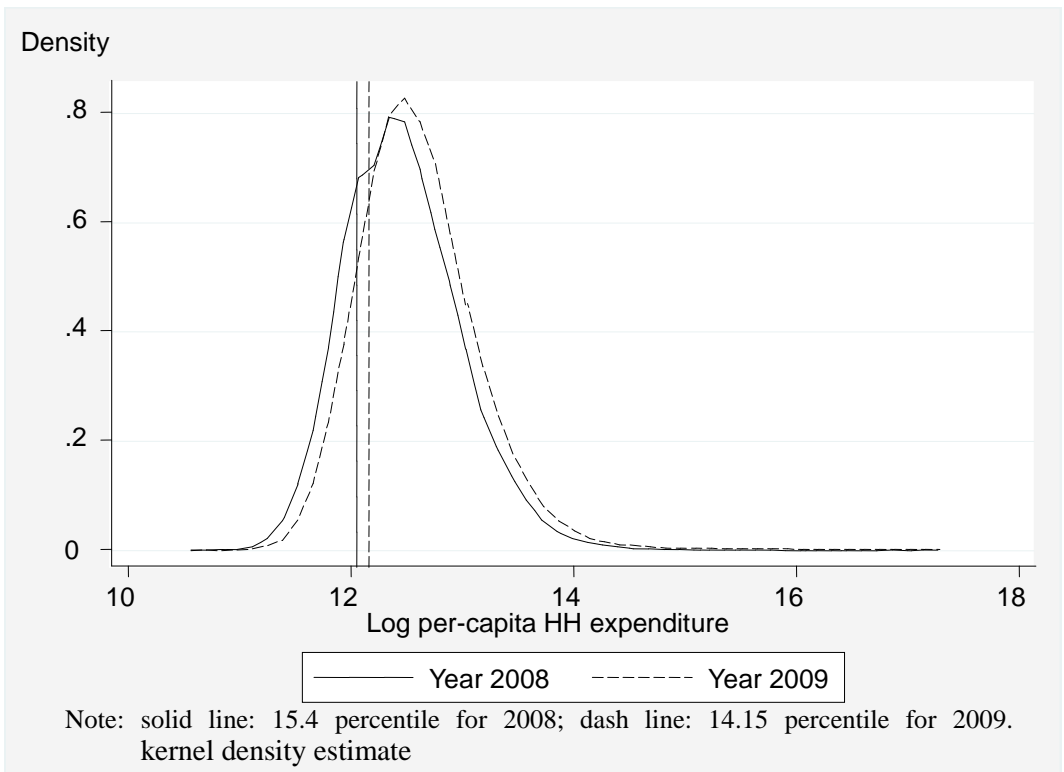


Figure 1-5 Distribution of Per-capita Household Consumption (log) before and after the 2008 Crisis (rural)

Source: JICA Study Team

The above figure shows the distribution of per capita household expenditures from the panel data households of 2008 and 2009 National Socio-Economic Survey (Survei Sosial Ekonomi Nasional or SUSENAS). The continuous line depicts the 2008 distribution and the dash line depicts the 2009 distribution. The poverty lines for the respective years are shown by the vertical line with corresponding line types (continuous or dash line). The poverty lines also correspond with the respective official poverty rate in the two years. The above figure suggests that the 2009 per capita household expenditure distribution is to the right of that of 2008. In terms of impacts on income distribution, there has been a nominal decrease in poverty incidence (in terms of head count ratio). The peak of the distribution moves in the right direction, signifying the macro economic growth, which is translated into higher household per capita expenditures. An important feature of the above graph should be made by comparing the increasing the poverty line with the changes in the median income.

The tables show the values of log per-capita household expenditure (nominal) at the 5th, 10th, 20th, 30th, 40th, 50th, 60th, 70th, 80th, 90th, and 95th percentiles separately for years 2008 and 2009. For example, Table 1-1 (a) presents that as of 2008, a sample household, which was located at the 5th percentile in the per-capita household expenditure distribution, had a log per-capita household expenditure of 11.803, and as of 2009, a sample household which was located at the 5th percentile in the per-capita household expenditure distribution had log per-capita household expenditure of 11.921. The last column (Column 5) shows that per-capita household expenditure for a household which was located in the 5th percentile in the distribution increased by 12.5% between 2008 and 2009.

Table 1-1 (a) shows that in terms of % change, households which were located at lower percentiles of the distribution (such as 5th to 30th percentiles) seem to have increased per-capita household expenditure more than households which were located at higher percentiles of the distribution (such as 60th to 95 percentiles). However, this does not necessarily imply that expenditure inequality shrank over this period, because it could be that wealthy households increased expenditure more than poorer households in terms of absolute amount. Tables 1-1(b) and (c) present the distributions of per-capita household expenditure separately for urban and rural areas. Table 1-1(b) on urban households would imply that expenditure inequality has increased over the 2008-2009 period, because wealthier households increased expenditure more than or at least by similar margins with poorer households in terms of % change. In contrast, Table 1-1(c) on rural households shows that the dynamics in the distribution of per-capita household expenditure would be more pro-poor in comparison with that in urban areas.

Table 1-1 Distribution of Per Capita Household Consumption (log) in 2008 and 2009

Table 1-1 (a): All sample households (N=65,239)					
percentile	2008 log p/c exp.	2009 log p/c exp.	diff=(b)-(a)	exp((c))-1	
	(a)	(b)	(c)		
5 th	11,803	11,921	0,118	0,125	
10 th	11,955	12,082	0,126	0,135	
20 th	12,158	12,286	0,129	0,137	
30 th	12,330	12,445	0,114	0,121	
40 th	12,481	12,590	0,110	0,116	
50 th	12,631	12,736	0,104	0,110	
60 th	12,791	12,889	0,098	0,103	
70 th	12,970	13,068	0,098	0,103	
80 th	13,196	13,293	0,097	0,102	
90 th	13,525	13,625	0,099	0,104	
95 th	13,808	13,912	0,104	0,110	
Table 1-1 (b): Urban households only (N=26,133)					
percentile	2008 log p/c exp.	2009 log p/c exp.	diff=(b)-(a)	exp((c))-1	
	(a)	(b)	(c)		
5 th	12,053	12,138	0,085	0,089	
10 th	12,222	12,323	0,101	0,106	
20 th	12,452	12,556	0,104	0,110	
30 th	12,646	12,739	0,093	0,098	
40 th	12,806	12,902	0,096	0,101	
50 th	12,967	13,060	0,093	0,097	
60 th	13,132	13,227	0,096	0,100	
70 th	13,311	13,409	0,097	0,102	
80 th	13,525	13,621	0,097	0,101	
90 th	13,830	13,926	0,096	0,101	
95 th	14,094	14,208	0,114	0,121	
Table 1-1 (c): Rural households only (N=39,106)					
percentile	2008 log p/c exp.	2009 log p/c exp.	diff=(b)-(a)	exp((c))-1	
	(a)	(b)	(c)		
5 th	11,714	11,847	0,133	0,142	
10 th	11,865	11,992	0,127	0,136	
20 th	12,038	12,180	0,141	0,152	
30 th	12,185	12,318	0,133	0,142	
40 th	12,324	12,442	0,118	0,126	
50 th	12,450	12,563	0,113	0,120	
60 th	12,577	12,689	0,112	0,119	
70 th	12,721	12,827	0,106	0,112	
80 th	12,902	13,001	0,099	0,104	
90 th	13,159	13,266	0,108	0,114	
95 th	13,404	13,506	0,102	0,108	

Source: SUSENAS Panel 2008-2009 data

1-1-2-2 Medium-Term National Development Plan 2010-2014

The new GOI under SBY-Boediono (President and Vice President) has yet to announce the RPJMN as of December 2009, and is expected to announce it by the end of January 2010. According to unofficial

sources³, macroeconomic targets for the new RPJMN include GDP growth of 6.5% per annual average, fiscal deficit of 2% of GDP, unemployment rate of 5-6% poverty rate of 8-10%, and average inflation rate of 5%. In order to achieve these targets, it is expected that GOI will prioritize the following four approaches: (1) accelerate the provision of physical infrastructure; (2) improve soft infrastructure; (3) build new social infrastructure; and (4) develop creativity for medium-term development.

1-1-3 Decentralization and Its Distributional Impacts

There has been debate over whether the power to redistribute should be centralized or decentralized when factor mobility and the associated location based transaction costs play a key role.⁴ A salient feature of the Tiebout model is the insight that the information sharing of preference among local residents, and their ability to move across jurisdictions of their choice, makes the case for fiscal decentralization. On the other hand, critics argue that the transaction costs associated with labor mobility has been reduced significantly to the extent that local rational taxpayers are tempted to get the maximum of the spillover benefits of public goods and services from other jurisdictions, while trying to minimize their own fiscal burden. In a federal system, this would lead to fiscal consumption across jurisdictions. The resulting non-cooperative solutions may not be socially optimal.⁵

There are, however, instances where centralized policy intervention may be desirable but not feasible; for example, when there are informational asymmetries between the central government and local governments on location-specific variables, such as costs of public goods provision and tastes over public services. In such cases, the local government may use the information as a strategic variable to bargain with the central government. The local governments have incentives to cheat the central government to maximize their parochial interests. The resulting public goods provision is unlikely to be socially optimal or efficient.⁶

Administratively, the decentralization can be classified into three categories: deconcentration, delegation and devolution.

³ Dr. Mohamad Ikhsan (2009), "Economic Strategy for 2010-2014" (Special Advisor to Coordinating Minister for Economic Affairs), mimeo.

⁴ Started with the seminal paper by Tiebout (1956).

⁵ Wildasin (1991) Keen and Marchand (1997).

⁶ Raff and Wilson (1997), Dhillon et al (1997), Cornes and Silva (1998), Bucovestky et al (1998).

Table 1-2 Administrative Decentralization

Deconcentration (minimal change)	Delegation (intermediate change)	Devolution (substantial change)
<ul style="list-style-type: none"> • Provider staff working at local level are employees of and accountable to the center, usually through their respective ministries; central employees compensate for weak local capacity. • Accountability remains distant: the <i>short route</i> of accountability may be weak if provider monitoring is weak, and citizens may have to rely on a weak <i>long route</i> stretching to politicians at the center; a strong <i>compact</i> between policymakers and providers can compensate to some extent. 	<ul style="list-style-type: none"> • Providers could be employees of central or local government, but the center typically defines pay and employment. • Local government has some authority over hiring and location of staff, but is less likely to have authority over firing. • Both <i>long</i> and <i>short routes</i> of accountability are potentially stronger; greater local knowledge can allow better matching of supply with local preferences and better monitoring, strengthening both the <i>compact</i> and <i>client power</i>. 	<ul style="list-style-type: none"> • Providers are employees of local government. • Local government has full discretion over salary levels, allocation, and numbers of staff, as well as the authority to hire and fire. • An overarching civil service framework covering local governments may still establish standards and procedures for hiring and managing staff. • Potentially strongest <i>long</i> and <i>short routes</i> to accountability, but influenced by local social norms and vulnerable to local capacity constraints and politics.

Source: World Bank (2005)

Indonesia has gone through a drastic process of decentralization and most public services have been delegated to even district and sub-district levels (rather than provincial levels). Habibie formulated the grand design and institutions of decentralization including two decentralization laws in 1999, Law No. 22/1999 on Regional Governance and Law No. 25/1999 on Fiscal Balance between the Centre and the Regions, in accordance with the process of political democratization. This series of decentralization activities had 4 characteristics: (i) stronger focus was put on devolution than distribution, provincial governments were to perform the substitution function of the central government and all the authorities except for ones that the central government must keep possessing were delegated to governments of districts and cities; (ii) relationship of responsibility was changed from a vertical one (central – province – district/city – village/sub-district) to a horizontal one (local governor – local parliament) – local governor became responsible basically not for the central government but for local parliaments; (iii) the rules for the inter-governmental money transfer from central to local –detailed rules regarding the distribution of natural resource revenue such as petroleum, and the introduction of general purpose grant (DAU – Dana Alokasi Umum); (iv) the village autonomy was revived – village administration and institutions can be fashioned in accordance with local traditions and needs.

To avoid “unfunded mandates” the system of local revenues was changed in accordance with Law No. 25/1999. There are different sources of income: local taxes, charges, and fees from local enterprises and borrowings (own source income). Additionally, the provinces and districts receive money from different equalization funds (Dana Perimbangan), which play an important role for the regional budgets. A central issue of the fiscal decentralization is DAU. Local governments can freely decide on spending and managing the grants. The specific purpose grant (DAK–Dana Alokasi Khusus) is supposed to ensure a minimum service standard. Further funds for equalization are the regional share of the property tax (Pajak Bumi dan Bangunan-PBB) and property transfer tax (Bea Perolehan Hak Atas Tanah dan Bangunan-BPHTB) and the regional share of natural resources revenue (DBH – Dana Bagi Hasil). Apart from these funds, a certain amount from the national budget (Anggaran Pendapatan dan Belanja Negara-APBN) is destined for the provinces and regions. Shared taxes fluctuate in line with fluctuations in commodity prices on the international markets.

Table 1-3 Fiscal Situations in 2001 and 2008

Revenue sources	2001 (avg of 273 regencies/cities)	2008 (avg of 434 regencies/cities)
Own revenues	6.65%	6.28%
Revenue sharing (tax, natural resources)	13.21%	25.01%
General allocation fund (DAU)	69.63%	57.77%
Special allocation fund (DAK)	0.61%	6.82%
Other Gol/provincial transfers	2.93%	4.12%
Balance from previous year	6.97%	
Total income	100.00%	100.00%

Source: UNDP (2009)

Various problems emerged during the implementation period. One problem was the lack of clarity of the laws concerning decentralization. A great number of laws were prepared without a blue print, which led to a lot of confusion about the law itself and rendered valid reference impossible. United Nation Development Program's (UNDP)-National Human Development Report 2004 diagnosed an unclear distribution of functions between the central government and the regions. Another problem was that both provinces and districts had to absorb more government workers than they could immediately make use of. As a result, high routine expenditures and little service delivery occurred. Further problems regarding finances were the own-source revenues, which were hardly high enough to finance the district's tasks, since all major taxes were kept by the central government. This led to the introduction of new local taxes, which in turn had a negative influence on the investment climate. UNDP argued that the fiscal structure favors the resource-rich regions and could lead to stronger regional disparities. Apart from these disparities, there were worries about the dominance of natural resources as the main income sources for local governments, which could lead to an over-exploitation and negative effects for the environment. Another problem was the unintended incentives for local elites to form new local governments, even if this was not necessary and proved inefficient.

In order to solve the above-mentioned problems and improve the decentralization process, many laws and regulations were endorsed or amended after 2001. The revised Law No.32/2004 on Regional Autonomy and revised Law No. 33/2004 on Regional Fiscal Balance replaced the older Law No. 22/1999 and 25/1999. While Law No. 32/2004 concern with the implementation of public election system for local governors, the Law No. 33/2004 strengthen the upper governments' supervision function on regional budget and financial administration. In 2004, on the other hand, the amendment process revealed the old and continuous problem at the central level, lack of coordination among the ministries and especially, demarcation problem between the Ministry of Home Affairs (MOHA) and the Ministry of Finance (MOF). Lack of leadership at central level contributed significantly to the coordination and rivalry problems. The perception that Law No. 22/1999 is just a sectoral law belonging to MOHA still remains. The demarcation problem between MOHA and MOF seems to be endless when it comes to the question of who should be the authority of decentralization process. Each one of them proposed the amendment of Law No. 22/1999 and Law No. 25/1999 respectively and the bigger problem was that each one of them was working on overlapped issues differently.

The issue of the demarcation between the Ministry of Home Affairs and the Ministry of Finance still exists in this day. The 2004 revision of the decentralization laws did not change the fact that a close coordination is needed between the central agency which calculates and transfers the money and the other agency which supervises, monitors, and evaluates how the money was used.

The Ministry of Finance has a mandate on the fiscal balance calculations and transfers requiring the Ministry to monitor the development performance of the region. Different legal documents are needed from the local governments for the calculations to be correct (e.g. the last budget must have been

examined by state auditor as is the case for budget transfers.) Different administrative procedures are required, and are then issued by the Ministry of Finance.

It is over these very administrative requirements that the Ministry of Home Affairs claims significant authority. The main mandate of the Ministry of Home Affairs is for the administrative issues of the local governance. At times this would touch upon the financial administration, which is where the regulations and guidelines issued may be very close (if not overlapping) with the mandate of the Ministry of Home Affairs.

The power struggle issue is even clearer at times like these when another round of decentralization law revisions is on the table. In the 1999 and 2004 versions, the decentralization laws comprised one law on local government and another on the central-local fiscal balance. For the last couple years, both the Ministry of Home Affairs and Ministry of Finance have been offering ideas for the law revisions. As of now, the two are producing academic papers and exchanging ideas on the issues.

Indonesia consists of 33 provinces (Propinsi) and 496 districts/cities (Kabupaten/Kota). Their sub-units are the sub-districts (Kecamatan), which consist of villages (Desa or Kelurahan), the smallest units in the political system of Indonesia. Each of the provinces is headed by a governor and has a legislative body, the Regional People's Representatives Council (Dewan Perwakilan Rakyat Daerah-DPRD). The governor is the head of an autonomous region and the same time the representative of the central government, subordinated under the president through the MOHA. The provinces are responsible for macro-planning, human resource development and research, the management of regional ports, environmental protection, trade and tourism promotion, pest control/quarantine and spatial planning. Regional governments shall cover the authorities in all fields of governance, except authorities in the fields of international policies, defense and security, judicature, monetary and fiscal, religion and authorities in other fields. Their fields of governance include public works, health, education and culture, agriculture, communication, industry and trade, capital investment, environment, land, co-operative and manpower affairs. These activities should be supervised by the central government, which has the power of nullifying regional decisions. In order to manage these new responsibilities, approximately 2.2 million national civil servants and 16,000 service facilities were transferred from the central government to the regions.

The provinces and sub-province governments need institutional reform to support their increased responsibilities to: (i) improve the investment climate; (ii) manage local public finances and strengthen governance; (iii) effectively plan the use of their newly gained powers and resources for development purposes; and (iv) improve service delivery.

The challenge for the Indonesian government in decentralization lies in finding an effective way to control regions and ensure national objectives without excessively limiting local autonomy. The rules and procedures necessary for this process are provided by the Government Regulation No. 79/2005, which implies a stricter treatment of faulty regional regulations concerning the local economy, but also concerning the exploitation of natural resources, for a sustainable development.

According to UNDP, however, actual governmental functions remain unclear. It is not yet clear whether functions of policy-making, monitoring, and implementation should be divided or shared and neither is it apparent to whom the local governments should be accountable. Provinces do not have administrative power over the districts/municipals, the latter are not answerable to the former and, hence, render monitoring difficult. This resulted in the lack of provincial financial power over the districts/municipals.

Table 1-4 Legal Framework of Decentralization

Law no. 22/1999: stipulations on provincial authorities	Law no. 32/2004: stipulations on provincial affairs
<ul style="list-style-type: none"> - gives the province authority over inter-regency/municipality areas of responsibilities - province to manage functions that the local governments are not able to conduct - management of functions delegated to the province as administrative region (§9) 	<ul style="list-style-type: none"> - management of 11 mandatory affairs at provincial scale. - management of optional affairs, corresponding to local conditions (§13)
Law no. 25/1999 on Fiscal Equalisation	Law no. 33/2004 on Fiscal Equalisation
<ul style="list-style-type: none"> - governs sharing of revenues between national, provincial, and local governments 	<ul style="list-style-type: none"> - §11 adds stipulations on income tax revenue sharing - accommodates slight changes in sharing of revenues. The province gets about 16% and regencies/cities get about 64% of all revenue sharing including property tax, except for the various mining revenues which are predominantly for the national government
GR no. 25/2000 on Provincial Authorities	GR no. 38/2007 on Distribution of Authorities between Levels of Government
<ul style="list-style-type: none"> - the GR refers to Law no. 22/99 §9; provincial government manages cross regional affairs that are not performed by local governments and delegated administrative affairs of the national government § 3: - the provincial government is responsible for 108 functions in 20 sectors (compared to 202 functions of the central government in 25 sectors); - the provincial government is also responsible for other functions; those that cannot be accomplished by a regency/city 	<ul style="list-style-type: none"> - the GR defines 31 shared areas of responsibilities, to be co-managed by the national, provincial and regency/city governments. Each sector to be regulated by the relevant ministry. Attachments: - the GR determines mandatory affairs and optional affairs (optional affairs are those most relevant to local economic and political characteristics); - the GR specifies the possibility of the province to take over or return affairs to local governments.

Source: UNDP (2009)

Case Study 1: Decentralization in Indonesia and Neighboring Countries

Decentralization has been a world-wide phenomenon of the past few decades with, many OECD countries having delegated major public functions to local governments by the end of the 1990s. East Asian economies have followed this international trend with the expenditures in 2005 of local government over national expenditure exceeding 60% in China, and nearly 50% in Vietnam in terms of the expenditure share.

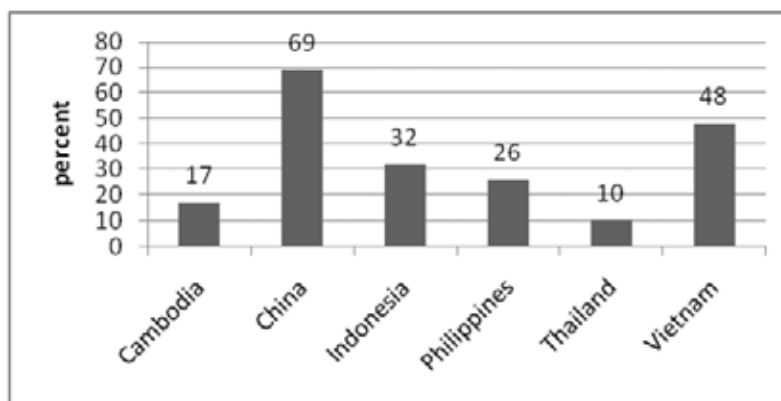


Figure 1-6 Share of Local Expenditure over National Expenditure

Source: World Bank (2005)

There is, however, an increasing awareness of a growing inequality across regions with, as shown in the tables below, the gap between the wealthiest and the poorest localities being significantly high. In China, the per capita revenue in the wealthiest region holds at about USD 280, while in turn it is less than USD 20 in the poorest region. Similar disparities have been observed in other decentralizing countries, including Indonesia, the Philippines, and Vietnam. With appropriate income transfers and central government, however, the revenue gap has not necessarily translated into a welfare gap. For example, a regional gap in revenue, as measured by when the coefficient of variation approaches 1.0, has remained below 0.2 for all these countries.

Each of these countries utilizes different intergovernmental transfer schemes; conditional and unconditional. In China, a Tax Sharing System (1994) assigns shares of certain taxes to sub-national governments' general revenue. While the System basically defines the fiscal relationship between the central and local governments, province-level (i.e., autonomous region, municipality, or special administrative region) government has its discretion over fiscal share with its lower tiers of governments. For unconditional transfers, a complex accumulation of old and new systems co-exist with conditional grants accounting for more than half of all transfers and dominated mainly by social security, wage increase, and fiscal stimulus grants. In Indonesia, certain taxes are shared with the lower levels for unconditional transfers in the form of: formula-driven DAU revenue sharing accounts for at least 26% of domestic revenues; and provincial and sub-provincial shares based on obligations (Law No. 33/2004). The role of conditional transfers, however, is minor with DAK under development with a 10% sub-national matching requirements based on Law No. 33/2004.

Table 1-5 Disparities in Provincial Revenues per Capita (in USD) (before Grants)

	China	Indonesia	Philippines	Vietnam
Maximum	283.2	59.5	7.6	343.4
Minimum	18.1	3.8	0.2	6.5
Average	55.7	12.1	1.5	36.9
Max./min. ^a	15.7	15.7	35.4	53.0
Standard deviation	54.8	11.6	1.4	61.1
Coefficient of variation ^b	0.98	0.96	0.97	0.79

Note: (a) The ratio in revenues between the province with the highest revenues and the province with the lowest revenues. (b) The coefficient of variation is the standard deviation divided by the average.

Source: World Bank (2005)

Table 1-6 Regional Disparities in HDI

	China	Indonesia	Philippines	Vietnam
Maximum	0.85	0.73	0.65	0.84
Minimum	0.52	0.54	0.39	0.49
Average	0.70	0.64	0.56	0.74
Max./min.	1.64	1.34	1.65	1.72
Standard deviation	0.07	0.04	0.11	0.06
Coefficient of variation	0.10	0.06	0.19	0.08

Note: (a) Data for the Philippines are at the regional level.

Source: World Bank (2005)

Table 1-7 Per-capita DAK and DAU by Province (IDR)

CODE	PROVINCE	DAK		DAU	
		2006	2007	2006	2007
11	ACEH	146278.15	196554.10	1238942.08	1390989.32
12	SUMATRA UTARA	51188.29	79769.39	660400.07	743741.74
13	SUMATRA BARAT	100660.07	158815.99	1106716.04	1228807.49
14	RIAU	33911.01	42634.95	393906.03	530491.00
15	JAMBI	74634.85	133590.40	1042795.12	1146194.15
16	SUMATERA SELATAN	45313.93	65450.04	615752.64	704230.97
17	BENGKULU	186627.45	256447.87	1466705.85	1605416.84
18	LAMPUNG	42746.57	62261.25	590698.26	645174.13
19	BANGKA-BELITUNG	165947.26	240738.58	1365585.36	1567431.89
20	KEPULAUAN RIAU	61084.99	106332.51	771300.82	1036463.05
31	JAKARTA	0.00	0.00	85659.11	13217.87
32	JAWA BARAT	17294.48	20279.29	334495.24	390020.11
33	JAWA TENGAH	27921.85	40069.42	493297.68	540704.02
34	YOGYAKARTA	37312.75	51184.51	723413.35	786788.74
35	JAWA TIMUR	24970.76	36893.41	453930.26	508128.79
36	BANTEN	10802.55	25440.35	293141.51	345845.82
51	BALI	68625.67	100019.42	831386.18	945359.05
52	NUSA TENGGARA BARAT	68953.23	95424.33	710551.99	817270.25
53	NUSA TENGGARA TIMUR	112931.99	167943.38	1039570.04	1135427.96
61	KALIMANTAN BARAT	86943.69	138990.76	1146561.81	1249042.96
62	KALIMANTAN TENGAH	196537.16	254443.32	2269798.36	2501865.63
63	KALIMANTAN SELATAN	97571.04	121882.03	1003887.51	1096721.76
64	KALIMANTAN TIMUR	72540.22	89719.00	751451.56	988579.63
71	SULAWESI UTARA	145778.74	229855.48	1280190.65	1407496.12
72	SULAWESI TENGAH	123493.37	199625.18	1406714.66	1539204.62
73	SULAWESI SELATAN	85703.30	128404.65	868699.80	960451.48
74	SULAWESI TENGGARA	160565.00	245470.65	1444442.13	1587489.05
75	GORONTALO	143509.63	229673.36	1493268.08	1476981.91
76	SULAWESI BARAT	148193.07	202040.98	1336293.31	1445920.24
81	MALUKU	197276.80	316514.64	1936552.23	2153434.00
82	MALUKU UTARA	315642.96	391927.93	2074430.00	2352906.58
91	IRIAN JAYA BARAT	388899.96	570967.85	4108684.48	4546786.05
94	PAPUA	342748.56	525150.16	3784758.57	4016792.08

Source: Data on DAK and DAU were taken from <http://www.djpk.depkeu.go.id/> and were summed up to obtain provincial data. Data on population by province were taken from BPS.

1-2 The Nature of Indonesia's Poverty and Policy Reactions

1-2-1 Poverty Profile

1-2-1-1 Indonesian Poverty Measure

Poverty rates in Indonesia are measured by the percentage of the population living below the poverty line. Statistics Indonesia (Badan Pusat Statistik-BPS) uses the basic needs approach for this indicator with poverty being seen as the economic inability to satisfy the basic food and non-food needs, as measured by household expenditure. BPS devises a method to identify the poverty line, comprising of two components: the food poverty line and the non-food poverty line. The food poverty line is the value of expenditures necessary to satisfy an equivalent of 2,100 kcal per capita per day. The consumption basket

represents 52 commodities including paddies, fish, meat, eggs and milk, vegetables, nuts, fruits, oils and fats, and other such food groups . On the other hand, the non-food poverty line is the minimum necessities of housing, clothing, education and health expenditures. The consumption baskets represents 51 commodities in urban areas, and 46 commodities in rural areas.

Indonesia is a country so large that interregional variations are immense. Provinces differ from one to another not only in terms of commodity prices, but also in terms of spending and consumption habits. Consumption baskets amounting to 2,100 kcal per day may be different from one province to another, which is another important variation between rural and urban. All of these characteristics must be taken into account in order to properly assess the extent of poverty in Indonesia and, in consideration of such, the poverty line in Indonesia is unique in every province broken down between urban and rural areas of each province.

Table 1-8 lists the poverty lines for all provinces in Indonesia separately for urban and rural areas. In both 2008 and 2009, DKI Jakarta possessed the highest poverty line among all the Indonesian provinces. This signifies that one IDR in DKI Jakarta is worth less than one IDR in any other province in Indonesia.

Table 1-8 Poverty lines for 2008 and 2009
(IDR/capita/month)

Province	2008		2009	
	Urban	Rural	Urban	Rural
N. Aceh Darussalam	266,168	229,237	287,551	254,202
Sumatera Utara	218,333	171,922	232,104	190,905
Sumatera Barat	226,343	179,755	239,463	197,867
Riau	247,923	210,519	262,976	228,422
Jambi	223,527	162,434	232,642	173,563
Sumatera Selatan	229,552	175,556	256,863	191,185
Bengkulu	224,081	170,878	239,013	195,355
Lampung	203,685	160,734	220,769	177,400
Kep. Bangka Belitung	250,240	242,441	264,383	251,156
Kep. Riau	289,541	231,580	300,758	250,622
DKI Jakarta	290,268	-	315,713	-
Jawa Barat	190,824	155,367	201,380	167,394
Jawa Tengah	184,704	152,531	202,844	165,236
DI Yogyakarta	208,655	169,934	216,758	184,699
Jawa Timur	183,408	155,432	201,977	172,169
Banten	197,328	156,494	206,688	173,832
Bali	190,026	158,206	201,572	169,158
Nusa Tenggara Barat	193,241	148,998	211,461	169,641
Nusa Tenggara Timur	199,006	126,746	212,950	141,775
Kalimantan Barat	179,261	150,968	193,314	170,846
Kalimantan Tengah	196,354	180,671	214,889	212,749
Kalimantan Selatan	199,416	166,676	214,620	192,060
Kalimantan Timur	257,862	205,255	277,562	223,160
Sulawesi Utara	175,628	162,433	186,012	176,556
Sulawesi Tengah	196,229	160,527	212,089	175,679
Sulawesi Selatan	160,220	127,938	171,779	141,363
Sulawesi Tenggara	151,471	139,065	161,457	152,040
Gorontalo	154,987	143,584	164,013	153,384
Sulawesi Barat	156,041	141,701	168,106	153,948
Maluku	213,969	180,087	223,280	190,161
Maluku Utara	213,505	176,757	237,064	203,503
Papua Barat	244,807	230,254	286,040	258,672
Papua	264,625	213,548	288,702	239,368

Source: BPS

There are several surveys and data sets used to calculate and identify poverty status in Indonesia. The SUSENAS is the primary information source for national and provincial level poverty rates. Every year SUSENAS carries out a core survey covering approximately 275 thousand households collecting basic household level data on health, education, employment, and expenditures. With this dataset, the poverty rate at the kabupaten/kota level can be estimated.

SUSENAS also conducts a survey of what is called a Consumption Module. This is a detailed source of consumption and expenditure data, recording more than 200 food and more than 100 non-food commodities, at the household level. This module was initially surveyed every three years by BPS covering approximately 65 thousand households per round.

In 2003, it was acknowledged that the measurement for poverty needed to be conducted in a continuous fashion, requiring a longitudinal dataset that allowed for the following of the consumption status of a particular household over a period of time. It was then decided that around 10,000 households among the SUSENAS sample would be set as sampled households over the time period. The 10,000 panel households dataset allows poverty rate estimation at the national level with the annual 10,000 panel households being revisited every year, with approximately 5% changes from one year to another due to mobility and other statistical reasons. In 2007, GOI increased the number of samples in the panel to approximately 68 thousand households following a heated debate in 2006 concerning whether such number of panel households is sufficient to provide representative poverty statistics for the nation as a whole. In 2008, the BPS conducted a new sampling framework while keeping the number of household panels intact. The reason for the new sampling framework was the fact that the first panel drawn in 2003 may have already changed so much that a new set of longitudinal households would be required for future analysis. The 2009 panel was, as a consequence, based on the 2008 sampling framework.

In this report, the poverty lines are used in such a way to convert nominal income and expenditure into real equivalent using 2008 Jakarta prices as the base. For example, supposing that a household in urban Bali had a nominal per-capita household expenditure of IDR 200,000 in 2008, the real per-capita household expenditure of the same household using 2008 Jakarta prices as the base would be $\text{IDR } 200,000 \times \text{IDR } 290,268 / \text{IDR } 190,269 = \text{IDR } 305,503$. After this same exercise is repeated for all other regions and periods, the resulting per-capita household expenditure becomes real expenditure using 2008 Jakarta prices as the base.

For the policy intervention, which to a great extent is at the household level, a different dataset is required. The nationwide survey data cannot provide the exact location of a poor household since such can only be identified through a registration process applying certain criteria for a household to be deemed as poor. The first attempt to generate such list of poor families in Indonesia was made in 2005. In order to mitigate the impact of a reduction in fuel subsidies, GOI launched an unconditional cash transfer (Bantuan Langsung Tunai-BLT) program at the end of 2005. To identify eligible households to receive this BLT, GOI, through BPS, conducted a registration called Socio-Economic Listing (Pendataan Sosial Ekonomi-PSE) 2005.

PSE 2005 used proxy means testing to identify variables (and indicators) at the household level perceived to have strong correlations with household income. Hence, the proportion of eligible households in the PSE 2005 was certainly different from that of the survey-based poverty headcount ratio justified under the notion that eligibility should not only cover those below the survey-based poverty line, but should also address the existence of the near-poor.

As a result, about 15.5 million households were identified as eligible for the BLT at that time. Each of the households then received IDR 100,000 per month, payable every three months via PT. Pos Indonesia (Indonesian state-owned postal company). As income was not included as one of variable in proxy mean testing to determine the eligibility for the support, each that were eligible based on the variables above receive the same amount of cash transfer regardless their income.

The following table lists the 14 variables and their criteria used to determine whether a household was categorized as extreme-poor, poor, or near-poor.

Table 1-9 Poverty Criteria

IDENTIFICATION VARIABLES	Scoring [poor = 1; non-poor =0]
1. House floor area per household member	< 8m ² = 1, and 0 otherwise
2. Type of house floor	Dirt/low quality wood = 1, and 0 otherwise
3. Type of house wall	Bamboo/low quality wood = 1, and 0 otherwise
4. Toilet	None = 1, and 0 otherwise
5. Source of drinking water	Not-safe water=1, and 0 otherwise
6. House lighting	Non-electricity=1, and 0 otherwise
7. Source of cooking heat	Wood/charcoal=1, and 0 otherwise
8. Daily meal frequency	Once or less=1, and 0 otherwise
9. Ability to buy meat/chicken/milk weekly	None=1, and 0 otherwise
10. Ability to buy new clothes for each household member yearly	None=1, and 0 otherwise
11. Ability to go to health center/clinic	None = 1 and 0 otherwise
12. Occupation of household head	None, subsistence farmer/fisherman = 1 , and 0 otherwise
13. Educational attainment of household head	Elementary school or less=1 and 0 otherwise
14. Asset ownership (minimum value IDR 500,000)	None = 1 , and 0 otherwise

Source: BPS

The list of eligible households for the government intervention program is updated regularly with one notable update made in 2008 under the name of Social Protection Program Listing (Pendataan Program Perlindungan Sosial -PPLS) 2008. This update is of greater significance than the others since GOI intends to use the data as the basis for all social protection programs listed under Cluster 1 of the Anti-Poverty program (see next section on Strategic Policy).

1-2-1-2 Poverty Incidence

The poverty level population in Indonesia was recorded at around 32.4 million as of February 2009. This comprised about 14.15% of the total population, down from 23.4% immediately preceding the economic crises in 1999 (see figure 1-7), and significantly below the 40.1% poverty rate of more than three decades earlier in 1976.

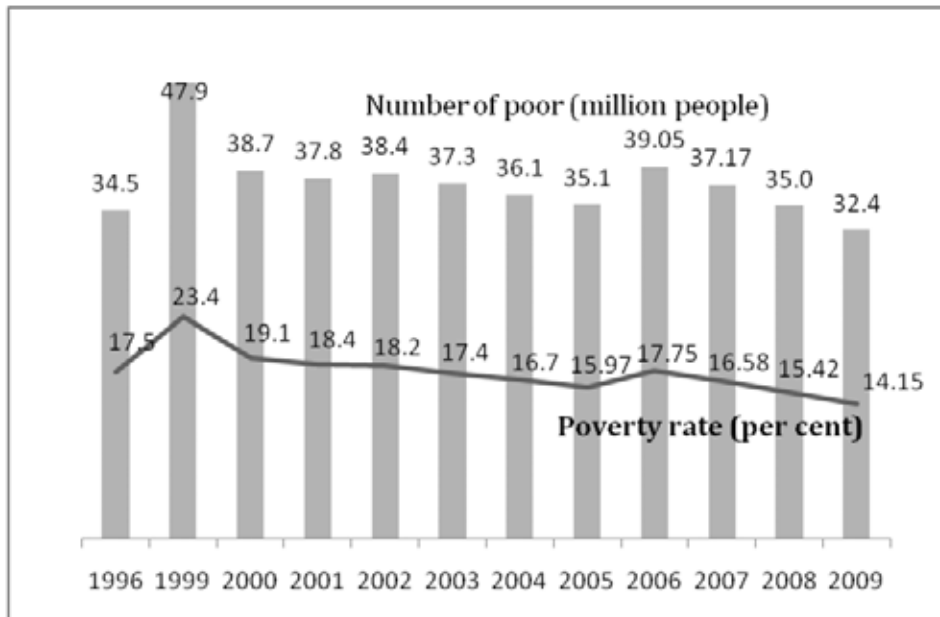


Figure 1-7 The Number of Poor and Headcount Ratio Indonesia, 1996-2009
Source: BPS, Statistics Indonesia, various years

The 1998 multifaceted crises hit Indonesia severely. On the economic front, the economy experienced a contraction of 13% in 1998 (in contrast to 5.8% growth in the previous year). The soaring exchange rate, together with the 75% inflation rate, reduced per capita income from USD 1,184 to USD 485 within just a year's time. Indonesia's foreign debt, as a percentage of GDP, rose from 24% in 1996 to 97% in 1999.

In this macroeconomic atmosphere, the poverty rate climbed from 17.5% in 1996 to 23.4% in 1999 with the number of people living below the poverty line having increased from 34.5 million in 1996 to 47.9 million in 1999. During this crisis period, Indonesians felt a number developmental reversals: jobs became much harder to find; economic contractions resulting in widespread layoffs, in turn forcing many to engage in the informal economy to continue earning a living in an economy without the unemployment support;⁷ widespread food scarcity resulting in malnutrition, especially among children under five;⁸ and increases school drop-outs.⁹ The entirety of this economic turmoil led to widespread insecurity and unrest, culminating in increased crime rates.¹⁰

⁷ Hill (1999) reports the unemployment rates of 4.68% in 1997, 5.44% in 1998, and 6.36% in 1999, which may not be worsening drastically. However, as the labor force in agricultural sector changed from 40.7% in 1997 to 43.2% in 1998, there is a doubt that the redundant labor force was absorbed into the agricultural sector.

⁸ NIRA (2002) reports the cases of severe and morbid infant under-nutrition in the aftermath of the crisis.

⁹ Frankenberg et al. (1999) reports an increase of school drop-outs rates at middle and high schools by about 6% in urban area and by 3% in rural area.

¹⁰ Asian Economic News (2001) reports increase of crimes by 5.2% in 1999.

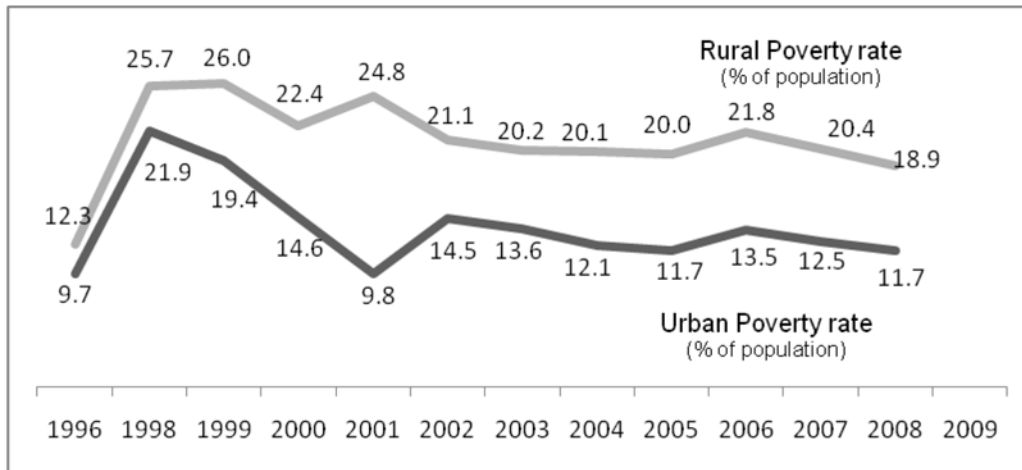


Figure 1-8 Rural and Urban Poverty Rate, 1996-2009

Source: BPS, Statistics Indonesia, various years

Poverty in Indonesia is still largely a rural phenomenon as is illustrated in Figure 1-8, which shows the headcount poverty ratio in rural areas exceeds that of the urban areas. The percentage indicates that the amount by which the two differ is much higher in recent years than prior to the end of the 1990s crisis. The poor in the rural areas are to a great extent dependent on the agricultural sector. In the areas outside of Java and in the remote regions, rural areas are in essence concentration points of poverty with the agricultural sector incapable of providing sufficient income for the poor. In fact, the poor in the rural areas are often the largest net consumers of agricultural products. Many of those living in coastal areas face problems with access to both technology as well as economic growth centres.

Figure 1-9 below shows the distribution of the per headcount poverty ratio of Indonesia provinces. Three panel years of the distribution are shown: 2002, 2005 and 2009. The darker red areas denotes ratios further above the average, while the darker blue area signifies ratios farther below the average (i.e. national headcount ratio) for each year. There are several key points that stand out in the above three distributions. First, the poverty incidence is higher in provinces outside of Java. Secondly, provinces in Java, Kalimantan and some of Sumatra, were below the average in 2002. Note, however, that the map in 2002 needs to be interpreted carefully. The survey of household incomes was only partially sampled in both Aceh and Papua, resulting in somewhat skewed estimations of head count ratios in those regions. This explains the relatively low poverty incidence indicator in Papua in 2002, as compared with later years. On the other hand, despite the data limitations, it can be shown that Aceh has improved drastically in its poverty ratios over the years indicated. It should be noted that both regions have special autonomous status and are the most decentralized regions in Indonesia.

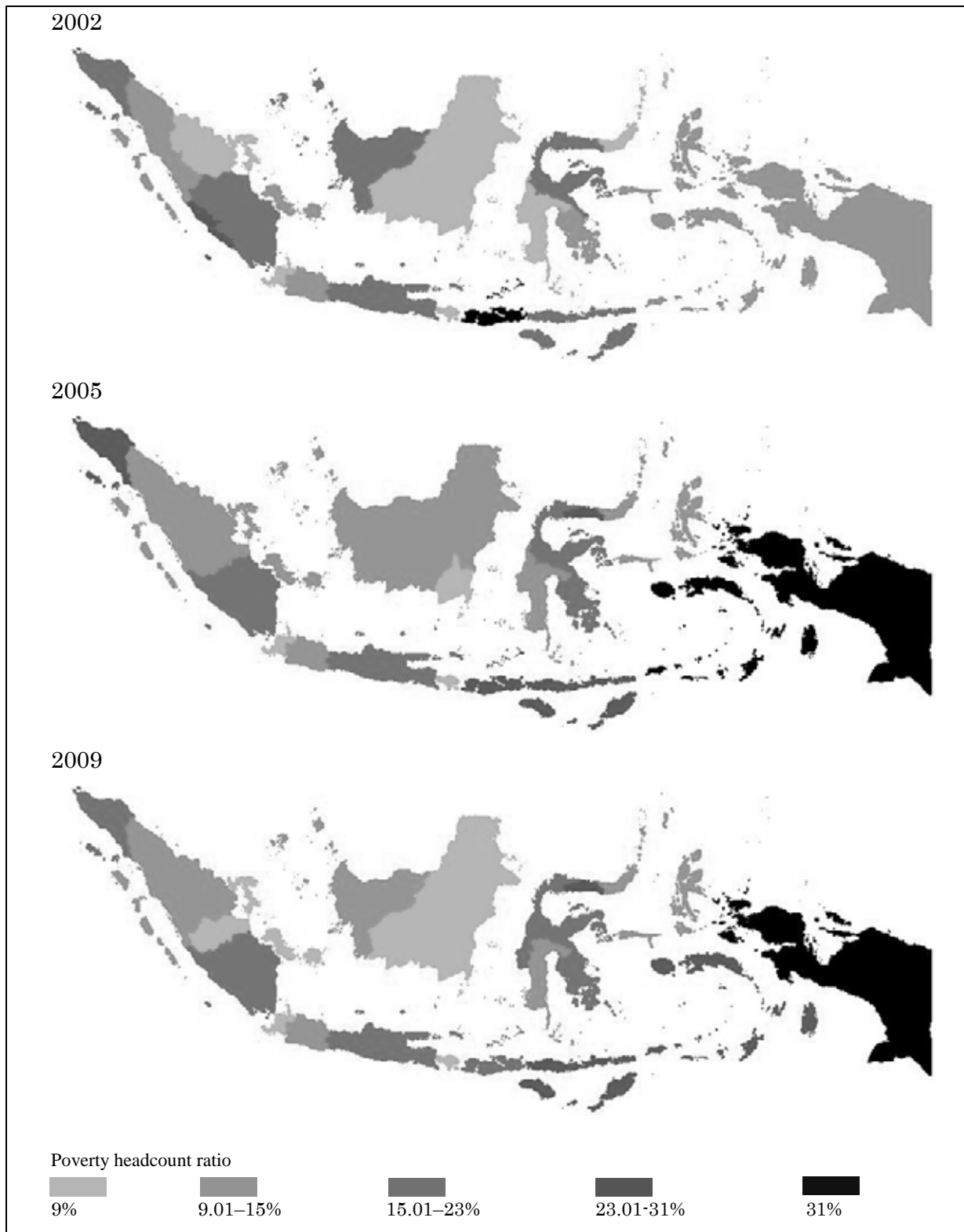


Figure 1-9 The Provincial Distribution of Headcount Ratio in Indonesia, 2002, 2005 and 2009
 Source: BPS, Statistics Indonesia, various years

As mentioned previously, the steadily decreasing trend in poverty within Indonesia over the last several years has been recognized. However, Indonesia is large; widely spread country and as such variations among provinces immense. In Java and outside of Java differences emerge with the different facets of development as well as variations within provinces also being significant. Moreover, in the past decades

variations have further spurred by a move toward a new decentralization scheme. When local governments are able to choose their own local spending patterns, the impacts of local budgets on social and economic development begin to vary location to location. Indonesia's new decentralization scheme is placed primarily at the regency/city (kabupaten/kota) level, leaving the province with more of a coordination role. Despite this fact, the subsequent analysis will utilize provincial level data as provincial level BPS data leading to various indicators are more widely available and reliable.

Poverty is a multidimensional problem in several ways. It is multidimensional in terms of the variables by which poverty is measured, as it can be viewed in terms of income, assets, or other basic necessities that people are assumed to possess. Poverty is also multidimensional in its correlation with education, public health, or infrastructure variables. As a result one can also identify different non-income poverty indicators, a list of which is shown in Appendices D and E. The following table shows the correlation coefficients of income poverty (represented by the poverty index) with other non-income poverty indicators. These variables are all in natural logarithmic forms.

Table 1-10 Correlation Coefficients of Poverty Index with Other Non-income Poverty Indicators

	<i>Poverty</i>	<i>Primary</i>	<i>Illiterate</i>	<i>Area</i>	<i>Floor</i>	<i>Wall</i>	<i>Toilet</i>	<i>Water</i>	<i>Electricity</i>
<i>Poverty</i>	1.000								
<i>Primary</i>	0.270	1.000							
<i>Illiterate</i>	0.439	0.395	1.000						
<i>Area</i>	0.134	-0.263	-0.164	1.000					
<i>Floor</i>	0.800	0.186	0.414	-0.014	1.000				
<i>Wall</i>	0.567	0.415	0.488	0.003	0.637	1.000			
<i>Toilet</i>	0.430	0.417	0.421	0.239	0.378	0.332	1.000		
<i>Water</i>	0.466	0.489	0.291	0.009	0.350	0.098	0.297	1.000	
<i>Electricity</i>	0.544	0.389	0.240	0.391	0.325	0.105	0.432	0.833	1.000

Notes: All variable in natural logarithmic (ln) form. *Primary*: the percentage of households whose head has less than a primary school level of education. *Illiterate*: the percentage of households whose head is illiterate. *Area*: the percentage of household with less than 8m² per household member. *Floor*: the percentage of households with a low quality floor in their residence. *Wall*: the percentage of households with low quality house walls. *Toilet*: the percentage of households without or with shared toilet facilities. *Water*: the percentage of households with low quality drinking water access. *Electricity*: the percentage of household without electricity.

Source: SUSENAS Panel 2008-2009 data

Education is an important correlate of poverty. Low educational levels hinder poor households' ability to earn sufficient incomes since they have diminished work opportunities. Two indicators can be seen here: the percentage of households whose head has less than a primary school education, the percentage of households whose head of household is illiterate. The first indicator has a correlation coefficient¹¹ of 0.270 with the poverty, while that of the second is 0.439. Bear in mind that the correlation is obtained using provincial data.

These indicators are shown for the last three years for which the panel household data from SUSENAS is available. Overall, there is an improvement trend in these indicators in all provinces meaning that more household heads have higher than primary school level of education and more head of households are literate. The poverty rate, however, is quite high for head of households with less than primary school education. On average roughly a quarter of Indonesian household heads have less than a primary school education. In certain provinces, the proportions are closer to one third. This particular indicator is not easy to improve in the short run since educational attainment needs time, which differs from the other indicator, namely the illiteracy of the household heads. Still, there are some provinces with relatively high illiteracy rates such as Nusa Tenggara or Papua contributing to a relatively low illiteracy rate overall. The illiteracy

¹¹ Correlation coefficient is defined as the covariance of the two variables divided by the product of their standard deviations.

variable, unlike the education variable, can more easily be fixed by conducting different acceleration packages at the rural level.

Other correlates of poverty also include housing conditions. Three indicators for this factor are shown here, namely the percentage of households with less than 8m² per household member (correlation with poverty: 0.134), the percentage of households with low quality floor of residence (correlation with poverty: 0.800), and low quality house walls (correlation with poverty: 0.567).

The low correlation between the household area and poverty denotes a mixed relationship between the two. Indeed, at the micro and household level, poverty is associated with a low household area. At the macro level, however, this may not necessarily be the case. The data shows that urban provinces like Jakarta actually rate high in the percentage of household with less than 8m² per household member. This denotes the housing challenges experienced in urban contexts in the midst of high economic development. Over time, the percentage of households living with insufficient housing area has actually been declining in the last three years, but, as can be seen from the table, the decline is quite slow.

On the other hand, the quality of flooring and walls are more correlated with poverty than household housing area. Poor houses usually have a lower quality floor, such as a mere soil, and non-brick wall, which helps explain the relatively high correlation between these qualities and the poverty.

Two indicators utilized to denote sanitation facilities that significantly affect health status; the percentage of household without or with shared toilet facilities (correlation with poverty: 0.430), and the percentage of household with unfiltered¹² drinking water source that reflect the low quality of source (correlation with poverty: 0.466). The correlation between poverty and sanitation facilities is quite high with sanitation facilities and reliable water sources are two important infrastructural supports for health and productivity. In 2007 and 2008 provinces in Sumatra had more than 50% of its residents without their own toilet. By 2009, these provinces had already been able to reduce the number to less than 50%, while for some provinces in eastern part of Indonesia the figure remains higher than 50%. In terms of water facilities, seven provinces still have more than 50% of their citizens without access to a decent drinking water source in 2008 and 2009. As these two facilities may affect citizen health and productivity, expedited improvements are needed in relation to sanitation facilities.

Finally, infrastructure is represented by the percentage of households without electricity (poverty correlation: 0.544). Nationally, 9.03% of Indonesians do not have access to electricity. However, the conditions in Papua and Nusa Tenggara are particularly worrisome as these two provinces contain more than 50% of the households with no access to electricity. It is important to note that electricity is important for the supporting of economic growth through the utilization of machinery to produce goods and services while also making it easier for students to study in the evening hours since immediately after school they are likely to need to help their parents in the fields. Improvement in access to the electric power sources in Indonesia's eastern region is crucial to boosting of economic growth.

Appendix E illustrates some of the above indicators between the poor and non-poor as of 2009 and based thereon one can interpret through the comparison gaps in the headcount. For education indicators, non-poor households clearly fare better than the poor with about 39.19% of poor households heads nationally having less than a primary education, compared to a mere 23.00% of non-poor households. In terms of regional differences, the percentage of the poor with a head of household who has not completed primary school ranging from 22.22% in Papua to 58.49% in West Kalimantan compared to percentage for non-poor households ranging from 8.98% in Jakarta to 36.52% in Gorontalo. The prevalence limited educational levels in the poor segment are doubles that of the non-poor segment. These figures show positive correlations between a lack of education and the incidence of poverty.

¹² Here, 'unfiltered' refers to natural water spring, river, and waterfall.

Nationally, 13.58% non-poor households live in very limited residential floor space; less than 8m² per member of the household. This figure is more than double that of poor households with 35.92% of poor households sharing that level of very limited house space with other members. This might also relate to the fact that the poor households tend to have more children since they are unable to afford the use of contraceptives. The lowest percentage of non-poor households and poor household with limited housing areas is 3.06% in Central Java and 6.82% in Yogyakarta. An interesting fact to note is that in Jakarta, the capital city of Indonesia, 85.54% of the poor households live in areas with less than 8m² per person, and 33.80% of non-poor live in the same condition. The prevalence of non-poor households who live in very limited space in Jakarta is only slightly less than the highest one of Papua with 35.94% of the non-poor households live in a small area, while in term of the poor, 80.62% of Papua residents live in less than 8m² per person. This aspect of Jakarta reflects its position as an attractive city to immigrants from all over Indonesia that contributes to the growing number of slum areas, which requires sound policy in order to avoid the negative impacts of over-urbanization.

Poverty also may have negative correlations with the ownership of toilet facilities. This can be seen from the fact that 34.52% of non-poor households own toilet facilities, while the percentage of poor households without toilet facilities is almost double that. In terms of regional disparities, Riau has the highest number of households who own their own toilet facilities both for the poor or non-poor population while Gorontalo is the worst in both categories. The situation in Gorontalo is perturbing as 92.98% of poor household and 59.14% of non-poor are without their own toilet facilities. This places Gorontalo as the most backward region in terms of toilet facility ownership. The situation in other regions also needs special attention especially with poor populations as toilet facility access relates highly with health issues. Poor toilet facilities in a region may contribute to the spread of diseases, such as diarrhea, hepatitis A, dysentery, cholera bacillus, which will in turn reduce productivity of residents.

Jakarta as the capital city and center of business activities of Indonesia has an advantage in terms of access to electricity with only 0.03% of the non-poor population and 1.20% of poor population without access to electricity. On the other hand, only a small number of people, especially the poor in eastern part of Indonesia would benefit from electricity. The extreme cases are the poor in Papua and East Nusa Tenggara where 11.2% and 22% of them have access to electricity. Regions such as East Nusa Tenggara, Papua, and West Sulawesi are in the lowest tier in terms of access to electricity, and it is not incidental that these provinces also have poverty rates over than national poverty rate as electricity may increase economic productivity.

1-2-2 The Nature of Indonesian Poverty

1-2-2-1 Poverty and Economic Growth

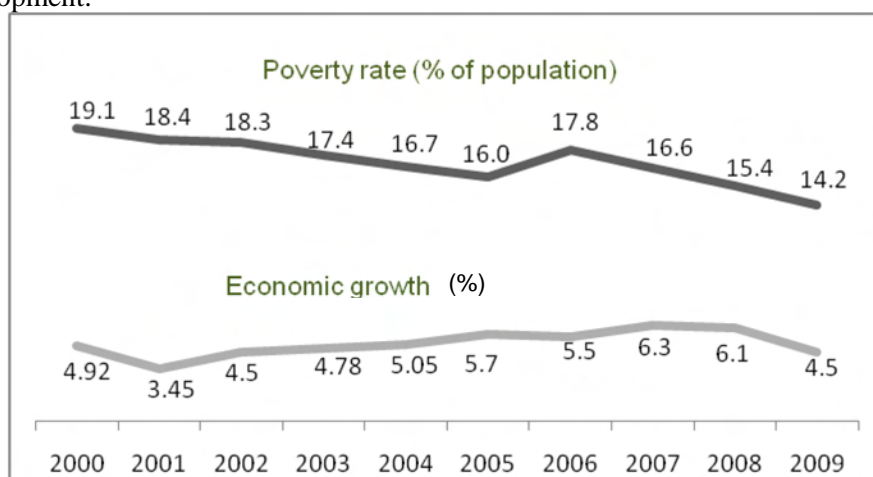
The fight against poverty has been a focus of Indonesian economic development with various anti-poverty programs having been launched since the Suharto administration in the New Order era. The Reformation period, subsequent to the end-1990 multidimensional crisis, has continued the fight, confronting challenges in a different socio-economic and political environment. This sub-chapter is meant to provide an overview of the poverty conditions in Indonesia, and introduce the policy framework that GoI employs for the anti-poverty program.

Since 2006, various poverty reduction programs have been able to reduce the number of poor individuals by approximately two million people each year. Poverty reduction programs have a long history in Indonesian development, and the 1998 economic crisis did significantly reverse past poverty gains taking about a decade before the post-crisis Indonesia was back to the pre-crisis 1996 level.

Economic growth is considered as the most effective long-term, sustainable policy for this overarching goal as economic growth enlarges the capacity of the economy to produce goods and services and is expected (effectively in per capita terms) to impact the poor through multiple mechanisms. One of the

mechanisms is the trickle-down effect; a mechanism wherein poverty alleviation relies on the existing socio-economic structure. As an illustration of this mechanism, growth may induce industrialization leading to higher incomes through greater formal labor absorption. The poor, who generally are in the informal sector, may in turn benefit from economic growth through several rounds of the multiplier effect created there from.

Economic growth may have more significant impacts on poverty alleviation if it is indeed designed to be pro-poor; specifically in supporting development measures of importance for the poor, such as rural infrastructure investment, agriculture, incentives for labor intensive industries, and micro and small enterprise development.



Source: BPS, Statistics Indonesia, various years

Figure 1-10 Poverty Rate and Economic Growth

It is appropriate here to define the term pro-poor economic growth. In essence, pro-poor growth should increase the consumption of the poor; however, it could also be the case that the consumption of the poor population grows at a smaller rate than overall consumption. As such pro-poor growth may also be viewed from the distributional perspectives. According to USAID (2005), growth strategies can be ranked into two different categories: how quickly the consumption of the poor rises relative to other segments of the population; and how quickly the consumption of the poor rises in and of itself.

Table 1-11 provides the mean real monthly per-capita household expenditure (in 2008 DKI Jakarta prices as the base) as well as poverty measures (headcount index) for 2008 and 2009. Mean per-capita household expenditure increased by about 1.4% from 2008 and 2009 while poverty (in terms of headcount) reduced by approximately 1.3% points during the same period. Previous studies found that economic growth was the main engine for poverty reductions (Dollar and Kraay 2002¹³; Sala-i-Martin 2002¹⁴). Table 1-11 suggests a negative correlation between economic growth and poverty, which is consistent with Dollar and Kraay (2002) and Sala-i-Martin (2002): higher mean per-capita household expenditure (driven by economic growth) is associated with a lower poverty rate for the country.

¹³ Dollar, David, and Aart Kraay. 2002. "Growth is Good for the Poor" *Journal of Economic Growth* 7 (3): 195-225.

¹⁴ Sala-i-Martin, Xavier. 2002. "The World Distribution of Income (Estimated from Individual Country Distributions)." NBER Working Paper 8933.

Table 1-11 Expenditure and Poverty of Sample Households in 2008 and 2009

	2008	2009
Monthly Per Capita Real Expenditure		
- Mean (Rp/capita/month)	632,385	641,019
- Change over period (%)	-	+1.37
Poverty*:		
- Headcount index (%)	15.42	14.15
- Percentage point change over the previous period	-	-1.27

Note: Only observation of panel component (N=65,239 household) and without weight

*) Calculated by BPS

Source: SUSENAS Panel 2008-2009 Data

Priority in poverty alleviation programs must be placed on pro-poor economic growth as opposed to just on any kind of economic growth. In order to achieve this kind of growth in Indonesia, the poor segment must participate and have equal economic access. Pro-poor economic growth has two correlates: (i) labor-friendly economic growth; and (ii) rural-based economic growth. Labor-friendly and labor intensive economic growth will most likely have high pro-poor impacts. Additionally, this approach also implies the importance of empowerment of the poor through improved education and skills in order to increase their access to more and better employment opportunities with labor-intensive industries in the form of small and micro enterprises in the formal and informal sector perhaps being the priority choice.

That is not to say that the economy should totally reject capital-intensive industries since they are still beneficial for economic growth that can indirectly benefit poor households as well. However, in a labor-surplus country like Indonesia, especially at the lower-end of the labor market, labor intensive industries, including agriculture, are still the optimal choice to be sought, especially when poverty alleviation is considered as the key objective. The rural economy has different poverty profiles and dimensions, and the labor surplus in this part of Indonesia must be provided with more and more incentives so as to increase employability in the rural economy.

1-2-2-2 Poverty and Mobility of the Poor

Table 1-12 shows the transition of poverty status over the two-year period of 2008 and 2009. 81% of the sample households experienced no poverty for either year.¹⁵ About 6% of households were below the poverty line both in 2008 and 2009. The remaining 14% of households fell below the poverty line only once in the two years. This data is consistent with previous studies, which found that a large portion of poverty in Indonesia is characterized by transitory, rather than chronic, poverty (Widyanti, Suryahadi, Sumarto, and Yumna 2009).

Incidence of poverty generally seems to have reduced in 2008 and 2009 in comparison with the earlier years examined by Widyanti et al (2009), which found that using the Indonesian Family Life Survey (IFLS) panel data set (1993, 1997, and 2000),¹⁶ households that never experienced poverty over the

¹⁵ Here, poverty is defined by nominal per-capita household expenditure below the poverty line listed in Table 1-8.

¹⁶ The Indonesia Family Life Survey (IFLS) conducted by RAND in collaboration with other institutions.

seven-year period constituted 66% of the total number of the sample households (See Table 1-13, which is excerpted from Widyanti et al 2009). Over the two-year period (2008 and 2009) households that experienced no poverty over the two-year period, 81% of the total number of the sample households, were examined. As it is not possible to make a rigorous comparison of the results of only a three-year panel data on one hand and two-year panel data on the other hand, Tables 1-12 and 1-13 provide only suggestive evidence that the incidence of poverty historically seems to have been reduced.

Table 1-12 The Patterns of Changes in Sample Households' Poverty Status in 2008 and 2009

Pattern	2008	2009	Frequency (%)
(1)	(2)	(3)	(4)
Always Poor (5.55%)	Poor	Poor	5.55
Once Poor (13.66%)	Poor	Not Poor	7.34
	Not Poor	Poor	6.32
Never poor (80.79%)	Not Poor	Not Poor	80.79

Note: Only observation of panel component (N=65,239 household) and without weighting.
Source: SUSENAS Panel 2008-2009 Data

Table 1-13 Poverty Dynamics of Panel Data Households
(Excerpted from Widyanti et al 2009)

Poverty pattern	1993	1997	2000	Incidence (%)	
Always poor	Poor	Poor	Poor	4.23	
Twice poor	Poor	Poor	Not poor	4.33	9.89
	Poor	Not poor	Poor	3.56	
	Not poor	Poor	Poor	2.00	
Once poor	Poor	Not poor	Not poor	10.93	20.16
	Not poor	Poor	Not poor	4.00	
	Not poor	Not poor	Poor	5.23	
Never poor	Not poor	Not poor	Not poor	65.72	
Number of observations (N)				6,403	

Source: RAND IFLS

Table 1-14 provides summary statistics on poverty movements of sample households in the SUSENAS panel 2008 and 2009. About 6% of sample households moved from a non-poverty status to a poverty status between 2008 and 2009 while about 7% of sample households exited from poverty over the two-year period. Combining the two numbers, about 14% of sample households experienced changes in poverty status over the two-year period (either non-poverty to poverty or poverty to non-poverty). The net change in the share of sample households in poverty was -1.02% over the same two-year period. This is consistent with the national trend in poverty, which is shown in the last column of Table 1-14, with the national poverty rate fell from 15.69% to 14.15% between 2008 and 2009.

Table 1-14 Poverty Movements of Sample Households in 2008 and 2009 (%)

Periods	Fall into poverty (1)	Move out of poverty (2)	Change in status (1) + (2)	Change in status (1) – (2)	Poverty Rate (Headcount)
2008	-	-	-	-	15.69
2009	6.32	7.34	13.66	-1.02	14.15

Note: Only observation of panel component (N=65,239household) and without weighting.
Source: SUSENAS Panel 2008-2009

This reduction in poverty may be unexpected given the most recent financial and economic shocks that originated in the US in September 2008 and spread globally. The SUSENAS survey 2008 was conducted in March 2008, so the sample households were not yet affected by that economic shock as of the 2008 SUSENAS survey. If the shock had a negative influence on household welfare in Indonesia, it should have been seen as deterioration in household consumption as of the SUSENAS2009 survey that was fielded in March 2009. However, as can be seen in Column (6) in Table 1-14, Indonesia seems to have continued to reduce poverty despite the financial and economic shocks, which plagued economies in many parts of the world with economic downturns. In fact, according to an IMF estimate, the Indonesian economy should achieve 3 to 4% economic growth in 2009 despite being in the midst of global economic and financial shock.¹⁷

The 2008-2009 dynamics of poverty in Indonesia can be seen in the probability transition matrix showing the likelihood of each category to remain in that category or to end up in another category a year hence. All of the SUSENAS panel households are divided into 4 categories for this purpose as shown in Figure 1-11 below.

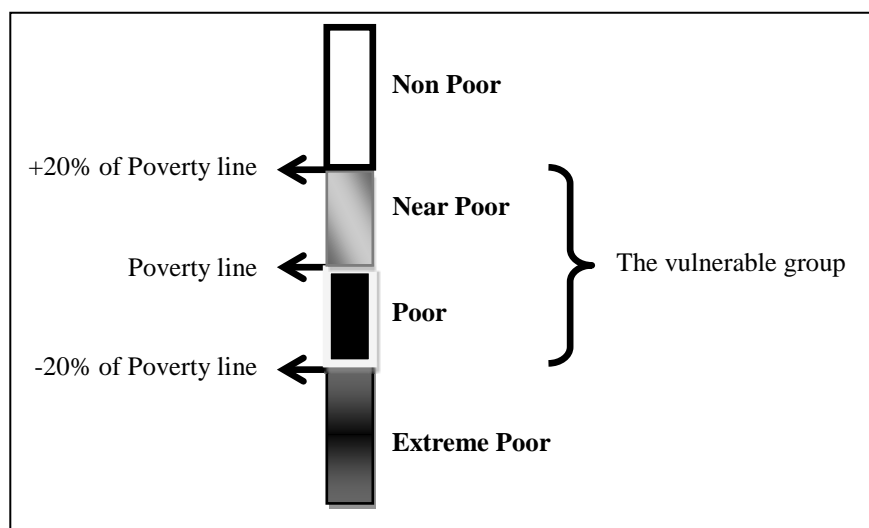


Figure 1-11 Classifications of Poverty

Source: JICA Study Team

The poor and the near-poor constitute a vulnerable population as they are within $\pm 20\%$ from the poverty line, which indicates that these households in this group are easily caught below the line; bear in mind that the level of the poverty line in Indonesia is quite low. As a result, a 20% range above and below the poverty line is comparatively not a large interval. Still, this group is quite a large population. For Indonesia in 2008, the above definition of poor constituted about two thirds of all households below the

¹⁷ As shown in: <http://www.imf.org/external/np/sec/pn/2009/pn0993.htm>

poverty line, which means that even a small improvement in expenditures could bring a household above the poverty line. However, such an improvement may just as easily be washed away by small expenditure deteriorations in other areas, for example an increase in price of some basic necessities.

Table 1-15 Mobility Matrix 2008 and 2009

2008	2009											
	Urban				Rural				Total			
	EP	P	NP	NoP	EP	P	NP	NoP	EP	P	NP	NoP
EP	17.02	22.42	21.24	39.32	29.75	25.63	19.09	25.54	26.29	24.75	19.67	29.29
P	5.76	12.40	19.58	61.26	12.93	21.71	20.79	44.57	10.93	19.11	20.45	49.52
NP	1.28	6.54	11.99	80.19	6.53	14.82	20.69	57.95	5.00	12.41	18.16	64.42
NoP	0.27	1.16	2.42	96.15	1.88	4.84	8.90	84.38	1.17	3.22	6.06	89.54
Total	1.21	2.94	4.81	91.05	5.21	9.05	12.26	73.48	3.61	6.60	9.27	80.51

Note: EP: Extreme Poor, P: Poor, NP: Near-poor, NoP: Not Poor

Source: SUSENAS Panel 2008-2009

The above table shows that there is significant mobility within the three states of poverty (extreme-poor, poor, and near-poor). For the extreme poor, households remain within the three states with a probability of 70.71%; the poor with a 50.49% probability; and the near-poor with a 35.5757% probability. As the initial poverty status is shifted from extreme poor to poor and further on to near-poor, the probability of escaping the three states of poverty in the next year becomes higher.

Looking at this poverty transition from a different perspective, the probability of staying within the same poverty status in 2009 compared to 2008 was not high. For the extreme poor, it was 26.29%; for the poor it was 19.11%; and for the near-poor was 18.16%; all of which are significantly different from the 89.54% non-poor.

Moreover, the probability of escaping from poverty increases as the initial poverty status shifts from extreme poor to poor and further to near-poor. This can be seen specifically for the probability to end up with locating above the poverty line. The above table shows that there is no less than a 48.97% probability that the 2008 extreme-poor would end up above the poverty line in 2009. For the poor, the probability to escape the poverty is even higher with the no less than 70% probability of 69.97% that the 2008 poor can end up above the poverty line in 2009. The corresponding probability for the near-poor is also higher at about 82.58%. This is encouraging for policy makers and the poverty alleviation programs. However, it should be noted that such results are directly related to the fact that the poverty line is still held quite low.

Let us now turn to the possibility of ending up in the vulnerable state, specifically speaking, within the 20% range above and below the poverty line. For the extreme-poor the chance holds at 44.42%; for the poor 39.56%; for the near-poor 30.57%; and for the non-poor the chance dramatically drops to below 10%. These probabilities are still quite high for the extreme-poor, poor, and the near-poor. As such, it is not that easy to escape the vulnerable state of being in the $\pm 20\%$ range around the poverty line.

Disaggregated into rural and urban, we can see that the probability of the households in the three states of poverty (extreme-poor, poor, and non-poor) to move into a non-poverty situation is much higher in urban areas. Moreover, the probability to stay not poor in urban areas is much higher than in rural area with 96.15% of urban households who were not poor in 2008 able to maintain this status in 2009, while in the rural areas only 84.38% were able to do so.

On the other hand, the probability of staying in each poverty status in rural areas is much higher than in urban areas. In rural areas almost 29.75% of extreme-poor households in 2008 remained in that state into 2009, while in urban areas the number was almost half at 17.02%. This condition is similar for poor and near-poor households, where 12.40% and 11.99% remain poor and near-poor in urban areas compared to 21.71% and 20.69% remaining poor and near-poor in rural area.

Households in rural areas are more vulnerable than in urban area with only 7.82% of households who were in near-poor status in 2008 becoming worse off in a year after, while in the rural area this number reached 21.35%.

1-2-2-3 Poverty and Labor Market

One important factor influential towards the extent of poverty in a country is labor market conditions. A sustainable poverty alleviation program should include efforts to improve labor market conditions so as to allow the poor to participate workforce. Table 1-16 below shows the current state of the Indonesian labor market, especially in the period from the recovery period proceeding the end-1990s crisis.

Table 1-16 Labor Market Conditions in Indonesia, 2004-2009

INDICATOR	2004	2005	2006	2007	2008	2009
Labor force (million people)	103.97	105.80	106.28	108.13	111.48	113.74
Labor market participation rate (%)	67.6	68.0	66.7	66.6	67.3	67.6
Unemployment rate (%)	9.9	11.2	10.3	9.8	8.5	8.1

Note: Labor force=15 years old and over with paid jobs or jobseekers. Labor market participation rate=labor force/population over 15 years; Unemployment rate=unemployed/labor force. Only 2009 is based on Feb. 2009 figure and all others are annual average.

Source: BPS

Indonesia is an economy of more than 168 million people 15 years of age or older as of 2009. With a 67.6% labor market participation rate, the economy has close to 114 million people in the labor market. The labor force grew an average of about 1.8% annually over the last five years.

There is a trend of declining unemployment after a slight increase between 2004 and 2005. The unemployment rate in 2009 is 8.14%¹⁸ with approximately 9.3 million people unemployed with country specific unemployment characteristics. This majority unemployment reside in urban areas, with ages between 15-24 years of age and high school educational background. The majority of Indonesians unemployed is still of school age and are unemployed due to a lack of experience and, hence, unable to compete in the employment market. This is a typical problem for an economy where income must be earned, as the economy does not provide sufficient welfare support programs or, more specifically, unemployment benefits. One way to limit unemployment would be programs to keep school age people in school.

As mentioned earlier, sustainable poverty alleviation must be in hand with participation in the workforce. Greater participation in the labor market is expected to create income, including for the poor, which in turn raises the poor above the poverty line. Poverty alleviation programs hold firm behind the scenes would exhibit a declining poverty rate alongside a declining unemployment rate. Figure 1-12 below shows what has occurred in Indonesia.

¹⁸ As of August 2009, 7.87%.

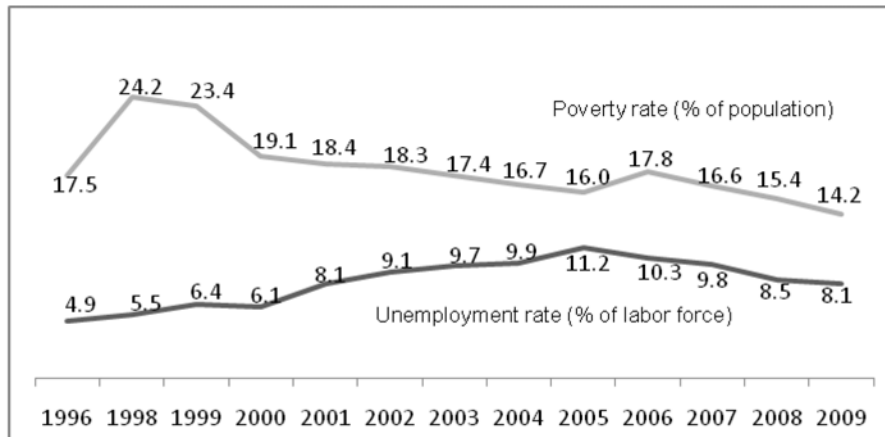


Figure 1-12 Poverty and Unemployment Rate, 1996-2009

Source: BPS, Statistics Indonesia, various years

Indonesia has only experienced such a trend in poverty and unemployment rates since 2006. In the early recovery period, between 2000-2005, the constant declining poverty rate was actually accompanied by an increasing unemployment rate. This signifies a condition where poverty alleviation is essentially detached from the workforce. This point should be linked back to the issue of the vulnerability of poor Indonesians. Concentrated income distribution around the poverty line results in a significant number of near-poor, and hence a high turnover of poor. Indeed, the number of poor brought out of poverty in this early recovery period is relatively small from year to year. In most years, the number of former poor was less than one million people, which is substantially different from that after 2005. The number is approximately two million per year, and the decline in the poverty rate was accompanied by a negative trend in the unemployment rate.

While it is aimed to see the negative trend of both poverty and employment rates, yet there is another important feature in the Indonesian labor market which is of significance to poverty alleviation. Sustainable poverty alleviation should be considered against the background of formal employment creation. However, this is not the case for post-crisis Indonesia.

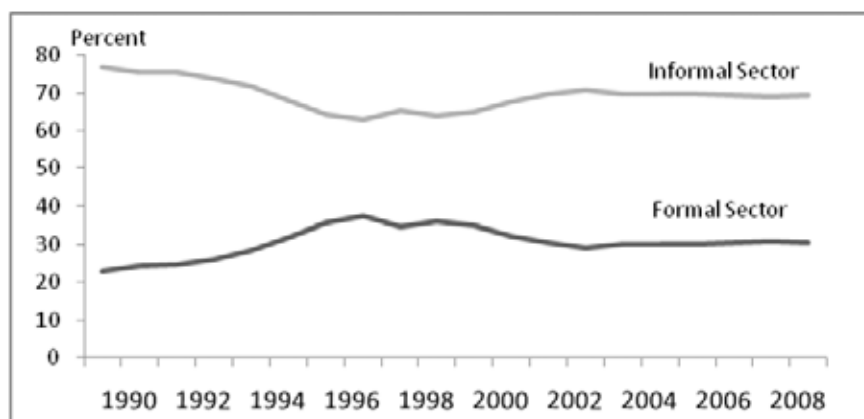


Figure 1-13 Proportions of Formal and Informal Sector Employment in Indonesia, 1990-2009

Source: BPS, Statistics Indonesia, various years

Figure 1-13 above shows the proportion of formal and informal sector employment in Indonesia from 1990-2009 with the proportion calculated from the employment status of Indonesian workers. Two statuses are included for formal workers, namely: (i) paid workers; and (ii) self-employed with paid employees. Other statuses categorized as informal include self-employed, self-employed with unpaid workers, unpaid or family workers, and casual workers (in agriculture and non-agriculture sectors). As can be seen from the above graph, Indonesia is on a clear path of declining informal and increasing

formal sectors up to the mid-1990s. Entering the end-1990s crises period, the economy suffered from significant turnaround in the trend. In fact, it is very clear that until 2003 there was a reversing trend in these formal and informal labor proportions. In the last five years, the proportions remain the same. Labor absorption in the formal sector accounts for about 30% of the workers, leaving the other 70% in the informal economy.

The informal economy is of great concern due to its vulnerable characteristics, specifically its association with low job security, erratic working hours, improper work conditions and the fact that labor in the informal economy is not covered by formal regulations. Minimum wage laws, for example, are mandatory for all establishments, however, there are many informal establishments that do not observe the minimum wage. Thus, enforcement of such laws is limited to the formal establishments.

A high proportion of labor in the informal economy cannot be separated from various rigidities in the labor market. Needless to say, these rigidities are spurred primarily by government regulation, namely the Law No. 13/2003 on labor, which provides protection to labor to the extent that it increase rigidities in the Indonesian labor market. Indeed, protectionistic labor regulations would only protect those in the formal economy, and have very little impact on labor in the informal economy. Furthermore, various rigidities in the labor market have resulted in firms limiting their recruitment of permanent workers by recruiting contract workers or outsourcing with the latter contributing to increases in the proportion of the informal economy.

Revision of Law No. 13/2003 has been a source of debate in the last couple of years with the calls for revision being headed by the business sector which views that the current law as protectionist in nature. Observations in the labor market do suggest a decline in formal labor absorption. This macro statistics is typically complemented by micro stories of how firms reallocate existing business to other locations, leading to sporadic layoffs across the country. Existing firms also tend to stop recruiting for the fear of long-term commitments to employees. On the other hand, labor regards the current law as still inadequately covering their aspirations, especial in terms of its emphasis on worker job security Leading to the opinion that aspirations towards these revisions not being acceptable from a worker's point of view. It is appropriate at this point to note labor laws typically protect those in the formal sectors better than those in the informal sectors. Given the fact that only about one third workers are in the formal sector, this leads to the conclusion that most Indonesian workers do not actually enjoy protections stipulated by the law. The alternative way of thinking suggests that if the protections could be lowered, this in itself would serve as an incentive for investment to step in and recruit workers in the formal sector.

Several attempts at revising the 2003 Labor Law have been made by the current government; however, successful revision would be only possible with a high level commitment at both the government and the parliamentary levels. Tripartite agreements among the government, employers and employees would only be realized under strong and effective national leadership. Issues regarding the revisions have been trimmed down to five general items: the minimum wage; severance pay; contract employment; outsourcing; and the employment of foreign workers. Each of these will be discussed briefly below.

The active minimum wage policy has resulted in a rapid rise in the minimum wage over the period of 2000-2002. Since 2001, the determination of wage policy has been decentralized to the regional government, which complicates the already complex minimum wage determination methods in Indonesia. In some cases, the determination of the minimum wage is used as a means of political leverage by regional leaders in search of support for their upcoming elections. For an example, the minimum wage in Jakarta for 2009 is IDR 1,069,865. Pressures to increase the minimum wage have also come from labor unions. With the previous minimum wage was set by the minimum life requirement (kebutuhan hidup minimum), subsequent standards are set higher following the appropriate life requirement (kebutuhan

hidup layak)¹⁹. All of these factors contribute to the increasing of the minimum wage, and hence the average wage in general.

Concerns over the rapid rise of the minimum wage are usually directed towards employment as the impacts on employment usually are more severe among more vulnerable groups: females, the less educated, and youth. Bird and Manning (2005) shows that minimum wages do not redistribute income to the poor. The reason should be clear enough: only a small portion of poor households have an employee in the formal sector for which the minimum wage is binding. But the story does not end there. Raising the minimum wage typically results in overall price increases so that the poor who are earning just the minimum wage actually lose as they are also consumers at the same time. Suggestions of reorienting the minimum wage so that it is non-binding, thus serving as benchmark in a bipartite bargaining, have been made for example in Islam and Nazara (2000).

The second issue is the revision of the labor law severance pay, which has been seen as an issue prior to the crisis, but has turned out to be more serious when job markets become complicated post-crisis. A study by Padjajaran University suggests that there have been increased costs from severance pay on firms since the enactment of Labor Law 2003 and that increasing severance pay has actually discouraged new hiring. Again, firms are reluctant to hire younger workers as it bind firms to long-term commitments. On the other hand, high severance pay would mean that it would be costly to dismiss older workers leading to the situation wherein firms are effectively stuck with current workers. High severance pay requirements encourage firms to hire non-permanent workers and participate in sub-contracting.

Contract employment and outsourcing also comprise major aspects of the revision of the Labor Law with contracting and outsourcing being necessary in the changing business environment of today. Drawing back out of this production method would have great implications on Indonesia's competitiveness. The use of contract workers is limited in the current labor law, which has led to the issue of core and non-core activities being the source of debate concerning the appropriateness of contracts and sub-contracting. Contracting and sub-contracting also have impacts on human capital investments by firms; firms usually prefer to invest in their permanent, rather than non-permanent, workers.

The final issue in the labor law revision is that of the employment of foreign workers, more specifically, Indonesia's view that foreign workers must be restricted. To the extent possible, domestic labor must be able to fill positions in the place of foreign workers. The discrepancy in wages and salaries between domestic and foreign workers is one issue that the labor law must address. Should Indonesia opt for a salary cap on foreign worker pay or go for a more restrictive negative list? Another issue is the language proficiency requirement for foreign workers as language proficiency may be benefitting to the economy in several ways. First, language proficiency may be needed if, in the long-term, Indonesia expects foreign workers to be more socially integrated in the economy as a whole. Secondly, language proficiency may better facilitate the transfer of technology from foreign to domestic workers, which has been a condition on the use of foreign labor.

A successful revision of the Indonesian labor law would in the end benefit workers and a greater proportion of formal labor should be one objective pursued within the Asian Decent Work Decade (ADWD). Indeed, Indonesian workers are very capable of maintaining employment for themselves though informal labor has a direct relationship to the inability of the formal market to offer employment. Formal labor starts with investment with improvements in the business and investment climates being in order. It therefore follows that a labor law carrying too much protection for labor eventually hurts the recruitment of labor itself.

¹⁹ The appropriate life requirement is set in every province by the local statistics office based on the appropriate survey on the local level. The minimum life requirement is then set at a certain percentage (usually 80%) of the appropriate life requirement.

1-2-2-4 Importance of Informal Sector²⁰

In February 2009, there were 168.28 millions of population age 15 and over, with 113.74 millions of them are economically active, with 104.48 million workers, and 9.26 million unemployed. The labor force participation was 67.60% while the unemployment reached 8.14%. The number of employees increased in all sectors during February 2008- February 2009, except construction sector and transportation, storage, and communication sector which decreased by 123 and 66 thousand people respectively.

The figures below show the number of workers by their employment status.

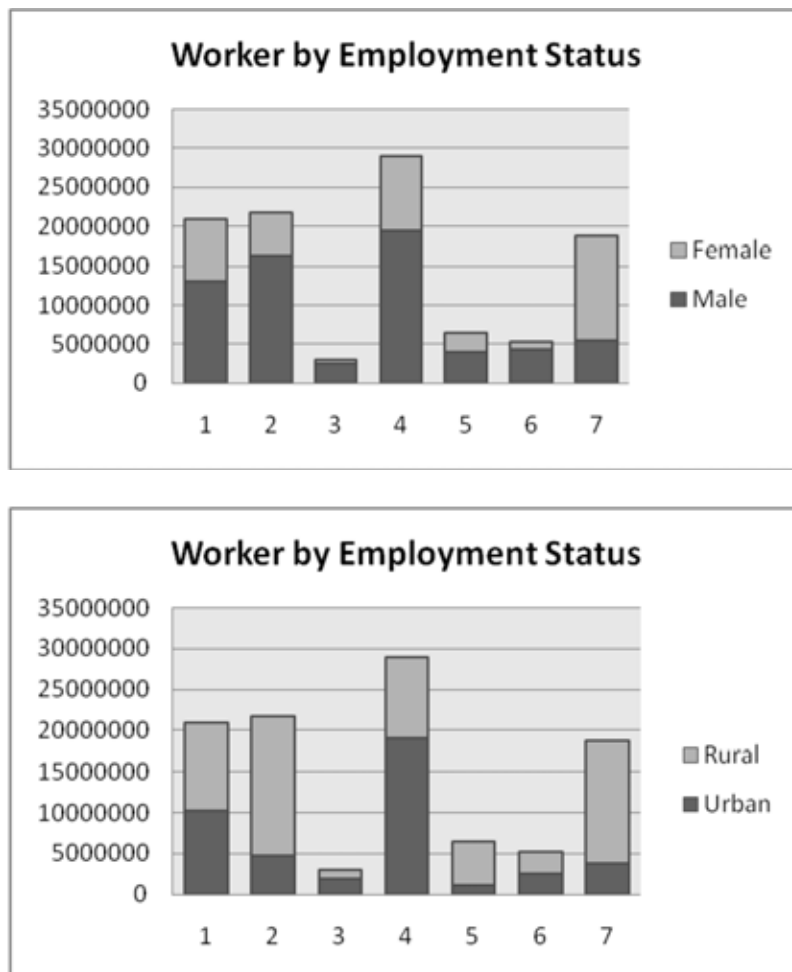


Figure 1-14 Number of Workers by Employment Status

Notes: 1. Own Account worker 2. Employer assisted by temporary/unpaid worker 3. Employer assisted by permanent worker 4. Employee 5. Causal employee in agriculture 6. Causal Employee not in agriculture 7. Family worker

Source:BPS

Most workers have status as employee, employer assisted by temporary/unpaid worker, and own account worker with the share 27.7%, 20.7% and 19.9% are respectively with a small fraction or the worker, less than 3%, work as employer assisted by permanent worker. Another status with large number of worker is family worker with the share of 17.7% in which 71.5% of them are female worker. The rest 11% of the workers works as casual employment both in agriculture and non-agriculture. Most of

²⁰ Data on this subsection is drawn from National Labor Force Survey (Survei Tenaga Kerja Nasional –Sakernas) carried out in February 2009.

employees are male and they work in urban area which indirectly shows that informality has rural area and female faces.

Most of informal activity occurs in rural area, and the industry that has most informal activity is agriculture, forestry, hunting and fisheries. Almost 90% of this industry is taken place in rural area. The second largest industry of informal activity is wholesale trade, retail trade, restaurant and hotels. A larger percentage of this small industry is in the urban area, with almost 60% in the urban and the rest is in rural area.

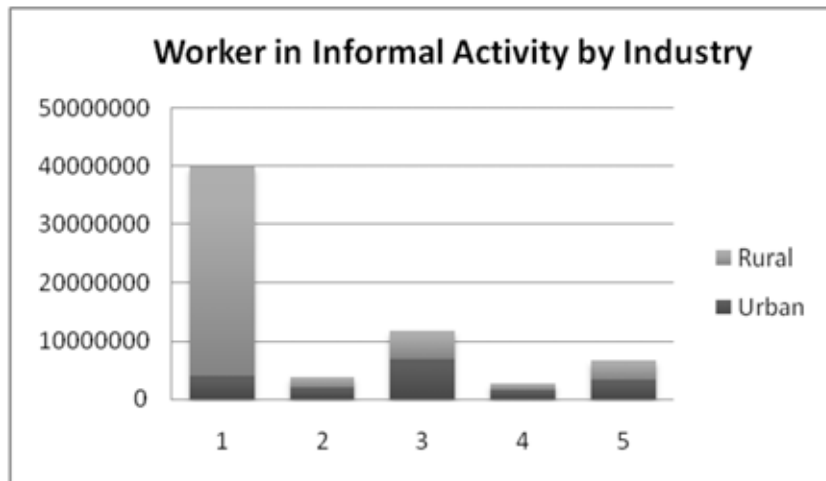
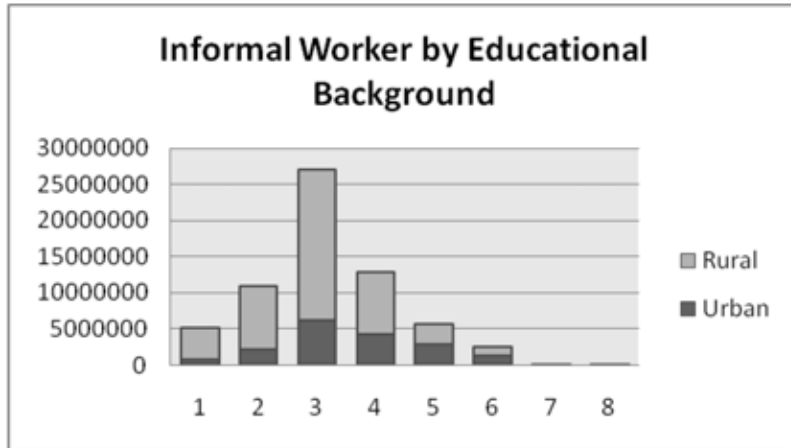


Figure 1-15 Number of Informal Workers by Industry

Notes: 1. Agriculture, Forestry, Hunting and Fisheries 2. Manufacturing Industry 3. Wholesale trade, retail trade, restaurant and hotels 4. Community, social and personal services 5. Others (Includes mining and quarrying, electricity, gas and water, construction, transportation, storage, communication, financing, insurance, real estate, and business services)

Source: BPS

As can be seen from Figure 1-16, the share of uneducated worker is much higher in rural area than in urban area. More than 60% of worker with junior high school or less education find their livelihood in rural area. The share for general senior high school graduated in informal activity is even between rural and urban. While the opposite picture happens in urban area where the share of relatively educated people engaged in informal activity is higher. This might related with the fact that more educated people opt to live in urban area, so that when they are not getting the job, they are still stay in the city and work in the informal activity. However, nowadays there is also a tendency that high educated people start to do business, and they may start with the informal one.



Notes: 1. No Schooling 2. Did not complete/Not yet completed Primary School 3. Primary School 4. Junior High School 5. Senior High School, 6. Vocational High School 7. Academy/ Diploma 8. University

Figure 1-16 Number of Informal Workers by Educational Background
Source: BPS

1-2-2-5 Economic Rationale for Policy Intervention

In order to provide rationale for policy interventions, let us describe a characteristic of Indonesian economy using a simple model, following Harris-Todaro (HT) (1970) model of two-sector economy.

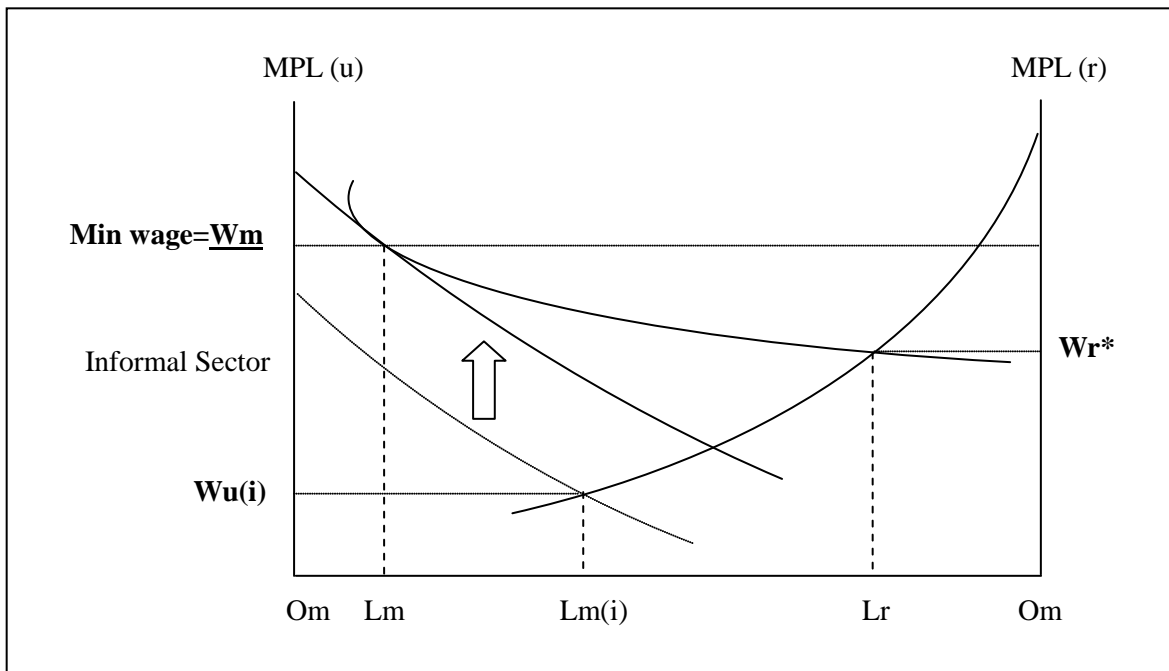


Figure 1-17 HT Model of Migration

Source: JICA Study Team

The HT condition tells that as long as the rural wage (as determined by the marginal product of labor $MPL(r)$) is less than the expected wage of the urban wage (as determined by the probability of getting the urban job times urban wage), then the rural workers are likely to migrate to the urban sector. When urban

wage is rigidly determined by the minimum wage, then there will be a surplus of labor in the urban sector. In the above diagram, minimum wage is set to W_m , while the equilibrium rural wage where the rural workers are indifferent between migration and non-migration decision is set at W_r^* .

$$\text{HT Condition: } W_m \times (O_m L_m / O_m L_r) = W_r^*$$

so that W_m and W_r^* are along the rectangular hyperbola.

Note that the minimum wage is not binding for informal sector, accounting for 70% of labor force in Indonesia, as represented by the dotted marginal product of labor lying below the MPL (u) in formal sector. The number of unemployed workers is represented by the distance $L_m L_r$ in theory. In practice, however, the informal sector absorbs this labor, whose wage $W_u(i)$ is determined by the intersection of the two marginal product curves; the number of workers in $L_m L_m(i)$ are in the informal sector. The remaining worker $L_m(i) L_r$ are unemployed, whose living conditions are really severe.

The policy implications of the model are the following. First, the very “bottom” people who are excluded even from the informal sector need to receive a “targeted” attention and social provision from the public sector, in terms of income support and other social welfare programs. Second, the informal sector workers receive low wages, reflecting their lower marginal products. The increase of their productivity closer to formal MPL (u) would increase their equilibrium wage, and also reduce the level of unemployment. The productivity increase in informal sector (i.e. micro, small, and medium enterprises) can be realized through building human and physical capital via vocational trainings and credit facilities. Third, the increase of productivity in rural sector would increase the rural wage and rural workers; however, it could reduce informal sector workers.

1-2-2-6 Poverty and Inequality

Poverty should also be linked with the notion of inequality. Although the two are of different conceptual strands, it is advisable to discuss their linkages. One of the most common measures of inequality is the Gini coefficient. The Gini coefficient measures the extent to which income distribution deviates from the most optimal equality line. The value ranges within 0-1 interval, with 0 representing perfect equality and 1 representing perfect inequality.

Despite the poverty incidence, Indonesia experienced an improvement in the Gini coefficient immediately following the crisis with the 1999 Gini coefficient for household expenditures standing at 0.31, markedly down from the 1996 coefficient of 0.35 that represented the conditions before the 1998 economic crisis. As shown by the above table, poverty incidence was significantly high in 1999 as a result of transient poverty due to significant price hikes and exchange rate depreciation in 1998.

Table 1-17 Gini Index and Poverty Rate

	Gini Index	Poverty rate
1996	0.35	17.5
1999	0.31	23.4
2002	0.33	18.3
2005	0.33	16.0
2006	0.36	17.8
2007	0.36	16.6

Source: BPS Publications

Needless to say, the improvement in the Gini coefficient during the economic crisis was not structural as the main reason for the improvement was the fact that the crisis severely hit the urban economy in Java,

while at the same time several exporting cash-crops regions in Sumatera, Kalimantan and Sulawesi enjoyed the severe exchange rate depreciations.

Entering the recovery period, there is a tendency towards worsening inequality, and, in 2002, the Gini coefficient was recorded at 0.33. Recent BPS publications recorded the 2007 Gini coefficient at 0.36, slightly higher than the pre-crisis 1996 Gini coefficient.

It is clear that recovery brings in different rates of economic improvement for different income groups. Subsequently after the end-1990s economic crisis, Indonesia has been engaging in different types of reform changing the very nature of the society economically, politically, socially, as well as governmentally. One specific impacts of this reform is the inequality between different socio-economic groups in Indonesia.

An important piece to the extent of post-crisis inequality in Indonesia is the new decentralization scheme. Since 2001, Indonesia has engaged in a new decentralization reform establishing a new structure of central-local government fiscal relationship while placing a greater degree of expenditure-side autonomy in the hands of local government.

There are two ways in which decentralization may affect inequality. First, on the revenue side, the new decentralization reform considers natural resources (oil, gas, etc.) as sources of transfer from central government resulting in natural resource rich provinces (and districts) receiving more money from the central government. Presumably, the increasing variation in these transfers will result in increasing inequality. Second, on the expenditure side, the new decentralization reform equips local government with the utmost discretion on spending choices. Some old bureaucrats continue with the business as usual, but many have legitimately engaged in reforms that enable the local government to spend the most for their people resulting in examples of best practices in managing public expenditures beginning to emerge. In the best-practice regions, some district governments are even able to provide free education and healthcare for their people with the result that, in these regions, inequality is most likely declining.

The recent inequality can also be linked to the labor market perspectives. In Indonesia, currently, about 70% of workers work in the informal sector. As has been shown by much research, this sector is associated with low wages, low job security, low legal and regulatory protections, and, to a great extent, exploitation. Informality in the labor market has been shown to be a reversal of positive trends subsequent to the economic crisis. This is a source of great concerns in Indonesia since a key to this issue, to a large extent, lies outside of the labor market itself. The key issue to the formalization of the labor market is an investment climate that encompasses policy in different dimensions such as taxes, business licenses, small medium enterprises (SMEs), as well as industrial relations.

Case Study 2: Social Safety Net in Korea before and after the 1997 Financial Crisis

The Korean economy has grown at a miraculous annual growth rate until the country was hit by the 1997 Asian financial crisis. The annual per capita income growth rate held at an average of 6.6%²¹ between 1990 and 1996 with the country obtaining membership in Organisation for Economic Co-operation and Development (OECD) in 1996. Even though a fraction of the people surely suffered from a lack food and educational opportunities, Social Safety Net was not a significant issue for a country that had been continuously been growing and whose unemployment rate had remained extremely low. As Table 1-18 shows, the Korean unemployment rate was lower than even that of Japan, as low as almost 2 % in 1995 and 1996, for the 4 years (1994-1997) leading up to the crisis. But, the Asian financial crisis, which struck Korea in November 1997, drastically altered the Korean economic and social environment.

Table 1-18 Unemployment rate (%)

Year	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07
Korea	2.5	2.4	2.5	2.9	2.5	2.1	2.0	2.6	7.0	6.3	4.4	4.0	3.3	3.6	3.7	3.7	3.4	3.2
Japan	2.1	2.1	2.2	2.5	2.9	3.2	3.4	3.4	4.1	4.7	4.8	5.0	5.4	5.2	4.7	4.4	4.1	3.9
USA	5.6	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.2	4.0	4.7	5.8	6.0	5.5	5.1	4.6	4.6

Source: WDI

Table 1-19 Youth (age 15-24) unemployment rate (%)

Year	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07
Korea	7	7.4	7.7	..	7.2	6.3	6.1	7.7	16	14	12	11	..	10	10	10	10	8.9
Japan	4.3	4.5	4.4	5.1	5.5	6.1	6.7	6.6	7.7	9.3	9.2	9.7	10	10	9.5	8.7	8	7.7
USA	11	13	14	13	13	12	12	11	10	10	9	11	12	12	12	11	11	11

Source: WDI

Table 1-20 GDP and GNI per capita

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
(1)	11,383	12,337	12,944	13,615	14,645	15,761	16,704	17,318	16,015	17,410
(2)	8,203	9,201	9,876	10,627	11,672	12,818	13,843	14,592	13,644	15,047
(3)	8,200	9,190	9,860	10,610	11,640	12,770	13,790	14,510	13,420	14,870
Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	
(1)	18,730	19,331	20,598	21,071	21,961	22,783	23,884	25,021	25,498	
(2)	17,137	18,169	19,656	20,145	21,671	22,783	24,736	26,833	27,939	
(3)	17,050	18,130	19,670	20,160	21,740	22,760	24,770	26,880	28,120	

(1) GDP per capita (constant international price, base year=2005)

(2) GDP per capita (current international price)

(3) GNI per capita (current international price)

Source: WDI

Income per capita dropped in 1998 for the first time since the end of the Korean War in 1953. As Table 1-20 shows, the GDP, measured based on purchasing power parity (2005 constant prices), decreased from USD 17,318 in 1997 to USD 16,015 in 1998, which is lower than the USD 16,704 of 1996. The job market situation, however, was much more serious. The unemployment rate in Korea, which was as low

²¹ This increase is calculated from per capita GDP at international constant price, based on WDI (World Development Indicator) database.

as 2.0% in 1996 jumped to 7.0% in 1998. It then gradually declined from 1999, holding at between 3 and 4% since 2002. Even though Korea's macro economy is regarded as fully recovered from the 1997 shock as of the beginning of the new millennium, the Korean unemployment rate has not returned to its pre-crisis levels. The unemployment rate of the youth between age 15 and age 24 is more serious, standing at around 9% in 2007, higher than that of Japan.

These tough macroeconomic conditions in Korea through 1997 and 1998 generated much unemployed labor and pushed the Korean society to adopt a more flexible labor market approach. The collapse of small and large Korean corporations made once-very-stubborn labor unions temporarily powerless, and demands from foreign investors taking over bankrupted firms forced the Korean government to legislate more firm-friendly labor market regulations.²²

In the process of this drastic social environment changes, Korean society and the Korean government realized that their society lacked appropriate social safety nets. According to OECD (2000), measurements of economic inequality surged with the income of the poorest 20% decreasing in 1999 by 8.4% as compared to 1996, while that of the richest 20% increased by 3.7% in the same period. The Gini coefficient computed based on earnings increased from 0.29 in 1996 to 0.36 in 1999. Kang and Lee (2001) also confirmed the same trend using different measurements. In addition, according to the Korean Bureau of Statistics, the number of those who died as a result of psychological problems peaked in 1998 at 15.6 deaths per 100,000 persons before declining thereafter to 13.1 in 1996 and 11 in 2008.

Faced with such social problems, the Korean society began to discuss the reviewing and improving of its social safety net structure and the Korean government implemented a number of new policies, the most noticeable of which were the unemployment insurance and the Basic Livelihood Security System.

The unemployment insurance system was modified to cover more unemployed labor after 1997. When the system was first introduced in 1995, it was applied to workers at businesses employing no less than 30 workers. After a few revisions in 1998, unemployment insurance began to cover all workers employed for more than 1 month beginning from October 2008. Additionally, it began to cover part-timer workers who worked no less than 80 hours per month eventually leading to all workers now being covered by unemployment insurance in Korea. (MOL 2006)

The existing system of Livelihood Protection Benefits was also revised to cover more people in need, and it eventually was transformed into the system of National Basic Livelihood Security, in October 2000²³. The basic idea of this new system is to provide a necessary amount of monthly subsidy to those households living with income under a determined amount. Table 1-21 shows the baseline amount of monthly income.

Table 1-21 Baseline Monthly Income (unit: KRW 1000)

Members of a household	1	2	3	4	5	6
Baseline income	460	780	1,030	1,260	1,490	1,710

Source: MHWFA (2008)

²² Regarding the reforms in the Korean labor law since 1997, refer to OECD (2000).

²³ For more detailed description of the differences between the two systems, see KDI (2007).

Table 1-22 Subsidy for Housing and Subsidy for Livelihood (unit: Korean won)

Members of a household	1	2	3	4	5	6
Subsidy for housing	79,859	135,268	177,053	218,314	256,607	295,292
Subsidy for livelihood	307,752	521,276	682,304	841,312	988,877	1,137,958

Source: MHWFA (2008)

As of 2008, there are 7 different types of subsidies with set preconditions that are provided with the most important two being the subsidy for housing and subsidy for livelihood. Table 1-22 shows the amounts of these subsidies.

As Kang and Lee (2001) argued, the social safety net of Korea during the financial crisis was in general evaluated as insufficient. In contrast, the policies implemented by the Korean government after 1997 to build a better social safety net structure have been evaluated to be successful in supporting the poorest in Korea. However, one problem, which is often pointed out concerning the current system, is that it does not motivate the poor to work to escape poverty.²⁴ In response, the Korean government recently initiated programs to provide work opportunities to the poor and the unemployed labor. The new programs have not been fully established, and as such it is too early to evaluate their effectiveness. Despite this, from various policy announcements on the Korean government web pages, it is certain that the Korean government will focus more on job creation in order improve the social safety nets in Korea.

²⁴ See KDI (2007).

Chapter 2 Poverty Reduction, Social Protection, and Safety Net Programs in Indonesia

2-1 Overview of Poverty Reduction Policies

2-1-1 Framework of Poverty Programs

2-1-1-1 Targeting and Public Finance Issues

People, whether poor or non-poor, are coping with risks and uncertainties. It is known that the poorer one is, the more vulnerable to risks and uncertainties one becomes. Hence, that most vulnerable population should be covered by public social assistance while the non-poor population is covered by private or public social insurance schemes.

Table 2-1 Classification of Risks and Insurance/Protection Providers

	Private Sector	Pub Social Insurance	Pub Social Assistance
(Beneficiaries)	Non-Poor	Poor/Non-Poor	Poor
Health	JAMSOSTEK	JAMKESMAS	JAMKESMAS
Old Age	JAMSOSTEK	Yes	Non-existing
Unemployment	Severance pay	No insurance	Non-existing
Education	(not targeted)	(not targeted)	BOS / Scholarship
Credit	SME support	Deposit Insurance	(not targeted)
Food	(not targeted)	(not targeted)	RASKIN
Community	(not targeted)	(not targeted)	PNPM

Note: JAMSOSTEK= Jaminan Sosial Tenaga Kerja (Worker's Insurance), JAMKESMAS= Jaminan Kesehatan Masyarakat (Public Health Insurance), BOS= Bantuan Operasional Sekolah (School Operational Assistance), SME= Small Medium Enterprise, RASKIN= Beras Miskin (Rice for the Poor), PNPM= Program Nasional Pemberdayaan Masyarakat (National Community Empowerment Program)
Source: JICA Study Team

The question for public finance is how much taxpayers are willing to pay for social programs they are not directly benefiting from. The answer depends largely on people's perception of "social contract." There are primarily two schools of thought in public economics: one being that of the Welfare State wherein welfare schemes carry universal coverage and are centrally administered; the other one being the "social state" where welfare is means-tested and targeted to the most in need and is operated by a sense of solidarity shared by all taxpayers.

The major challenges for Indonesian social protection and insurance are low coverage, fragmentation, and the existence of an informal sector (GTZ 2008). At present, less than 20% of the work force is covered by public security with those being covered being comprised mainly of military personnel through PT ASBRI, PT ASKES; civil servants through PT TASPEN, PT ASKES; and formal large-scale private companies through PT JAMSOSTEK. Currently, Indonesia lacks a coherent social protection system due to the existence of the informal sector and the difficulties of such as noted earlier in this report. However, the existence of the informal sector in Indonesia functions as a social security mechanism by providing (although at low wages) employment.

In terms of targeting, public social assistance is supposed to benefit the poor, however, it may not be politically viable for public sector to perfectly target the poor as some non-poor or near-poor individuals must also be made eligible in order to a buffer for adjustments. A health insurance scheme, for instance, is now publicly provided under JAMKESMAS (Jaminan Kesehatan Masyarakat or Public Health Insurance), which is currently providing free access to targeted poor households. The Ministry of Health plans to expand this health insurance card system to eventually cover all households in Indonesia, which will

clearly overburden public finances. Therefore, some mixture of private and public schemes, or public schemes with co-pay, will have to be envisaged.

Law No. 40/2004 on National Social Security System (NSSS) aims to expand the coverage of welfare and harmonize the fragmented welfare schemes. Welfare reform under this law has come into effective as of October 2009 and is expected to be realized gradually towards the end of the current administration. The basic principle is that eligible members of social insurance receive welfare delivery according to their needs, not according to their contributions.

2-1-1-2 Social Safety Net Program since the Crisis 1997-98

Faced with the social crisis in 1997-98, the social safety net became an urgent political agenda and a series of safety net programs were launched. For food security, special subsidy programs (Operasi Pasar Khusus-OPK program) targeted poor households, providing them with the 9 basic food groups (rice, cassava, sugar, cooking oil and butter, eggs, milk, meat and chicken, corn and sago, kerosene or (Liquefied Petroleum Gas) LPG, and iodized salt). For education, poor-targeted scholarships and food supplement programs as well as school operational assistance programs were launched. For health, the Jaring Pengaman Sosial (JPS, or social safety net) programs were launched to cover health services to the poor, providing training and operational assistance to midwives while also supporting local health centers. For energy areas, price subsidies for fuels and electricity were provided to the poor. For employment creation, the so-called Padat Karya (PK) program or better known as the “workfare” program was launched to provide jobs (rather than cash) to unemployed workers. All of these programs have been incorporated into regular social protection programs after the crisis, with the exception of the PK program, which apparently did not generate intended results in terms of employment creation.

The Government also launched the so-called “community empowerment” programs of which the Kecamatan (sub-district) Development Program (KDP), the Urban Poverty Project (UPP) are well known donor-funded projects. The basic principles of these projects are community-based and participatory approaches in terms of identification, preparation, and implementation of the projects. They are expected to improve the quality of social capital, or more traditionally, the concept of “gotong royong” (mutual help), improving the efficiency and effectiveness of targeting of development activities, promoting democracy, and increasing gender equity, governance, accountability, and transparency.

In August 2005, when the standards of living of the poor had started to recover from the crisis, oil prices increased from USD 40 a barrel (2004) to over USD 60 a barrel (August 2005). If no action had been taken, oil subsidy could have reached up to 34% of government budget. The government had to reduce oil subsidy in 2006, which worsened the poverty incidence rate. However, the Government at the same time initiated unconditional cash transfer (BLT: Bantuan Langsung Tunai) to cover 19.1 million households. Moreover, in 2007, UPP and KDP merged to become the National Program on Community Empowerment (Program Nasional Pemberdayaan Masyarakat -PNPM), and since 2009, PNPM has been scaled up nationally which covers all 6,408 sub-districts. Also in 2007, conditional cash transfers (Program Keluarga Harapan-PKH) was launched for 388,000 households in 7 provinces, and community-based conditional cash transfer (PNPM Generasi) was also begun in 127 sub-districts in 20 districts. Both PKH and PNPM Generasi are still at the piloting stage.

Unlike other developing countries such as Bangladesh, micro credit in Indonesia has not been used extensively as a major source for empowering poor individuals; instead, private banks have met demand through government guarantees providing an important source of capital for SMEs, which absorb a large number of workers in Indonesia.

Table 2-2 Chronology of Poverty and Safety Net Programs

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010						
President	Suharto		Habibie	Wahid	Megawati			Yudhoyono I				Yudhoyono II										
I. Macroeconomic Policy (Growth Strategy)	REPLITA VI (1994-99)					PROPENAS (2000-04)					RPJRP (2005-2025)											
						E-PRSP					RPJM (2004-09)			RPJM 2010-15								
SSN for Crisis 1997-99																						
	<div style="border: 1px dashed black; border-radius: 15px; padding: 5px; width: fit-content; margin: auto;"> OPK (Rice Delivery) JPS-BKPP/Health Card SBG/Alau Anak Sekolah - Scholarship SGG - School Assistance PDKMK </div>					RASKIN / WFP					ASKESKIN			JAMKESMAS								
Food Security																						
Health																						
Education																						
Employment Creation (PK)																BOS						
Cash Transfer											PKGI (Unconditional)			PKGI Phase II								
														EIT (Conditional)								
2. Community Empowerment Programs (Cluster 2)																						
Village Block Grants	IDT (Inpres Desa Tertinggal)					KDP (Kecamatan Development Project)					PNPM (Community CCT)											
Rural Infrastructure	P3DT					P2D																
Urban Poverty						UPP (Urban Poverty Program)					UPP III (2005-2011) / WB											
3. Support to SMEs (Cluster 3)																						
Business Loan (Government Microcredit)											KUR											

Note: See the List of Acronyms in front pages
 Sources: JICA Study Team

2-2 Review of On-Going Projects

2-2-1 Conceptual Framework: Strategic Policy Combatting Poverty in Indonesia

Poverty alleviation should be conducted continuously, and a sustainable poverty reduction plan should include strategic areas as the chart below illustrates. The first strategic area includes the need to cover the livelihood of the poor, and secondly to engage the poor in the production of goods, or in the workforce, to provide them with income.

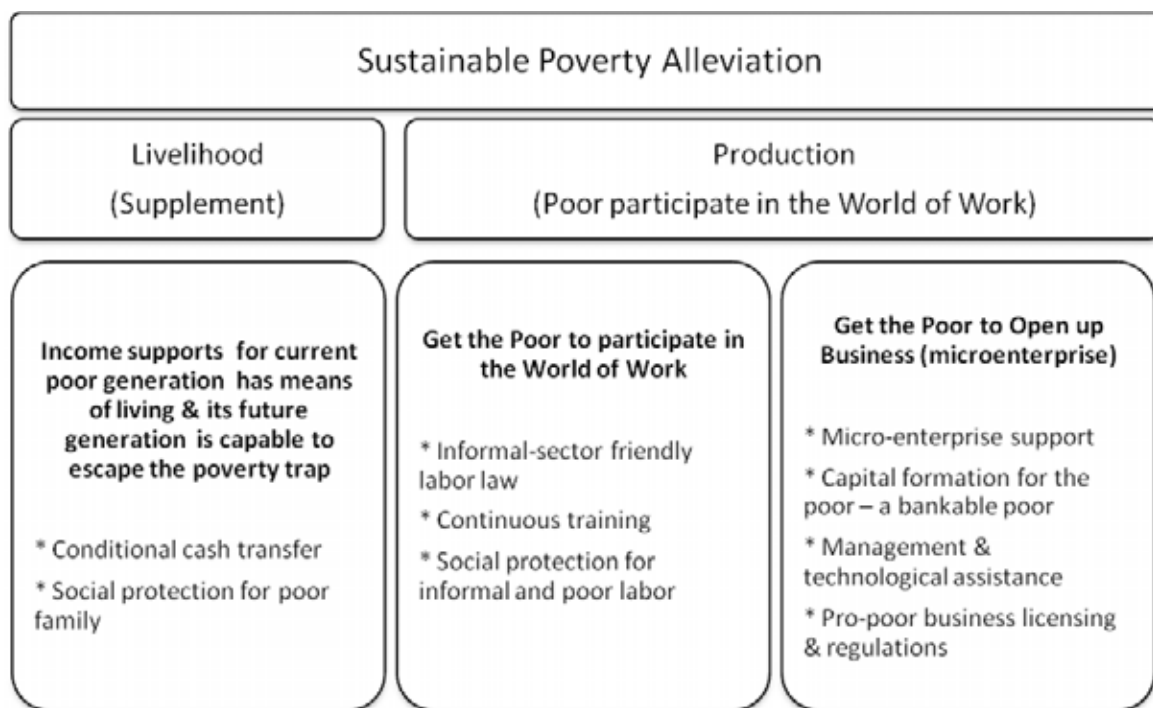


Figure 2-1 Strategic Areas of Poverty Alleviation Program

Source: JICA Study Team

It is important for a poverty alleviation program to address the social issues of the poor as the poor require basic social protection and assistance such as in the health and education sectors. Cash transfers are also an option, provided that poverty denotes a deficiency in one's income. It is also important to ensure that poverty is not inherited from one generation to the next by preparing the proceeding generation to engage in the production chain or in the labor market. Better education and health are therefore needed along with supplements to current income with planned conditional cash transfers being a sound intervention policy.

Furthermore, a sustainable poverty alleviation program should involve providing the poor with income by involving the poor in production activities. When it comes to employment, most of the poor are likely to be employed in the informal sector, particularly agriculture or other micro business. This indicates that there should be incentives for the work of the poor who are limited in their ability to provide skills and capital. In order to increase the involvement of the poor in the production of goods, the government needs to provide comprehensive support policies. One area that could be the focus of government efforts is the development small or micro enterprises, again keeping in mind that the poor will typically choose the informal sector to engage in production, as small and micro enterprises owned by the near-poor will likely employ the real poor. Thus, enhancing the role of SMEs will create jobs for both the near and fully poor.

In regards to the development of small and micro enterprises, one challenge would be the provision of capital as the poor are rarely given access to adequate capital. Direct intervention may be an option, particularly the providing of funds to the poor as start-up capital. Another option is collateral formation, which allows the poor greater access to loans from the formal banking sector. Collateral can be formed from physical as well as social assets. Among the physical assets, land is one of great importance in collateral formation, which is the reason supporting the need for a nationwide land titling program. Social capital can also be explored. People in the rural areas are known for their close social and extended family relationships, and social guarantees can be designed to allow for better access to banks and community-owned financial co-operatives.

Increasing the productivity on the production side of growth also requires technology. In the case of the poor, simple technology such as a better method for crop planting or simple bookkeeping for SMEs could increase productivity. This is where training in production techniques and management would be required. Assistance to the micro and small enterprises is not only limited prior to the business' establishment, but also throughout the production period. Assistance to the enterprises can also be channeled through the cooperative system as community owned cooperatives can make significant contributions to the providing of access to capital, technology, and also marketing since they have better access to information about and expertise in these areas.

Production processes would also benefit from better infrastructure, primarily in the rural areas. Roads, housing, water, irrigation, sanitation, and electricity would support income-generating process for the poor.

The majority of poverty alleviation programs that GOI is now adopting are continuations of those initiatives subsequently launched after the end-1990s crisis wherein the number of poor increased by no less than 13 million between 1996 and 1999. At the household level, the crisis resulted in severe economic hardships. To mitigate the negative impacts, GOI launched several SSN(JPS) programs aimed at mitigating the social, economic, and political effects of the crisis. For the food security, GOI conducted the OPK program designed to secure the purchase of farmers' outputs as well as to distribute the nine basic goods. In the education sector, GOI began scholarships for the poor, food supplements for students, and school operational assistance. On the health front, GOI revitalized services at local (public) health centers, providing health services (out and inpatient) to the poor, as well as training and operational assistance to midwives. In energy, GOI continued and enlarged subsidies for fuels and electricity. For employment, GOI set up labor intensive programs for infrastructure development. Finally, as part of the new regional autonomy scheme, GOI decentralized setting of regional minimum wages.

As Indonesia entered its recovery period, GOI continued its commitment to reduce poverty. President Yudoyono issued these commitment in two planning documents: (i) Law No. 17/2007 on Long Term National Development Plan (Rencana Pembangunan Jangka Panjang Nasional or RPJP Nasional); and (ii) Presidential Regulation No. 7/2005 on Medium Term National Development Plan (Rencana Pembangunan Jangka Menengah Nasional or RPJMN) 2004-2009.

An important milestone in the Indonesian poverty alleviation program was the fuel price increase in 2005. Fuel has long been a commodity receiving subsidies from the government. In 2005, international prices went up significantly, which in turn resulted in a considerable amount of subsidies. GOI has postponed the necessary domestic price adjustments for the years after the end-1990s crisis, as such adjustments are perceived as likely to make the government unpopular, especially among the more vocal urban population. Figure below shows a comparison of fuel price in some countries in 2004.

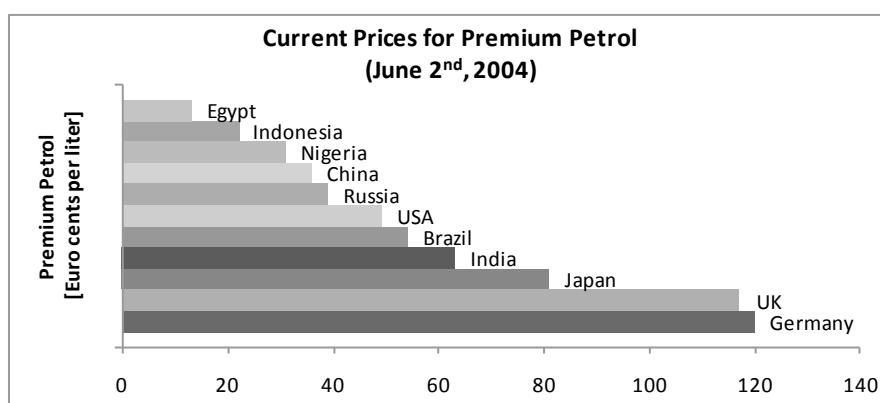


Figure 2-2 Prices of Premium Petrol (in Euro/10 liters)

Source: LPEM (2005)

The above figure shows that the price of petrol in Indonesia is much less than other countries. As mentioned earlier, this is due to the fuel subsidy policy as that implemented by government. The influence of oil and gas on government budget can be seen from the table below.

Table 2-3 Central Government Oil and Gas Revenue and Expenditure Cash Flows (USD Billion)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil and gas revenues	10.3	10.2	8.6	9.4	12.2	14.3	22.0	18.5	26.0
- Fuel subsidies	6.5	6.7	3.5	3.5	7.8	9.9	7.0	9.2	13.9
- Electricity subsidy	0.0	0.0	0.0	0.0	0.3	0.4	3.3	3.6	6.6
National Income	3.8	3.5	5.1	5.9	4.2	4.0	11.7	5.7	5.4
- DAU	0.6	0.9	2.0	1.9	1.9	1.3	1.5	4.4	4.4
- Oil-Gas revenue sharing	1.5	1.5	1.2	1.5	1.7	2.8	3.1	2.6	3.6
Central Gov't balance	1.1	0.2	2.1	2.3	1.4	-0.2	4.1	-1.3	-1.9

Source: Agustina et.al (2008)

A gap between foreign and domestic fuel prices at that time had spurred smuggling activities. The oil price in 2005 was recorded at USD 60 a barrel in August 2005, a tremendous hike from USD 40 a barrel in 2004, and the amount of the subsidy that needed to be borne became enormous. On 1st of October 2005, GOI decided the fuel price increase in order to reduce the subsidy. This round of fuel price increases was considered very high; gasoline by 87.5%, diesel gasoline by 104.8%, and kerosene by 187.5%.

Fuel price increases had ripple effects on other goods and commodities. In order to mitigate the negative impact, GOI devised a pro-poor compensation program under which, for the first time, an unconditional cash transfer to the poor households, or widely known as the Bantuan Langsung Tunai (BLT) program, was devised in October 2005. This program provides cash transfers of IDR 100,000/month (payable every three months) to about 15.5 million targeted poor household with a budget of IDR 4.6 trillion. The identification of eligible household was conducted by the BPS, and cash disbursement was performed by PT Pos Indonesia.

BLT marks a new era in Indonesia poverty alleviation program. GOI has the ability and data need to conduct massive cash transfer programs. Poverty alleviation became a buzzword to increase the

popularity of specific public intervention as different line ministries devised their own public intervention schemes and claimed anti-poverty characteristics.

However, poverty alleviation program certainly cannot be conducted in a sporadic fashion, and GOI understood that poverty reduction would need to be strategically formulated within a national framework. The conceptualization of the poverty alleviation program was initiated by the formulation of the Poverty Reduction Strategy Paper (PRSP). The actual PRSP was drafted, but was never officially launched by GOI. Instead, GOI mainstreamed the PRSP into a much simpler Presidential Regulation No. 13/2009 on Poverty Alleviation Coordination. GOI also established the Coordination Team of Poverty Alleviation (Tim Koordinasi Penanggulangan Kemiskinan or TKPK) both at the national and regional levels. The team has the mandate of synchronizing, harmonizing, and integrating policies and programs for poverty alleviation conducted by different sectors at national and regional levels. On the central level, the Team is chaired by Coordinator Minister of People's Welfare and co-chaired by Coordinator Minister of Economic and consists of 24 other relevant ministers, in addition to several chief of government bodies such as chief of National Family Planning Coordination Board, Chief of Indonesian Statistics, and Chief of National Land Board as member, while Deputy Coordinator Minister of People's Welfare for Coordination for Poverty Alleviation has a role as the team's secretary. In addition, several community leaders and entrepreneurs may join the team.

In the Presidential Regulation No. 13/2009, the poverty alleviation agenda is classified into three clusters, namely:

Cluster 1. Poverty alleviation programs based on social protection and assistance, aimed at the fulfillment of the basic needs, reduction of living hardships, and improvement of the quality of life of the poor. Programs included in this cluster are the Rice for Poor (RASKIN), School Operational Assistance (BOS), and Health Insurance for the Poor (JAMKESMAS). Programs in this cluster are directed toward the extreme poor.

Cluster 2. Poverty alleviation programs based on community development, aimed at improving the potential and capacity of poor groups by allowing the poor to get involved in the development. The main program for this cluster is the Program Nasional Pemberdayaan Masyarakat (PNPM) comprising different sub-programs allowing different line ministries to provide support for community empowerment.

Cluster 3. Poverty alleviation program based on the empowerment of micro and small enterprises, aimed at providing economic and financial access to potential entrepreneurs. This cluster is directed at groups or individuals who are no longer recipients of programs in Clusters 1 or 2. These groups or individuals are considered to have escaped extreme poverty and have enough capabilities to fulfill their daily basic needs. Programs included in this cluster are based on the capacity and empowering of micro and small firms, including the equity assistance through the People Business Credit (Kredit Usaha Rakyat-KUR).

The following section will elaborate on programs within each of the above clusters.

Table 2-4 Budget Allocation for SSN and Social Protection 2005-2010

Unit: billion Rupiah unless otherwise noted.
("Rp." in the table stands for Rupiah.)

		2005	2006	2007	2008	2009	2010 (expected)
EDUCATION	I. Education Sector	4,824.3	9,848.5	10,435.9	14,787.3	22,071.5	22,798.5
	1. School Operational Subsidy	4,824.3	9,848.5	10,435.9	12,541.9	19,074.5	19,950.2
	BOS allocation	4,824.3	8,658.3	9,841.1	11,869.3	19,074.5	19,950.2
	BOS book allocation	0.0	1,190.2	594.8	672.6	n.a.	n.a.
	Target (million students)	34.5	33.7	35.2	41.9	42.8	44.4
	Allocation per student (thousand Rp.)	Elementary = 235.0 Jun. High = 324.5	Elementary = 235.0 Jun. High = 324.5	Elementary = 254.0 Jun. High = 354.0	Elementary = 254.0 Jun. High = 354.0	Elementary/MI district = 397.0 Elementary/MI Kota = 400.0 Jun. High/MTs district = 570.0 Jun. High/MTs Kota = 575.0	Elementary/MI district = 397.0 Elementary/MI Kota = 400.0 Jun. High/MTs district = 570.0 Jun. High/MTs Kota = 575.0
	2. Education Scholarship for Poor Student	n.a.	n.a.	n.a.	2,245.4	2,997.0	2,848.3
	a. Elementary and Junior High	n.a.	n.a.	n.a.	682.8	1,023.9	1,097.7
	Target (thousand students)	n.a.	n.a.	n.a.	1,800.0	2,500.0	2,500.0
	b. Islamic Elementary and Junior High	n.a.	n.a.	n.a.	326.4	624.7	619.2
	Target (thousand students)	n.a.	n.a.	n.a.	640.0	1,198.0	1,180.0
	c. Senior High and Vocational	n.a.	n.a.	n.a.	571.4	450.7	450.2
Target (thousand students)	n.a.	n.a.	n.a.	732.0	5,778.0	5,771.0	
d. Islamic Senior High	n.a.	n.a.	n.a.	159.8	246.7	243.2	
Target (thousand students)	n.a.	n.a.	n.a.	210.2	325.0	320.0	
e. Higher Education	n.a.	n.a.	n.a.	446.2	572.8	360.0	
Target (thousand students)	n.a.	n.a.	n.a.	1,611.0	223.5	100.0	
f. Religious higher Education	n.a.	n.a.	n.a.	58.8	78.2	78.0	
Target (thousand students)	n.a.	n.a.	n.a.	48.9	65.3	65.0	
HEALTH	II. Health Sector	3,236.3	2,526.5	4,448.5	4,686.4	5,302.0	5,584.0
	1. Health services in Puskesmas	1,703.3	893.3	1,048.5	1,000.0	1,694.0	1,000.0
	Target (million households)	60.0	60.0	76.4	76.4	76.4	76.4
	2. Health services in 3rd class room in Hospital	1,533.0	1,633.2	3,400.0	3,686.4	3,608.0	4,584.0
Target (million households)	60.0	60.0	76.4	76.4	76.4	76.4	
PNPM	III. PNP Activity	282.3	2,395.7	3,775.8	6,836.5	9,041.6	12,920.9
	1. Rural and sub-district PNP (PPK)	42.1	1,520.4	1,453.4	3,552.9	6,002.5	9,629.0
	1,592 sub-districts Rp. 350 million/sub-district	1,144 sub-districts Rp. 0.5 - 1 billion/sub-district	1,993 sub-districts Rp. 1.0 - 1.5 billion/sub-district	2,818 sub-districts Rp. 3.0 billion/sub-district	4,371 sub-districts Rp. 3.0 billion/sub-district	4,804 sub-districts	
	2. Urban PNP (P2KP)	240.2	375.3	1,477.7	1,577.4	1,829.8	1,509.5
	752 sub-districts & 7,273 urban villages/villages Rp. 1.0 - 1.5 billion/sub-district	955 sub-districts Rp. 3.0 billion/sub-district	1,145 sub-districts & 11,128 urban villages Rp. 0.2 - 0.5 billion/village	885 sub-districts & 11,039 urban villages			
	3. Rural Infrastructure PNP (PPIP)	500.0	500.0	500.0	588.1	925.9	1,225.9
479 sub-districts & 3,250 villages Rp. 2.5 million/village	479 sub-districts & 3,124 villages						
4. Backward & Special Region PNP (PDT)			344.7	475.4	283.4	57.0	
8 provinces & 32 districts	All districts in Aceh, Nias and 32 districts, 186 sub-districts						
5. Regional Socio-economic Infrastructure PNP (PISEW)				52.5	470.6	499.5	
237 sub-districts Rp. 1.5 million/sub-district	237 sub-districts & 32 districts special regions in 9 provinces						
INCOME SUPPORT	IV. Social Protection System	4,620.0	18,618.8	8,384.0	15,106.7	4,911.0	1,100.0
	1. Conditional cash transfer (PKH)	0.0	0.0	838.4	1,006.7	1,100.0	1,100.0
	Target (households)			387,928 in 7 provinces, 49 districts/kota & 348 sub-districts Rp. 0.6 - 2.2 million/hh	625,099 in 13 provinces, 73 districts/kota & 811 sub-districts Rp. 0.6 - 2.2 million/hh	720,000 in 13 provinces, 73 districts/kota & 811 sub-districts Rp. 0.6 - 2.2 million/hh	720,000 in 13 provinces, 73 districts/kota & 811 sub-districts Rp. 0.6 - 2.2 million/hh
2. Direct cash transfer (BLT)	4,620.0	18,618.8	14,100.0	19.1	18.5	0.0	
Target (million households)	Rp. 100 thousand/hh Distributed every 3 months for 3 months	Rp. 100 thousand/hh Distributed every 3 months for 12 months	Rp. 100 thousand/hh Distributed every 3 months for 7 months	Rp. 100 thousand/hh Provided for 2 months			
V. Natural Disaster Mitigation Fund	3,258.0	2,900.0	2,700.0	3,000.0	3,000.0	3,000.0	

Source: Ministry of Finance

2-2-2 Cluster 1: Household Based Programs

2-2-2-1 Bantuan Langsung Tunai-Unconditional Cash Transfer

BLT was established in 2005 as a compensation program as the government reduced fuel subsidies. By introducing this program, GOI aims to prevent poor citizens from becoming worse off as the fuel price increased.

In this program, each eligible household is entitled to receive cash support up to IDR 100,000 per month regardless of their income with the payment made quarterly. The list of eligible household is produced using the data collected by BPS, called PSE 2005. As the list of recipients was produced in a limited amount of time, it was fairly inaccurate causing many complain that the list did not represent the real condition as many poor individuals were excluded from the list.

For the second phase of the program in 2008, BPS collected an updated PSE 2005 that is called PPLS 2008. Good consultations with the local leaders have made this new list much more appropriate than the PSE 2005. In 2008, 19,018,057 households were listed as eligible recipients under the program, while the recipients in 2009 were 186,000 less than the one in 2008.

2-2-2-2 Beras Untuk Rakyat Miskin (RASKIN) – Rice for the Poor

RASKIN is a social protection program aimed at ensuring access of the poor to rice, the staple food in Indonesia. RASKIN is expected to reduce the expenses that must be borne by poor families. RASKIN program require GOI to ensure the availability of rice stocks nationally. As such, RASKIN program also ensures that rice produced by the farmers is bought by the government. RASKIN originates from the OPK, which was one social safety net program launched by GOI following the end-1990s economic crisis. At that time, the mandate of the OPK was nine basic commodities, namely rice, cassava, sugar, cooking oil and butter, eggs, milk, meat and chicken, corn and sago, kerosene or Liquefied Petroleum Gas (LPG), and iodized salt.

The ultimate goal of RASKIN is poverty reduction through it has dual impacts as shown in the figure below. The first path comes from the procurement side that guarantees product price so that farmers are still able to sell their rice at reasonable prices at times of oversupply, so as to be able to increase the welfare of farmer. The second path, RASKIN increases the food security at the household level that eventually increases the productivity of the poor.

PROGRAM BENEFITS TO PROCUREMENT AND RASKIN POVERTY REDUCTION

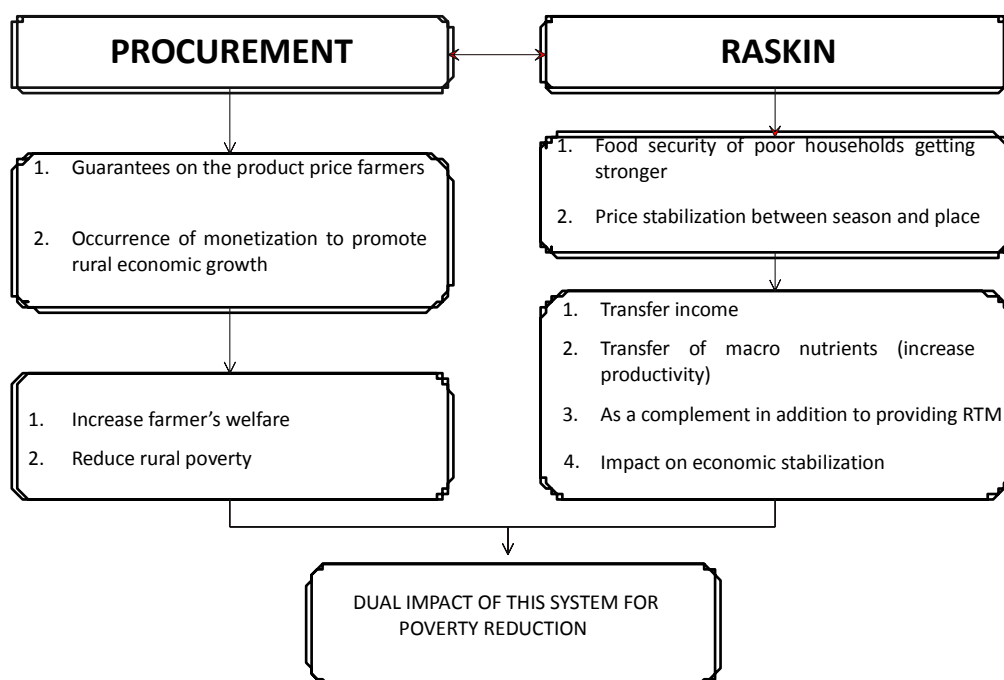


Figure 2-3 The Role of RASKIN for Poverty Reduction

Source: BULOG Presentation Material

In 2009, each household was able to buy 15 kg of rice per month at a subsidized price of IDR 1,600/kg with lists of eligible households are approved at the village level. However, in some places there are practices of distributing the subsidize rice even to non-eligible households. GOI allows this practice as long as it reflects the village needs and is approved by the village forum. In addition, consumers may pay for the rice at prices higher than IDR 1,600 to cover some transportation costs.

The table below shows the allocation and realization of RASKIN for the last five years. The number of recipients was increased year by year; only in 2009 it reduce as BPS has done the updating of the PPLS data. Since 2008, technically, RASKIN has been distributed to all the poor households in Indonesia.

Table 2-5 Effectiveness of Targeting by RASKIN

Year	2005	2006	2007	2008	2009
Number of Households	15,791,884	15,503,295	19,100,905	19,100,905	18,497,302
Target Households	8,300,000	10,830,000	15,781,884	19,100,000	18,497,302
Target %	52.56	69.86	82.62	100.00	100.00

Source: BULOG

Since 2008, all poor households are included in RASKIN target. This had increased gradually since 2005 when only about half of the poor households were within the RASKIN target. The number of targeted household for 2009 is 18.5 million people. RASKIN has also recorded relatively high percentages of realization on allocation, which has always been kept above than 96%.

For 2010, the term RASKIN will be replaced by Beras Bersubsidi (RASDI), which is Subsidized Rice to the targeted 17.5 millions household. As there is a deficit in the budget for this program, the price, months to be allocated, and monthly quantity per household is still being discussed. Some alternatives

include either allocating 13.5 kg per month per household for 12 months or 15 kg per month per household for 10 months or increasing the price.

2-2-2-3 Jaminan Kesehatan Masyarakat (JAMKESMAS) – Public Health Insurance

JAMKESMAS, formerly Health Insurance for Poor (Asuransi Kesehatan untuk Keluarga Miskin or ASKESKIN), has been in effect since 2008. Under JAMKESMAS, money is transferred directly by GOI to public health services or hospitals and the list of eligible people is decreed by the head of local government (district and city). The quota was declared by the Ministry of Health, and for 2008 JAMKESMAS was determined to have covered 76.4 million people. A report stated that the actual 2008 coverage was 72 million people. The total amount claimed in 2008 JAMKESMAS was about IDR 2.5 trillion, out of the allocated IDR 3.6 trillion, for hospitals and IDR 1 trillion for public health services (PUSKESMAS).

Local government can add more people to the list of eligibility, exceeding the quota, by paying for the program out of the local budget. As such, this is a way to reconcile differences between the allocated quota and the perceived actual needs by the local government.

The ultimate goal of providing access to health service for the poor is poverty alleviation through the scheme as shown in the figure below. Increasing the access and quality of health service for all poor households will make sure that standardized health services are implemented which will contribute positively to the productivity of the poor that may lift them up from poverty.



Figure 2-4 The Goal of Health Service Provision
Source: Ministry of Health

The government of Indonesia has begun providing assistance for health services since 1998 in order to help the poor cope with the severe financial crisis that hit the country together with other neighboring Asian countries. Since that time, this kind of assistance has been evolved. The development of health service program since 2004 can be seen as in the figure below.

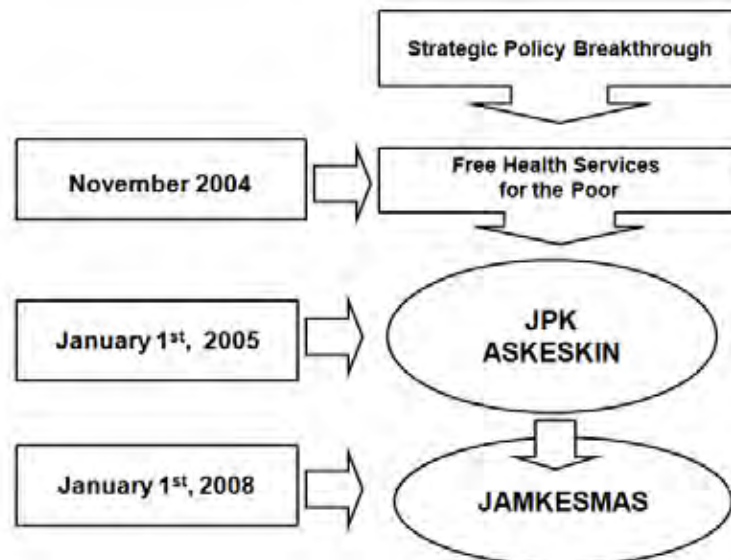


Figure 2-5 The Evolution of Health Programs
Source: Ministry of Health

There are four principles of JAMKESMAS: (1) National: JAMKESMAS covers all treatment as long as the beneficiaries follow the rules and referral system in throughout Indonesia, and central and local governments support the program; (2) portability: the database was sent to all hospital so that the beneficiaries with cards from one location are able to be treated in the other locations; (3) equity: all eligible persons have the same right in JAMKESMAS; (4) not for profit: if there is a profit, it will be used to increase services.

In the future, the government plans to introduce universal health insurance coverage starting in 2014. Currently, the poor, civil servants, and formal-sector workers are eligible for social health insurance and the rich can buy private health insurance, resulting in roughly 45% of 230 million Indonesian citizens being covered by some type of health insurance.

2-2-2-4 Bantuan Operasional Sekolah (BOS) – School Operational Assistance

BOS which is a support for primary and junior secondary school operations, has been in effect since the end of 2005, and was part of poverty compensation program launched by GOI to mitigate the impacts of fuel price hikes earlier that year. The assistance is provided to elementary and junior high schools, both regular and religious, both private and public schools.

With BOS it is expected that a nine-year basic education can be fulfilled, even for poor families. In 2008, BOS allocated no less than IDR 49.71 trillion with the assistance being provided to both schools and students. The allocation for each student is around IDR 397,000-400,000 (USD 40) for elementary school and almost IDR 570,000-575,000 (USD 60) for junior high schools. The allocation for each student in districts is a bit less than students in cities.

BOS is an appropriate intervention in light of a constitutional mandate to allocate 20% of the annual government budget to education. While BOS is initially directed to help poor families bear education costs, the scheme is actually a part of wider social protection program to guarantee education for all.

2-2-2-5 Program Keluarga Harapan (PKH) – Conditional Cash Transfer

It is expected that the conditional cash transfers will be able to improve the likelihood of the future generations of the poor escaping poverty as the next generation of the poor would have a better chance of engaging in the production chain since they will have better human resource quality. GOI is in the middle

of piloting a conditional cash transfer program (PKH), which will eventually replace the BLT, an unconditional cash transfer program as mentioned in previous subsection. The program was first launched in Gorontalo in 2007, covering seven pilot provinces. Under the PKH, a household would receive a cash transfer provided that the household satisfies certain criteria of health and education performance.

Health performance includes requirements that pregnant women undertake prenatal checks in POSYANDU (local health institutions) where they will get supplements for their pregnancy, and that they deliver their babies with the help of a trained health professional. Another requirement is that they themselves, along with their babies, make regular visits to posyandu; their children are also obliged to get complete immunizations (BCG, DPT, Polio, measles and hepatitis B); and children aged 6-11 months are also obliged to receive vitamin A supplements. Educational performance includes requirement that school aged children enroll in junior high school and primary school with a minimum attendance rate of 85%. If recipient households fail to sufficiently fulfill the requirements there will be several probationary periods, and, if they continuously underperform, the transfer will be terminated.

In April 2009, 587,712 targeted poor households received cash transfer from PKH. In the future, the coverage of this program will be expanded. PKH is supported not only by the central government, but also by local governments. Almost 65% of districts in Indonesia have allocated their local budgets in order to support the conditional cash transfers (PKH). Among other things, it is allocated to support monitoring and evaluation, and operational expenses.

2-2-3 Cluster 2: Community Based Programs

2-2-3-1 Program National Pemberdayaan Masyarakat Mandiri -National Community Empowerment Program

PNPM Mandiri is a poverty alleviation program based on community development, aimed at improving the potential and capacity of poor groups by allowing the poor to get involved in the development. The program was launched in 2007, as an extension of previous program by World Bank, Kecamatan Development Program (KDP). The program will have time period until 2015. The objective of this program is to increase the welfare of and job opportunities for the poor by increasing the capacity of the community to solve various problems to improve their quality of life, self-reliance, and welfare by actualizing their economic and social potential.

Components of PNPM Mandiri include community development, community block grants, strengthening local governance and partnerships and technical assistance for program management and development. For this program, each subdistrict will receive funds up to IDR 3 billions that will be directed to villages. In each village, the funds will be allocated to three main activities including infrastructure, economic, and social development. For the economic activities, there is a mandate to use the fund for microcredit targeted towards women.

PNPM comprises different sub-programs allowing different line ministries to provide support for community empowerment. There are two types of PNPM: Core and Support. PNPM Core consists of five programs, which are the Rural PNPM, Urban PNPM, Rural Infrastructure PNPM, PNPM for Special and Underdeveloped Region, and PNPM for Regional Social-Economic Infrastructure. On the other hand, PNPM Support consists of programs from other ministries that given out to the districts on top to the PNPM Core budget. The supporting programs are based on specific criteria of the districts that fit with the programs such as PNPM Tourism from Ministry of Tourism and PNPM Agribusiness from the Ministry of Agriculture.

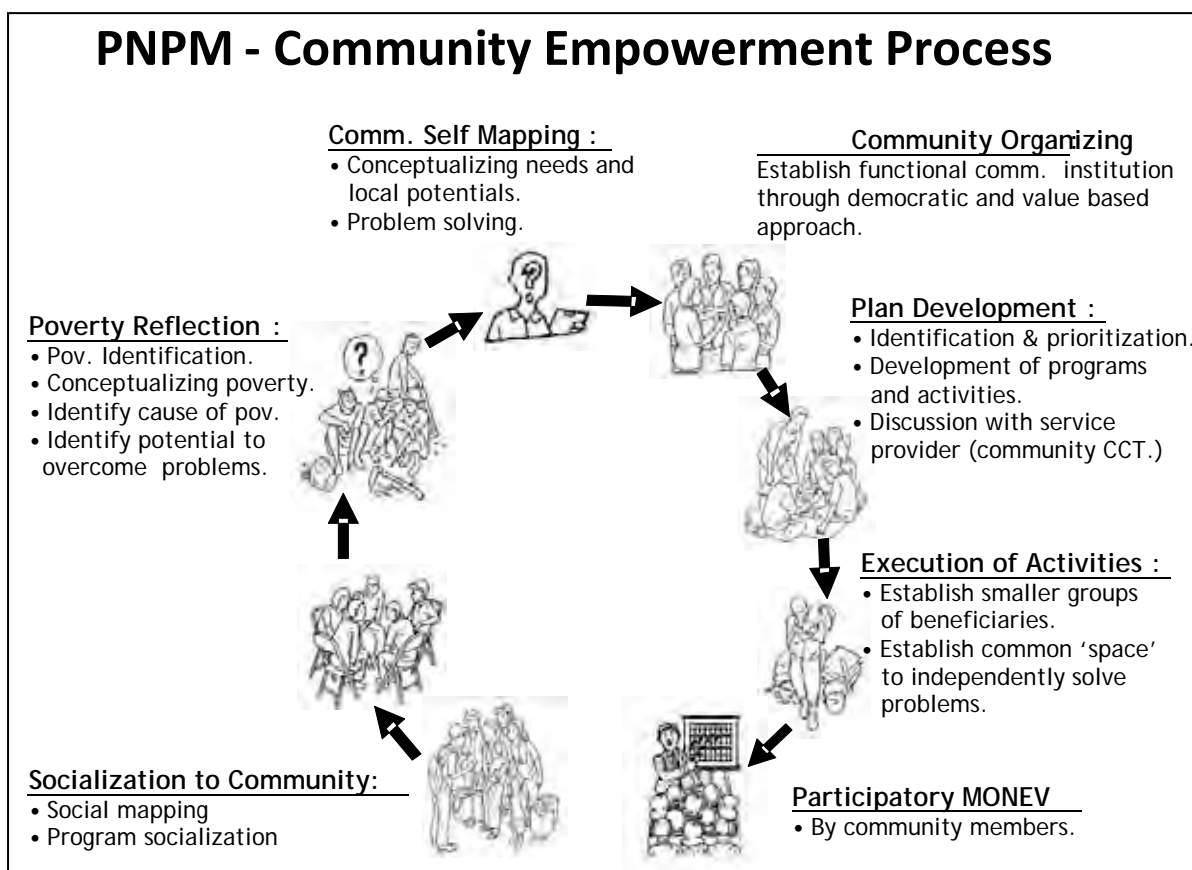


Figure 2-6 PNPM Community Empowerment Process
Source: BAPPENAS

2-2-4 Cluster 3: Market Based Programs

2-2-4-1 Support to SMEs through KUR²⁵

Micro, small and, medium enterprises dominate the structure of establishments in Indonesia. Following the BPS's definition, a micro establishment is one employing up to five workers, a small company is one employing 5-19 workers, and a medium firm is one employing 20-99 workers.

The relevance of micro and small enterprises to the poverty alleviation programs comes on two fronts. First is from the fact that they comprise the typical establishment that the poor, which are relatively low skilled and educated, can be associated with. When the poor open up a business, most likely it would be a micro or small establishment. On the other hand, if the poor seek employment, the likelihood is that it is with those establishments as well. The second point is related to the outputs, goods and services, produced. The poor rely heavily on outputs produced by micro and small enterprises. Therefore, the ability of these enterprises to produce goods and services efficiently would in turn benefit the poor.

Despite their significance, micro and small enterprises typically are informal in their operations. They are not registered and hence are unrecognized by authorities. As such, these businesses are highly

²⁵ Indonesian nuance of this term is "Business Loan for People" which clearly is different from Grameen-type microcredit; however, the term microcredit has been used for the sake of convenience.

associated with insecurity and unlawful activities. This informal economy employs casual and occasionally unpaid workers.

There is a low job security for labor in the informal economy leading to high turnover and difficulties for vertical, financial and social mobility. In retrospect, the informality also comes with flexibility. During crisis periods, flexibility allows the micro and small establishments to quickly adjust to efficiency needs. Indeed, that is the ultimate means of survival. Micro and small establishments continue to exist and produce goods and services, while medium and large companies would have to close down during the economic turmoil.

It is therefore very appropriate to frame the micro and small enterprise development as an economic, rather than social, policy. Social policies, which put to the fore, among others, the need for capital subsidization, usually result in inefficiency on the use of relatively limited resources. Many have shown that the micro and small enterprises are very capable of paying the on going interest rates charged by the banking sectors. What they actually need is access to such resources, rather than the subsidy which in turn disturbs the allocation efficiency of the economy. The economic approach to the development of the micro and small enterprises would put productivity and efficiency at the fore of the strategy.

To empower the micro and small enterprises, GOI has launched the third cluster of poverty alleviation programs that aims at providing economic and financial access to potential entrepreneurs. This cluster is directed to groups or individuals who are no longer recipients of programs in Clusters 1 and 2. These groups or individuals are considered to have escaped extreme poverty and have enough capability to fulfill their daily basic needs. Programs included in this cluster are targeted towards capacity building and empowering the micro and small firms, including the equity assistance through the KUR. Through this program, GOI provides a non-collateral credit of IDR 5 million through PT Asuransi Kredit Indonesia (ASKRINDO). KUR is channelled through several state-owned banks: Bank Rakyat Indonesia (BRI), Bank Mandiri, Bank Negara Indonesia (BNI), Bank Bukopin, Bank Tabungan Negara (BTN), and Bank Syariah Mandiri (BSM). Until June 2008, the amount of KUR was recorded at IDR 8.4 trillion with 916,000 clients. For 2009, it is planned that the amount would be extended to IDR 24 trillion.

2-2-4-2 Policy Blueprint for SME Development 2004-14

Ministry of State Cooperative and SME have a 10 year plan regarding SME development, which is summarized as follows:

1. Creating a Conducive Policy Environment
 - Simplification, streamlining, and rationalization of procedures for SME registration, and a process for SME support services
 - Fine-tune policy and regulatory framework for SME development
 - Promotion of public-private synergies and partnerships for SME development and integration
2. Human Resource Development and Capacity Building
 - Entrepreneurship Development Programs
 - Enhancing SME-sector skills in management and organization on a self-reliant basis
 - Fostering SME capabilities for inter-firm networking and linkages
 - Tracking and benchmarking SME capabilities, dynamism, and competitiveness
3. Enhancing SME Marketing Capabilities
 - Setting up regional and sub-regional networks of inter-linked, on-line clearing points or trading houses for SME businesses
 - Enhancing SME capabilities in and reliance on ICTs and e-commerce
 - Tacking and benchmarking SME readiness as sub-contractors and compliance to non-negotiable sub-contracting preconditions or compliance requirements on the demand side

- Traditional market rehabilitation
 - Improvement capability of cooperatives in retail business through Small and Medium and Cooperative Mart (SMESCO)
 - Participation in International and Domestic Exhibitions
4. Access to Finance
- Capacity building for improved SME access to financing: credit guarantee policies for KUR (Credit for People's Business) Channeling Banks, Bank Bukopin, Bank Mandiri, BRI, BTN, BNI, BSM)
 - Financial Institutional Capacity Building for Improved SME Financing (Micro Finance Institutions, Revolving Fund Management Agency)
 - Widening and Deepening SMEs Access to Credit
5. Access to Technology
- SMEs technology upgrading and transfer of innovative technologies

2-3 Conclusions

Indonesia has a tradition of “gotong royong” —an informal mechanism for mutual help among extended family members and community members. This tradition still exists and plays an important role in helping people with various needs when public support is not available. During the economic crisis of 1998-99, millions of Indonesians experienced a substantive drop in welfare with many otherwise non-poor individuals, especially in urban areas, becoming poor at least temporarily, and the traditional informal mechanism being shown to be insufficient. This clearly provided an impetus towards political demands for political and economic reforms and at which time President Suharto had to exit from government.

Assisted by the international donor community, the newly elected Government implemented a series of policies to tackle the crisis in both macroeconomic and social development areas. On the social development side, the Government had to provide safety nets for those who lost income sources and had difficulties in dealing with the demand of their daily lives. This is how a formal mechanism of SSN was initiated in the aftermath of the crisis of 1998-99. Since this time, the economic situation has recovered and the poverty rate has improved to pre-crisis levels by the mid-2000s.

Indonesia is entering into a new phase of social development. As demonstrated in Chapter 1, the global crisis of 2008-09 did not make Indonesia worse off in either terms of growth and poverty. However, a lack of formal social protection and insurance mechanisms make poor or near-poor populations remain vulnerable to the “chronic” nature of problems. This is why the Government has continued to extend support through SSN and reforms of national security system. As reviewed in this chapter, as of 2009, the government has proposed a “three cluster” system for supporting policies from which households, communities, and entrepreneurs are empowered through various programs targeted at them.

Chapter 3 Program Evaluation

3-1 Literature Review

3-1-1 Impact of Social Safety Net Program

In general, previous studies concluded that the government's social safety-net (SSN) programs had limited or little effect on household welfare and poverty reduction in the previous crisis period starting in 1997, but a few studies found that RASKIN was helpful in alleviating poverty during the previous crisis period. However, most studies reviewed here used data from the previous crisis period, and all government SSN programs were started after the outbreak of the previous crisis, so the impact evaluations by previous studies estimated the effects of the SSN programs on poverty reduction immediately after the SSN programs were set up. Given the chaos in the middle of the crisis as well as confusion in the introduction of the new SSN programs, it is possible that the effects of the SSN programs on poverty reduction may have improved over time. Our own study in this report examines this issue using the SUSENAS data 2008 and 2009 allowing us to provide a more updated program evaluation of the SSN program effects on poverty reduction.

More recent studies have examined the impact of community-driven projects on household welfare rather than the impact of the SSN programs. The Indonesian national government has shifted its policy focus to decentralization in order to mobilize local resources for economic growth and poverty reduction. The national government provides block grants to local communities, which then have the discretion to use the grants to satisfy their development needs. Some previous studies found positive impacts of such community-driven projects on household welfare. Some of these studies used a randomized study design, so the quality of such studies was high and the results were quite convincing.

The impact evaluation of government policies by donors, in the fields of social safety net and poverty reduction is sparse. One evaluation report by Save the Children (2008) is available for review and relates to the effect of the Kecamatan Development Program Education Pilot Project on student achievement. This pilot project provided block grants of IDR 500 million to Kecamatan. Each pilot Kecamatan had the discretion to spend the block grant for educational expenses of primary and junior secondary schools. Methodologically, this study just compares the means of test scores both in control and treatment schools before and after the policy intervention. For the subjects of reading, Indonesian language, mathematics, and science, treatment schools performed better than control schools, relative to before the intervention.

Another study, which is worth mentioning, is Voss (2008) (the World Bank) although this is a baseline report of a larger longitudinal study using data extracted from the interviews fielded in 2002 (SUSENAS) and 2007 Impact of PNPM Rural Survey (Survei Evaluasi Dampak PNPM-Rural; SEDAP). This study examines the impacts of a program called the National Program for Community Empowerment (PNPM-Rural) on household welfare and poverty reduction. PNPM-Rural gives local communities the initiative to determine their own local development priorities under the principle that local needs are most felt by local people. This evaluation project is on-going and no results are available as of September 2009. However, because of its quite robust study design (the difference-in-differences method with a propensity score matching approach) as well as the good quality of the data sources, its results are expected to be of high quality and may be a useful study for policy practitioners in the future.

Using panel data collected over fourteen months between 1998 and 1999, Sumatro et al (2004) found that participating in social safety net programs was generally associated with an increase in household consumption. In particular, the authors analyzed the following six social safety net programs: subsidized rice, scholarships, medical services, nutrition, employment creation, and subsidized credit. However, subsidized rice was the only program that significantly reduced the risk of poverty over the fourteen months.

Using a case-study approach with three districts as the study sample, Arifianto et al (2005) found that Health Insurance for the Poor (Jaminan Pemeliharaan Kesehatan Keluarga Miskin: JPK GAKIN) was better than previous health financing schemes such as Social Health Insurance (Jaring Pengaman Sosial Bidang Kesehatan :JPS BK) in providing access to health-care coverage to the poor. The report claimed that better performance came from the fact that JPK-GAKIN was fully administered by local governments, which enabled local governments to design or adjust the schemes in accordance with local conditions and needs. However, JPK-GAKIN had large room to improve for better access by the poor, such as poor fund monitoring and management; formal and informal barriers that prevented the poor from utilizing health care (high transportation costs, and a delay in the distribution of membership cards); limited targeting success; and no or little involvement of non-governmental stakeholders (in particular, JPK-GAKIN members) which would lead to less transparency and accountability of the program to its members.

Hastuti et al (2008) qualitatively examined the effectiveness of the RASKIN program using the meta-evaluation method (document review and secondary data analysis) supplemented by interviews with key informants at the central government and field research. Their findings showed that the program effectiveness was low due to the program's lack of socialization (publicity) and transparency; inaccurate targeting, prices, amounts, and distribution frequencies; high management cost; below optimal monitoring; and a poorly functioning complaint system.

Dhanani et al (2002) claimed that the skyrocketing inflation in food prices (especially rice prices) was one of the main determinants of poverty increases over the crisis period until 1998. This was due to the fact that poor and vulnerable people were net food buyers and because real wages kept decreasing over the crisis period. The authors argued that subsidized rice was delivered to a reasonably high proportion of the poor and the near-poor. The authors also claimed that although targeting was less successful, sales of subsidized rice were helpful for the poor by containing inflation in rice prices through a general equilibrium effect as well as by increasing the rice consumption by the poor.

3-1-2 Targeting

Previous studies found that the SSN programs were generally not successful in both targeting and coverage in the previous-crisis period starting in 1997. Again, one should take into account that most studies published so far used data from the period of the previous crisis. Thus, the evaluations of targeting and coverage were mostly made for the period when the SSN programs were just introduced or had been in place for a short period of time, at most a few years. It could be possible that both targeting and coverage of the SSN programs have improved over time.

One important lesson from previous studies reviewed here is that incentive plays an important role in shaping the degrees of targeting and coverage of the SSN programs. For example, previous studies found that the self-selection mechanism would perform better than administratively set criteria if a SSN program needs to increase targeting precision. Further, it was pointed out that in-kind provision was more amenable to targeting the poor as the non-poor typically did not bother to claim such in-kind goods (for example, foods and medical services) although they would line up for cash benefits. Lastly, previous studies found that if a SSN program intended to provide professional services (such as medical service and education) to the poor, the payments to the service providers must be directly linked to the quantities of services specifically provided to the poor. Otherwise, service providers had no incentives to direct their services to the poor, leading to loose targeting.

Using SUSENAS1999, Sumatro et al (2002) found that the social safety-net program missed the targets in many cases both in terms of low coverage and loose target. The table below was excerpted from Sumatro et al (2002).

Table 3-1 Effectiveness of Targeting of Government Programs (%)

Programs	Program Beneficiaries (% of total population)			% of Population Targeted (d)	Implemen- tation Ratio (e)=(c)/(d)	Targeting Expenditure Ratio (f)=(a)/(c)	Coverage Ratio (g)=(e)×(f)
	Poor (a)	Nonpoor (b)	Total (c)=(a)+(b)				
Subsidized rice	10.53	29.52	40.09	15	267.27	26.26	70.19
Employment creation	1.66	3.95	5.61	15	37.40	29.63	11.08
Primary school scholarships	1.16	2.88	4.03	6	67.17	28.78	19.33
Lower secondary school scholarships	2.43	6.02	8.42	17	49.53	28.86	14.29
Upper secondary school scholarships	1.08	2.66	3.71	10	37.10	29.11	10.80
Medical services	2.12	4.22	6.33	15	42.20	33.49	14.13
Nutrition	3.31	12.63	15.94	15	106.27	20.75	22.05

Source: Sumatro et al (2002).

Nonetheless, the authors found considerable heterogeneities in coverage and targeting across programs (relatively higher targeting in medical services and higher coverage in subsidized rice) and regions (the regional disparity in coverage at the district level ranged from near zero to almost 100 %).

Sumarto et al (2003) compared targeting efficiency of the two social safety net programs, employment creation and sales of subsidized rice, both of which were established by the government in response to the crisis initiated in 1997. As the method of targeting, the subsidized-rice program used administrative criteria based on the family planning agency's list, while employment creation programs used self-selection. The authors calculated benefit incidence in both static and dynamic senses. The former computed the probability of participating in the subsidized-rice/employment-creation program by expenditure quintile as of 1997, while the latter did the same by the quintile of changes in expenditure from 1997 to 2000. The authors found that targeting was much sharper for the employment-creation programs (targeted at the poor through self selection) than for the subsidized-rice program (targeted at the poor through administrative criteria).

Pradhan et al (2004) examined the impact of the health-card program on outpatient utilization. There were two distinct components in the health-card program, one component being the distribution of health cards targeted to the poor and the other component being budgetary support to health-care providers to compensate for the extra demand. The health cards entitled the owners to use health-care services with subsidized prices at public health-care providers. The budget support to health-care providers was not based on the actual utilization by health-card holders, but rather on the estimated number of households eligible for the health cards. The authors found that: (i) the distribution of health cards was pro-poor; (ii) the health-card program increased health-care utilization by the poor in comparison with the counterfactual case with non health-card programs; and (iii) however, the largest benefit of the health-card program seemed to have been captured by the non-poor. This unanticipated distribution of the benefit occurred because the general budgetary support to health-care providers was very loosely linked to utilization by health-card holders, so an increase in supply and quality of care, and especially drug availability at public health facilities due to the budgetary support by the health-card program attracted the non-poor whose utilization surpassed the utilization by the poor.

BOX1: List of Evaluation Reports on GOI Poverty Programs

- Arifianto, Alex, Ruly Marianti, Sri Budiyati, and Ellen Tan. 2005. "Making Services Work for the Poor in Indonesia: A Report on Health Financing Mechanisms (JPK-GAKIN) Scheme in Kabupaten Purbalingga, East Sumba, and Tabanan" SMERU Research Report.
- Dhanani, Shafiq, and Iyanatul Islam. 2002. "Poverty, Vulnerability and Social Protection in a Period of Crisis: The Case of Indonesia" *World Development* 30 (7): 1211-1231.
- Hastuti et al. 2008. "The Effectiveness of the Raskin Program" SMERU Research Institute.
- Pradhan, Menno, Fadia Saadah, Robert Sparrow. 2004. "Did the Healthcard Program Ensure Access to Medical Care for the Poor during Indonesia's Economic Crisis?" Tinbergen Institute Discussion Paper.
- Save the Children, UK. 2008. "Final Report on the Monitoring and Evaluation of the Kecamatan Development Program Education Pilot Project 2006 and 2007."
- Sumatro, Sudarno, Asep Suryahadi, and Lant Pritchett. 2003. "Safety Nets or Safety Ropes? Dynamic Benefit Incidence of Two Crisis Programs in Indonesia" *World Development* 31 (7): 1257-1277.
- Sumarto, Sudarno, Asep Suryahadi, and Wenefrida Widyanti. 2002. "Designs and Implementation of Indonesian Social Safety Net Programs" *The Developing Economies* XL-1: 3-31.
- Sumatro, Sudarno, Asep Suryahadi, and Wenefrida Widyanti. 2004. "Assessing the Impact of Indonesian Social Safety Net Programs on Household Welfare and Poverty Dynamics" SMERU Working Paper
- Voss, John, 2008. "PNPM-Rural Baseline Report" The World Bank.

3-1-3 Evaluation of Government Programs

Below are a series of evaluations that have been conducted on different anti-poverty projects launched by GOI.²⁶

²⁶ There is a possibility that other evaluations that have been conducted are not included in the below list, especially for on-going programs.

Table 3-2 List of Program Evaluation

Program	The Evaluators
Rural Infrastructure -Compensation for Oil Subsidy Reduction (PKPS)	LP3ES, 2005
Conditional Cash Transfer (BLT)	SMERU, 2006
Rice for the Poor (RASKIN)	SMERU, 2007
School Operational Assistance (BOS)	SMERU, 2005
Health Financing (JPK-GAKIN)	SMERU, 2005
SME: Agriculture-based Area Development Project in Sulawesi (SAADP)	SMERU, 2004
Water Supply and Sanitation for Low Income Communities (WSLIC2)	LP3ES, 2007
Rural Infrastructure Development Program (P2D)	Bennatin Surya Cipta, 2007
Partnership for Local Economic Development (KPEL)	Bennatin Surya Cipta, 2007
Community Empowerment for Rural Economic Development (CERD/PMPD)	LP3ES, 2007
Rural Income Generating Project for Small Farmers and Fishermen (P4K)	MICRA, 2007

Source: Hickling, 2008

Summary of evaluations results are provided below:

3-1-3-1 Rural Infrastructure -Compensation for Oil Subsidy Reduction (PKPS)

Following the oil subsidy reduction policy in 2005, The Government of Indonesia launched compensation program to support the livelihood of the poor especially in rural areas, this program emphasizing mainly on providing support on education, health and basic infrastructures, sanitation and environment quality improvement. IDR 250 millions was allocated per village to conduct development in accordance with their own needs

An evaluation for this program was performed using descriptive and qualitative analysis methods through interviews, and a number of focus group discussions. The evaluation is characterized by three large aspects: technical, financing, and social. The planning, implementation and facilitation time frames were too short, and supervision was weak. As a result, errors in targeting beneficiaries were large, 26.9% of village beneficiaries included in the program turned out to be villages with relatively more developed infrastructures. Furthermore, signs of corruption and marked up prices also very often arose in the project.

3-1-3-2 Conditional Cash Transfer (BLT)

BLT, as explained in Chapter 2, is a program that supports poor households by transferring cash to poor families in which every household will receive IDR 100,000 every three months time. Institutions in charge for distribution process were BPS and PT. Pos Indonesia. The evaluation of this program was conducted by SMERU. The approach was mainly qualitative evaluation, through in-depth interviews of 93 recipient households, 30 non-recipient households, and a number of community leaders in five districts in Indonesia, chosen through random purposive sampling. Focus Group Discussions (FGDs) were also conducted, with 5 FGDs being conducted for stakeholders in the level of district, 10 FGDs in the village level, and 12 FGDs among recipient households.

The evaluation suggests that the accuracy of the targeting may be questionable. Furthermore, they also found illegal retribution activity in the process of distribution with administrative problems emerging quite often; there were cases that BLT recipients were asked for some bribes in the name of (unauthorized) transportation fee, etc. The cash transfer recipients tend to spend their money on basic consumption with only a small number being used for health, education, or saving purposes. Problems arise in this program allegedly due to short period of planning, which inevitably followed by ineffective communication and coordination among implementing agencies.

3-1-3-3 Rice for the Poor (RASKIN)

RASKIN, as explained in previous chapter, is a program of GOI targeting poor households by selling affordable staple food to poor Indonesians. Evaluation for this program was conducted by SMERU Research Institute in 2007 through the support of BAPPENAS and Decentralization Support Facility (DSF), the institute incorporating the meta evaluation method in their report mainly through a mix of secondary data analysis and in depth interviews with several key informants. Additional field work in the form of FGDs also was conducted in three districts in West Sumatra, East Java and South-east Sulawesi.

The evaluation suggests that BULOG has been efficient and effective in distributing rice to the districts, while problems frequently occurred in distribution at the local district distribution point to targeted poor households. It also showed that the program has been considerably beneficial for the poor families for three main reasons: RASKIN helps poor individuals increase their consumption in terms of quality and quantity. Second, RASKIN helps in reducing family spending on staple foods, thus increasing flexibility in family spending. Third, RASKIN gives more room to families' disposable income, and thus increasing families' spending for education and healthcare.

3-1-3-4 School Operational Assistance (BOS)

The evaluation on BOS was completed by SMERU Research Institute, through fieldwork conducted in the period of February-March 2006 in 10 sample districts of five provinces. The evaluation mainly used qualitative approaches through interviews and focus group discussions. The main findings of the evaluation were that: (a) the listing of the targeted households and socialization stage of the programs were not properly addressed; (b) funds have been distributed in accordance with the implementation guidelines, but the delay in the distribution may have created some problems for the school, whose headmasters have an important role in fund allocation at the school level. The community has made some control mechanism to make sure that the fund is allocated properly. In terms of reporting, the school reports to the district level but not the parents so this reduces the transparency and accountability spirit so that internal and external monitoring on the implementation of this program is needed. In general, BOS has been recognized as an important and useful program for the development of schools, nevertheless, with so many administration tasks attached to this program, it may occupy the headmasters and reduce their attention for the educational activities.

3-1-3-5 Health Financing (JPK-GAKIN)

The evaluation on this program was carried out by SMERU in three districts using both primary and secondary data sources. Primary data was collected based on interviews with implementers and beneficiaries of the program. The outcomes of the evaluation shows this program is better than the preceding program, which is JPS BK in term of providing the poor with access to health service. The advantage of this program was the role of local government as implementer without sufficient local knowledge of what health services are needed and what schemes are appropriate. Several shortcomings of this program were a lack of efficiency in the fund management at the districts' hospital level, lack of claim verification that makes non poor households enjoying the benefit, lack of utilization by the poor, high unit cost per patient that may related with the accuracy of targeting, lack of private health service participation in the scheme, lack of monitoring, evaluation and coordination among stakeholders.

3-1-3-6 SME: Agriculture-based Area Development Project in Sulawesi (SAADP)

This project is an economic-commercial project in Central and Southeast Sulawesi funded using loans from the World Bank in the 1996-2003 period. In 1999, the project was redesigned from agriculture development to the local community initiative that stress on microfinance at the village level. Evaluation was conducted by SMERU on the redesigned project in four districts. In this project, it is easy for the villager to get access to the fund, nevertheless, the management of interest earning wasn't transparent and the monitoring and evaluation is not properly done, that increase the probability of corruption to emerge. This project may be associated with increasing the propensity to save. Overall, the result of evaluation shows that the project is relatively unsuccessful as some of the microfinance units were stagnant and there is limited impact to the improvement of social economic condition of the people.

3-1-3-7 Water Supply and Sanitation for Low Income Communities (WSLIC2)

This project aims at increasing the poor population's access to proper basic sanitation and clean water conducted by World Bank in collaboration with several related ministries. The evaluation was carried out in five villages using semi structured interview, FGDs, and direct observation. Based on evaluation, WSLIC-2 has succeed in reducing traveling distance to acquire water and increasing the water quality, reducing water collection time that may be translated into more productive activities that eventually will increase people's welfare, bringing positive improvement on sanitation behavior, reducing water borne diseases, increasing community ownership on the water and sanitation facility. On the other hand, some problems such as language, low participation from some villagers because of the high cost and previous project's bad experience, lack of motivation of the operator, high dependency on facilitators and fund from donor that threaten sustainability, lack of basic information and indicators for measuring the impact of the project, and there are still poor villages has not reached yet by the project.

3-1-3-8 Rural Infrastructure Development Program (P2D)

This program is a joint project of Ministry of Home Affair (MOHA), The World Bank, and The Government of Japan implemented effectively from 2001 and ended in 2005. The program is intended to promote development throughout regions in Indonesia with focus on rural areas infrastructures. The objective of this program is to support regional economic growth, empowerment of communities in rural areas, as well as alleviating poverty in rural. BAPPENAS launched the evaluation process for this program in 2007; the approach was mainly qualitative, especially incorporating AHP (analytical Hierarchy Process) in their analysis. In general P2D was considered as a success, in the sense that almost all formal targets were attained. Socialization of the program in the preparation phase reached satisfactory response from district and sub district authority. Monitoring and Evaluation process works relatively well supported by better information system and reports. Physical infrastructure expansion leads to more working opportunities to the community, while once infrastructure is established, it helps by providing more accessible economic opportunities. However there were several weakness in this program, which mainly caused by bureaucracy problems. Physical Infrastructure constructions relied on tendering mechanisms, while contractors used only small portion of the community in the construction process, thus the society as a whole did not receive sufficient opportunities to actively participate in the process. As a consequence, this nurtured corruption and collusion practices in that environment

3-1-3-9 Partnership for Local Economic Development (KPEL)

This program developed initially by BAPPENAS, UNDP and United Nations Human Settlements Program with the main goal being to develop the local economy by increasing community participation and increasing the accountability and transparency of local authorities.

Evaluation on KPEL program was completed by BAPPENAS in 2007, the approach was mainly qualitative, the analysis focused on AHP (Analytical Hierarchy Process) with 10 key elements and 9 success indicator. The evaluation concluded that there were some weaknesses in KPEL. First, a common

problem was found in the decentralization era: the irresponsible local authority with strong and complicated bureaucracy; and limited access to financing information by SMEs. Problems with SMEs financing also occurred due to lack of capability in making standardized fund proposals with limited production capability and low product quality control making proposals even less attractive. Second, problems with the availability of SMEs database resulted in this program not being able to offer optimal solutions to capital needs. Third, the program itself has not shown satisfying results in alleviating poverty, since the capital absorbed through this program was inadequate to boost dramatic change in the local economy. Fourth, there were delays in funding distribution due to noncompliance with standard procedure.

3-1-3-10 Community Empowerment for Rural Economic Development (CERD/PMPD)

This program is one of the community empowerment programs conducted in Indonesia in the framework of poverty alleviation especially after the Asian Crisis in 1997. This program was funded by Asian Development Bank in joint cooperation with GOI and strong coordination with the NGOs, local governments and universities. The main objective of this program was to first encourage integrated community empowerment through increasing community capacity and participation in planning and managing rural/ village development activities. And, second, to increase the capacity of local government in facilitating rural development activities.

CERD evaluation was carried out by BAPPENAS in 2007. The approach was mainly qualitative studies, with focusing in in-depth interview, Analytical Hierarchy Process, and documents review. The main findings were that program benefit was far from optimal mainly due to ineffective coordination among institutions and the fact that this limited human resource capacity contributed largely to incompetent project loan management. Secondly, infrastructures development has not shown significant impact, findings in the field shows that community participation in village development decision making was low, hence infrastructures built had very low frequency of utilization, yielding insignificant benefit since its construction was not based on people's aspiration in the first place. In addition, focusing only on infrastructures development, the program has less impact on drastic improvement to rural people's income.

3-1-3-11 Rural Income Generating Project for Small Farmers and Fishermen (P4K)

This is a program carried out by the Ministry of Agriculture in cooperation with the Bank Rakyat Indonesia. Its objective is to alleviate poverty in rural areas through improvement in Human resources and SMEs funding support with the targeted beneficiaries being small scale fishermen, farmers, and agriculture casual workers, as well as community groups dominated by poor individuals. The program focused on SMEs empowerment and promoting savings. The program was funded by a joint cooperation of GOI and UNDP, divided in three phases from 1979-2005.

Evaluation for this program was carried out by MICRA (Microfinance Innovation Center for Resources and Alternatives), which mainly focused on three parts: P4K program effectiveness, alternative inputs to improve P4K effectiveness, and the best practices in poverty alleviation programs. The methodology used was literature reviews, structured interviews, field surveys and FGDs. The main findings were that P4K in general is able to contribute effectively in alleviating poverty this is due to incorporating participatory rural appraisal in targeting poverty. Database and information documentation were very informative and comprehensive, program management coordinated by the Ministry of Agriculture performed relatively well and considerably effective. However, problems arise since the objective of P4K was covering a widespread multi-objective, which makes it difficult to attain. Another problem is the limited amount of loans offered, and lack of technical assistance in supporting participant to move on to a higher level loan. Sustainability of this program was also in question since the return for these loans is not sufficient in providing incentives to banks (in this case Bank Rakyat Indonesia) to participate in this program in long term.

3-1-3-12 Poverty Project Cycle

This series of evaluations illustrate one important feature of Indonesian anti-poverty programs. To highlight the feature, let us acknowledge first the typical cycle of an anti-poverty programs. The cycle comprises five steps as follows:

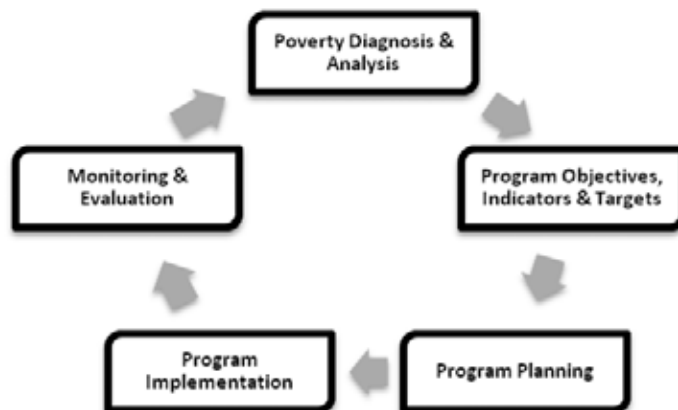


Figure 3-1 Cycle of Poverty Program

Source: JICA Study Team

1. Poverty Diagnosis and Analysis

Included in this diagnostic step is the micro level identification of the poor along with the identification of possible root causes of poverty. A region-based poverty analysis or poverty mapping may also be done. One needs to be careful at this point with the identification of poor as it may involve a difficult administrative decision. As an example, the government would have to choose whether to have the household registration nationally conducted or in a decentralized fashion. The identification would also involve a choice of specific criteria to determine the poverty condition.

2. Program Objectives, Indicators, and Targets

Objectives are specific goals based on the target population and/or area selected in the analysis phase. Indicators in this context include *inputs*, *outputs*, *outcomes* and *impacts*. Targets are specified as a value of the indicators to be achieved within a particular unit of time. Objectives should comply with international standards (for example the MDGs), and at the same time must be discussed with key stakeholders. Targets need to be achievable. It is important that when the objectives, indicators, and anti-poverty targets are determined, one also takes into account the impacts on and of the distribution of income.

3. Program Planning

Planning involves detailed work on the main components of the program. These components involve time frame, implementation agent(s), institutional roles and capacities, available resources, partners, reporting, and the final consultation and approval processes in addition to monitoring and evaluation plans. Some of the tasks in the planning stage can consist of creating regulations, and operational and technical standards or guidelines. It is important to remember that set forth under planning will later be used for program reporting and monitoring, and for accountability and transparency. Program planning must also be participatory.

4. Program Implementation

Implementation is a very important stage. It is not only about execution, but also requires program socialization: informing local communities and target groups about the program details and how to access information, benefits, managers, local offices, and other important program

implementation aspects. The implementation also needs to ensure proper cooperation and coordination among the key implementation agents (at both the central and sub-national levels). Implementation also needs to have appropriate feedback mechanisms, and public and regular reporting.

5. Monitoring and Evaluation

Monitoring is to provide information on whether the policy or program has been implemented according to plan. Effective management enables the identification of problems and helps determine solutions whenever the program implementation differs from that planned. Evaluation is to identify impacts by isolating the effects of a particular intervention from other factors. Proper monitoring and evaluation requires baseline data as a reference. Thus planning for evaluations should be started from the initial phase, including determining the objective, methodology, schedule and financing. The monitoring and evaluation needs to combine both quantitative and qualitative methods.

An attempt was once made to evaluate the program using the above five elements of the program cycle. The results obtained indicated that typical anti-poverty programs in Indonesia are relatively better in the diagnostics, objective and indicator formulation, and planning stages; are relatively fair in the implementation stages; and are relatively weak in the monitoring and evaluation phases.

The relatively better initial stages are the results of past experience. Diagnosing, formulating objectives and indicators, and creating programs are very important to budget allocation. These initial stages also typically involve only government employees and bureaucrats writing up standard operating procedures for certain programs. The implementation, however, starts to involve many external parties. More intensive coordination becomes necessary, and the same time adjustments need to be taken to accommodate particular situations.

Weak monitoring and evaluation is caused by the fact that past programs were typically project-based and ended with a particular fiscal year. There is no guarantee that a particular program would be extended to the subsequent fiscal year. As such, a monitoring and evaluation may not be an important element of the program. It turns out, however, that as of late certain programs have been continued. Examples include RASKIN, BOS, and JAMKESMAS. In this particular situation, monitoring and evaluation are pivotal to the continuing and improvement of the programs.

3-2 Evaluation by JICA Team

3-2-1 Quantitative Evaluation (Econometric Study)

This section examines the impact of some social safety-net (SSN) and poverty-alleviation programs on household welfare or poverty reduction using the most updated data from Indonesia. In particular, we look at RASKIN, free medical services, and business loans²⁷ to investigate whether each of these programs helped alleviate poverty and promoted household welfare in 2008 and 2009.

Data used in this study is from SUSENAS 2008 and 2009. The surveys were carried out by Statistics Indonesia (BPS). SUSENAS is an annual socio-economic survey, which typically collects data from about 200,000 households throughout Indonesia. In this case, we use for our analysis the panel component of the SUSENAS data, which is a subset of the whole SUSENAS. The sample size of the

²⁷ Business loans include not only loans from government programs but also loans from other sources. More specifically, the sources of credits include: i) sub-regency development program; ii) urban poverty eradication program; iii) other government programs; iv) banks; v) cooperatives/foundations; vi) personal sources; and vii) other sources. We group the former three categories into one group as government sources and the latter four categories into another group as other sources.

panel component of SUSENAS is about 65,000 households (which were interviewed in both 2008 and 2009 surveys.)

3-2-1-1 Program Coverage by Income Groups

SUSENAS asked survey respondents whether the household received RASKIN in the past three months, received free medical services in the past six months, and received business loans in the past year.

Table 3-3 presents the distributions of the three SSN or poverty alleviation programs (RASKIN, free medical services, and business loans) by household expenditure quintiles. For business loans, to distinguish government sources from other sources, we calculated the distributions of the availability of business loans not only for all sources of loans but also for government sources of loans alone. More specifically, real per-capita household expenditure as of 2008 (2008 DKI Jakarta prices as the norm) was used to divide the sample households into 5 groups (Q1: the lowest quintile to Q5 : the highest quintile), and Table 3-3 presents the share of households (%) that received each SSN or poverty alleviation program separately for 2008 and 2009.

Table 3-3 Household Participation in Various Social Safety Net or Poverty Alleviation Programs by Quintiles of Lag per Month per Capita Consumption in 2008 and 2009 (%)

Programs	Quintiles of Initial Per Month Per Capita Consumption					Total
	Q ₁	Q ₂	Q ₃	Q ₄	Q ₅	
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2008						
1. RASKIN	70.66	62.34	53.42	38.12	17.84	46.46
2. Medical Service (Health card, ASKESKIN, letter of poor, etc)	22.49	19.28	16.50	13.77	10.02	15.94
3. Business credit (all sources)	3.84	4.99	5.55	6.32	7.09	5.68
4. Bus. credit (gov. sources only)	1.20	1.27	1.42	1.68	1.25	1.37
2009						
1. RASKIN	61.68	53.64	44.37	32.51	14.01	39.46
2. Medical Service (Health card, ASKESKIN, letter of poor, etc)	24.06	20.78	19.17	15.74	10.86	17.64
3. Business credit (all sources)	2.96	4.35	5.09	5.92	6.87	5.18
4. Bus. credit (gov. sources only)	1.14	1.35	1.34	1.46	1.30	1.33

Note: Only observation of panel component (N=65,239household) and without weight.

Source: SUSENAS Panel 2008-2009

The above table suggests several things as follows. First, the share of households that received RASKIN is quite large (overall, 46% of households for 2008 and 39% of households for 2009) in comparison with the other two SSN or PA programs (overall, 16% and 6% of households received free medical services and business loans, respectively in 2008 and 18% and 5% of households received free medical services and business loans, respectively in 2009). Changes in the coverage of RASKIN may be brought about by differences in the actual rice distribution methods. As noted earlier, villages are allowed to determine their own ways of RASKIN rice distribution so as to fit the conditions of the villages.

Second, the distributions of RASKIN and free medical services were pro-poor in both 2008 and 2009 (the lower real per-capita household expenditure, the more likely the household received RASKIN and free medical services.) The proportion of households receiving business loans, on the other hand, is positively linked with the income groups. This reflects the nature of these programs. RASKIN and free

medical services are targeted to the poor households. Business loans, on the other hand, are currently included in the KUR, which belongs to the Cluster 3 or the wider PA program. As such, cluster 3 is directed to those already graduating from the community-based PNPM program. Therefore, it is not surprising that the most poor would have less access to these business loans.

3-2-1-2 Impact of Programs on Household Consumption

A natural question that comes to mind is why the trend of poverty in Indonesia has been insulated from the most recent economic and financial shock. For the rest of this section, we contribute to answering this important question. In particular, we examine whether the SSN or poverty alleviation programs helped the poor and the near-poor to escape from poverty over the 2008-2009 period. On one hand, since the Indonesian economy has experienced positive economic growth even in 2008 and 2009, there may not have been an economic shock felt by the poor and the near-poor in 2008 and 2009, unlike the financial, economic, and political chaos of 1997. On the other hand, the Indonesia government has strived to make its economy more robust to external shocks by planning and introducing reforms in many socioeconomic spheres of society, including social safety nets, pension, and health insurance. It could be that these government initiatives have been so effective that some of the poor and the near-poor have managed to escape from poverty due to the benefits of these government programs.

SUSENAS asked the respondent whether his/her household received RASKIN in the past three months, free medical services in the past six months, and business loans in the past one year. For business loans, we are more interested in whether government programs were effective in promoting household welfare, so we use the availability of business loans from government sources as one variable of our analysis. We examine the correlations between each of these SSN or poverty alleviation programs and changes in household expenditure from 2008 and 2009 while econometrically controlling for many household characteristics. A positive correlation between the receipt of these SSN or poverty alleviation programs, and an increase in household expenditure is consistent with the hypothesis that these SSN or poverty alleviation programs increased household welfare by allowing Indonesian households to spend more on their needs.

Following econometric model was estimated using OLS.

$$\log(y_{2009}) - \log(y_{2008}) = \beta_j + \beta_1 S_{2008} + \beta_2 X_{2008} + \varepsilon \quad (1)$$

where

y_{2009} and y_{2008} are real per-capita household monthly expenditures in 2009 and 2008, respectively;

S_{2008} is a vector of dummies of the receipts of the SSN or poverty alleviation programs (RASKIN, free medical services, and government loans) in 2008;

X_{2008} is a vector of control variables which are listed in Table 3-4. A description of each variable is in the below Table 3-4;

ε is the remaining error; and

$\beta_j, \beta_1, \text{ and } \beta_2$ are the coefficients to be estimated. β_j is the constant specific to region j where region is defined by either urban or rural area within a province.

There are 33 provinces in the SUSENAS data set. However, there are no rural areas in Jakarta. Thus, we estimate 65 region-specific intercepts to allow for different region-specific changes in household per-capita consumption between 2008 and 2009 due to, for example, regional differences in inflation.

Table 3-4 The Impact of Participation in the Social Safety Net or Poverty Alleviation Programs on Household Consumption

(Dependent variable: Change in log real per capita consumption between 2008 and 2009)

Independent Variable	A	B	C
Change in income between 2008 and 2009			
Change in log real per-capita income		0.157***	0.154***
Village cluster of mean change in log real p/c income			0.018**
Previous Participation in social safety net programs:			
raskin08 (d)	0.008*	0.057***	0.058***
medical08 (d)	-0.004	-0.002	-0.002
govcredit08 (d)	-0.055***	-0.075***	-0.076***
Previous Household characteristics:			
age08/100	0.010	-0.026	-0.027
size08	0.033***	0.029***	0.029***
female08 (d)	0.030***	0.019*	0.019*
married08 (d)	-0.001	-0.010	-0.010
Previous Education level of household head:			
Less than primary08(ref. group)			
primary08 (d)	-0.001	-0.002	-0.002
lowsecond08 (d)	-0.001	-0.005	-0.005
upsecond08 (d)	-0.010*	-0.010	-0.010
tertiary08 (d)	-0.043***	-0.026***	-0.026***
Previous Sector of household main income:			
Agriculture08 (reference group)			
industry08 (d)	-0.020***	-0.003	-0.003
trade08 (d)	-0.009	0.010	0.010
service08 (d)	-0.015**	-0.003	-0.003
others08 (d)	0.004	0.008	0.009
Previous Employment status of household head:			
Not working08 (reference group)			
self08 (d)	-0.015**	-0.000	-0.001
wage08 (d)	0.012**	0.024***	0.024***
family08 (d)	-0.002	-0.040	-0.041
Previous Assets ownership:			
water08 (d)	-0.024***	-0.024***	-0.025***
electric08 (d)	-0.046***	-0.029***	-0.029***
Constant	-0.069***	-0.100***	-0.099***
Adj.R-squared	0.019	0.098	0.098
Number of observations	65,239	35,483	35,483

* p<0.05, ** p<0.01, *** p<0.001; (d) denotes a dummy variable.

Source: BPS Panel 2008-2009

Box 2 Explanation of Variables Used in Regression

DEPENDENT VARIABLE	
lnexpfreal08	: Change in log real per-capita household expenditure in 2008
poor09	: Dummy of being poor either, 1: poor in 2009 and 0: otherwise
INDEPENDENT VARIABLE	
Household-Level and Village-Level Incomes:	
meaninc09	: Village cluster mean change in log real per-capita hh expenditure from 2008 to 2009
lnexpfreal08	: lag of log real per-capita consumption in 2008
Previous Participation in SSN or Poverty Alleviation Programs:	
raskin08	: Subsidized rice in 2008
medical08	: Medical services in 2008
govcredit08	: Business credits from government sources in 2008
Previous Household (Head) Characteristics:	
age08	: Age of household head in 2008
size08	: Household size in 2008
female08	: Female headed household in 2008
married08	: Married household head in 2008
Previous Education Level of Household Head:	
primary08	: Primary-educated household head in 2008
lowsecond08	: Lower-secondary educated : household head in 2008
upsecond08	: Upper-secondary educated household head in 2008
tertiary08	: Tertiary-educated household head in 2008
Previous Sector of Household Main Income:	
industry08	: Industry in 2008
trade08	: Trade in 2008
service08	: Service in 2008
other08	: Other in 2008
Previous Employment Status of Household Head:	
self08	: Self: employed in 2008
wage08	: Wage employee in 2008
family08	: Family worker in 2008
Previous Asset Ownership:	
water08	: Access to tap water in 2008
electric08	: Access to electricity in 2008

Column A in Table 3-4 presents the result. The receipt of RASKIN is positively associated with an increase in household expenditure while the receipts of free medical services and government loans are negatively associated with an increase in household expenditure. However, the correlation between changes in household expenditure and the receipt of free medical services is not statistically significant at the conventional levels. If these coefficient estimates were literally interpreted, the receipt of RASKIN would promote household welfare while the receipt of government loans would reduce household welfare. However, it would be too naive to interpret these coefficient estimates as they are. There are some empirical problems in estimating Equation (1) with OLS. The OLS method cannot properly address the so-called endogenous bias (Wooldridge 2006²⁸): For example, because the distribution of RASKIN is pro-poor (see Table 3-3), people would be more likely to receive RASKIN/free medical services when household incomes are low (thus household expenditures are low). Household income tends to regress to its permanent income (long-term average), implying that those households who received RASKIN in 2008 tended to increase their incomes in 2009 regardless of the receipt of RASKIN in 2008. The exactly opposite story can be told for government loans: since the distribution of the receipts of government loans is anti-poor, those households who received government loans in 2008 tended to decrease their incomes in 2009 regardless of the receipts of government loans in 2008. The OLS method cannot distinguish this self-selection effect from the true effect of RASKIN /government loans on household expenditure.²⁹

²⁸ Wooldridge, Jeffrey M. 2006. *Introductory Econometrics A Modern Approach*. Thomson South-Western.

²⁹ Previous usage of free medical services has no significant correlation with change in household expenditure possibly in part because this dummy variable measures actual usage of rather than entitlement to free medical services. Even if households have entitlement to free medical services, they would not use free medical services in case all household members are healthy.

To reduce this endogenous problem in identifying the program impacts, one approach is to add an appropriate control variable. In particular, changes in household income could be an important omitted variable in the above econometric specification. Column B additionally includes changes in log real per-capita income as a control variable. The rest of the variables are the same as in Column A. Unfortunately, many sample households did not report household income, so the sample size has substantially decreased from 65,239 to 35,483 from Column A to Column B.

The estimates of the program impacts have increased in magnitude for RASKIN and government loans while the estimate of the program impact does not change meaningfully for free medical services after controlling for changes in household income.

Column C further includes village cluster mean change in log real per-capita household income between 2008 and 2009 as a control variable. This is to examine whether village-level formal and informal risk-coping mechanisms were in operation (Townsend 1994).³⁰ Although the coefficient on this added variable is statistically significant at the 5% level, the coefficient 0.018 is very close to zero, implying that each household's change in household expenditure moved almost independently from the average change in household income within a village. This is a strong sign of the (virtually) non-existence of village-level formal and informal coping mechanisms. In other words, many households hit by idiosyncratic shocks (sickness, death, crop failure, and so on, which affected only a small portion of village households) were not protected by village-level risk coping mechanisms.

Even when including village cluster mean change in log real per-capita household income between 2008 and 2009 as an additional control variable, the coefficients on the receipts of the SSN or poverty alleviation programs did not change meaningfully.³¹

3-2-1-3 Program Impacts On Poverty Alleviation

Next, we focus more on poverty rather than household expenditure as a measure of household welfare. Specifically, we estimate the following equation using Probit estimation:

$$\Pr (y_{2009} < \text{pline}_{2009}) = f(\alpha_0 + \alpha_1 \log(y_{2008}) + \alpha_2 S_{2008} + \alpha_3 X_{2008} + u) \quad (2)$$

where $\Pr (y_{2009} < \text{pline}_{2009})$ is equal to 1 if per-capita household expenditure is below the poverty line, and is equal to zero otherwise; and the rest of the symbols are identical to Equation (1).

Column A of Table 3-5 shows that higher per-capita household expenditure in 2008 strongly reduced the probability that the household fell into poverty in 2009. The receipts of RASKIN and free medical services in 2008 are associated with a higher probability that the household fell into poverty in 2009 while the receipt of government loans in 2008 has no correlation with the probability that the household fell into poverty in 2009.

³⁰ Townsend, Robert M. 1994. "Risk and Insurance in Village India" *Econometrica* 62(3): 539-591.

³¹ Correcting the endogeneity problem is not easy. Usually, economists attempt to fix endogeneity problems by utilizing the method of instrumental variables. In our setting, the instruments must affect the dependent variable (changes in household expenditure between 2008 and 2009) only through the policy dummies (the receipts of RASKIN, free medical services, and business loans). In other words, the instruments must satisfy the following two conditions: (i) the instruments must be strongly correlated with the policy dummies, and (ii) the instruments should not be correlated with other characteristics, which are correlated with the dependent variable. It seems very difficult to find such variables.

Table 3-5 Probability (Marginal Effect) of a Household to be Poor
(Dependent variable: Dummy of Being Poor 2009)
Probit Model

Independent Variable	A	B	C
Previous consumption and current income			
Log real per-capita consumption 08	-0.138***	-0.086***	-0.085***
log real per-capita income 09		-0.034***	-0.032***
Village cluster of mean log real p/c income 09			-0.012***
Previous participation in social safety net programs:			
raskin08 (d)	0.021***	0.020***	0.020***
medical08 (d)	0.008***	0.007***	0.007***
govcredit08 (d)	0.002	0.003	0.003
Previous Household characteristics:			
age08/100	-0.053***	-0.049***	-0.047***
size08	0.006***	0.002***	0.002***
female08 (d)	-0.003	-0.005	-0.005
married08 (d)	-0.006	-0.009**	-0.009**
Previous Education level of household head:			
Less than primary08(ref. group)			
primary08 (d)	-0.014***	-0.010***	-0.010***
lowsecond08 (d)	-0.021***	-0.014***	-0.013***
upsecond08 (d)	-0.028***	-0.019***	-0.018***
tertiary08 (d)	-0.029***	-0.020***	-0.020***
Previous Sector of household main income:			
Agriculture08 (reference group)			
industry08 (d)	-0.013***	-0.003	-0.002
trade08 (d)	-0.021***	-0.007***	-0.007***
service08 (d)	-0.017***	-0.006***	-0.005**
others08 (d)	-0.001	0.005	0.006
Previous Employment status of household head:			
Not working08 (reference group)			
self08 (d)	0.003	-0.003	-0.004
wage08 (d)	-0.001	0.004**	0.004**
family08 (d)	0.007	-0.005	-0.005
Previous Assets ownership:			
water08 (d)	-0.016***	-0.008***	-0.007***
electric08 (d)	-0.041***	-0.027***	-0.026***
Statistics			
Number of observations	65,239	43,052	43,052

* p<0.05, ** p<0.01, *** p<0.001; (d) denotes a dummy variable.

Source' BPS Panel 2008-2009

Again, this econometric identification may suffer from the endogenous bias of self-selection. The distributions of RASKIN and free medical services were pro-poor while the distribution of government loans was anti-poor (See Table 3-3). Then, it is likely that the ordinary Probit estimation cannot separate the self-selection effect (relatively richer households were more likely to receive government loans than relatively poorer households and the opposite is true for RASKIN and free medical services) from the true effect of the SSN or poverty alleviation programs on the probability of poverty. As previously mentioned, one method to overcome this problem would be to use an additional control variable which addresses the endogenous nature of the program variables.

Column B additionally includes log real per-capita income in 2009 as a control variable. The sample size has decreased substantially from Column A (65,239 households) to Column B (43,052 households) because of missing reports of household incomes for many sample households. As expected, a higher

household income in 2009 is associated with a lower probability that the household fell into poverty in the same year. In terms of the program impact of RASKIN/free medical services/government loans, we see only negligible changes in the coefficient estimates after controlling for household income in 2009.

Column C of Table 3-5 further includes village cluster mean log real per-capita household income in 2009 as a control variable. The idea is again to test whether village-level risk coping schemes were in operation. The estimated coefficient on this variable is negative and highly statistically significant, implying that if average per-capita household expenditure within a village is higher, a household within the same village was less likely to fall into poverty. This suggests the existence of some village-level risk coping schemes against idiosyncratic shocks. However, the magnitude of the coefficient estimate is much larger for own income (-0.032) than for village cluster mean income (-0.012), implying that own income is more important than village-level risk coping mechanisms for preventing households from falling into poverty.

Even when village cluster mean log real per-capita household income in 2009 is included as an additional control variable, the estimated effects of the SSN or poverty alleviation programs on the probability of poverty have hardly changed. Column C suggests that the receipts of RASKIN and free medical services in 2008 are associated with a higher probability of poverty in 2009 while the receipt of government loans in 2008 has no correlation with the probability that a household fell into poverty in 2009 although these estimates of the program impacts, without doubt, suffer from endogenous bias.³²

3-2-1-4 Regional Differences

For the rest of the analysis, possible regional differences in the impacts of the three SSN or poverty alleviation programs on household welfare and poverty reduction were explored. Specifically, the program impacts are estimated separately for: i) urban/rural areas; and ii) Java/non-Java areas.³³ The same econometric models and specifications as before were used: OLS is used to estimate Equation (1) and Probit is applied to estimate Equation (2). The results are presented in Table 3-6 (Equation 1 separately for urban and rural areas), Table 3-7 (Equation 1 separately for Java and non-Java areas), Table 3-8 (Equation 2 separately for urban and rural areas), and Table 3-9 (Equation 2 separately for Java and non-Java areas).

It is important to mention that the results in Tables 3-6 through 3-9 would suffer from empirical identification problems in econometrics, so the estimates of the program impacts should not be interpreted as they are. Still, there are some interesting regional differences, which might have some policy relevance. To save space, Tables 3-6 through 3-9 contain the coefficient estimates of the most relevant variables only and the coefficient estimates on the rest of the control variables are not shown although they are controlled in the regressions.

Table 3-6 finds no consistent differences between urban and rural areas in terms of the coefficients on income variables and the coefficients on the policy dummies (RASKIN, free medical services, business loans). Table 3-7 provides suggestive evidence that village-level risk coping schemes could exist in the Java region but may not be present in the non-Java region. Moreover, the coefficient estimate of free medical services is positive and statistically significant in the non-Java region and negative and statistically significant in the Java region. Again, it is difficult to tell whether this occurs because the distribution of free medical services was more pro-poor in the non-Java region than in the Java region or because the actual impact of free medical services on household welfare was larger in the non-Java region than in the Java region.

³² Again, to reduce the endogeneity problem, instrumental variables which are difficult to find in this context for this study are needed.

³³ The regression results separately by island are included in the Appendix. The grouping used for this analysis is (i) Sumatra, (ii) Java+Bali, (iii) Kalimantan, (iv) Sulawesi, and (v) Other.

Table 3-8 seems to suggest that previous household expenditure (in 2008) and own and within-village average incomes (in 2009) would influence the poverty status of a household (in 2009) more in rural areas than in urban areas. This makes sense because income level is higher in urban areas than in rural areas. As long as income level is above the poverty line, a higher income does not matter for the poverty status of a household. In terms of the estimated program impact of free medical services, we find positive and statistically significant coefficient estimates only for rural areas. Because it is unlikely that the actual impact of receiving free medical services in 2008 on the probability of being poor in 2009 is positive (i.e. free medical services increased the incidence of poverty) only in rural areas, this difference in the estimated coefficients would be because the distribution of free medical services was more pro-poor in rural areas than in urban areas. A similar conjecture is made based on the comparison of the magnitude of the coefficient on RASKIN between urban and rural areas. The magnitudes of the coefficient estimates are always larger in rural than in urban areas. This would imply that the distribution of RASKIN was more pro-poor in rural areas than in urban areas. Table 3-9 shows no clear differences in the coefficient estimates between the Java and non-Java regions.

Table 3-6 The Impact of Participation in the Social Safety Net or Poverty Alleviation Programs on Household Consumption, by Urban/Rural Separately
 (Dependent variable: Change in log real per capita consumption between 2008 and 2009)

Independent Variable	A		B		C	
	Urban	Rural	Urban	Rural	Urban	Rural
Change in income between 2008 and 2009						
Change in log real per-capita income			0.182***	0.135***	0.179***	0.128***
Village cluster of mean change in log real p/c income					0.023*	0.028***
Previous Participation in social safety net programs:						
raskin08 (d)	0.009	0.009*	0.065***	0.050***	0.066***	0.052***
medical08 (d)	-0.018**	0.004	-0.008	0.004	-0.008	0.004
govcredit08 (d)	-0.061**	-0.052***	-0.069**	-0.078***	-0.069**	-0.078***
Adj.R-squared	0.024	0.017	0.113	0.084	0.113	0.085
Number of observations	26,133	39,106	18,903	16,580	18,903	16,580

* p<0.05, ** p<0.01, *** p<0.001; (d) denotes a dummy variable.

The same set of control variables are used as before, but the coefficient estimates are not shown to save space.

Source: BPS Panel 2008-2009

Table 3-7 The Impact of Participation in the Social Safety Net or Poverty Alleviation Programs on Household Consumption, by Java/non-Java Separately
(Dependent variable: Change in log real per capita consumption between 2008 and 2009)

Independent Variable	A		B		C	
	Java	Non-Java	Java	Non-Java	Java	Non-Java
Change in income between 2008 and 2009						
Change in log real per-capita income			0.154***	0.160***	0.148***	0.159***
Village cluster of mean change in log real p/c income					0.036***	0.003
Previous Participation in social safety net programs:						
raskin08 (d)	0.013**	0.005	0.062***	0.054***	0.064***	0.054***
medical08 (d)	-0.020***	0.008	-0.027***	0.021**	-0.027***	0.021**
govcredit08 (d)	-0.063***	-0.046**	-0.078***	-0.070**	-0.078***	-0.070**
Adj.R-squared	0.014	0.023	0.091	0.105	0.091	0.105
Number of observations	29,757	35,482	17,925	17,558	17,925	17,558

* p<0.05, ** p<0.01, *** p<0.001; (d) denotes a dummy variable.

The same set of control variables are used as before, but the coefficient estimates are not shown to save space.

Source: BPS Panel 2008-2009

Table 3-8 Probability (Marginal Effect) of a Household to be Poor, by Urban/Rural Separately
 (Dependent variable: Dummy of being poor 2009)
 Probit Model

Independent Variable	A		B		C	
	Urban	Rural	Urban	Rural	Urban	Rural
Previous consumption and current income						
Log real per-capita consumption 08	-0.077***	-0.184***	-0.046***	-0.131***	-0.045***	-0.130***
log real per-capita income 09			-0.020***	-0.049***	-0.019***	-0.045***
Village cluster of mean log real p/c income 09					-0.010***	-0.015***
Previous participation in social safety net programs:						
raskin08 (d)	0.014***	0.024***	0.013***	0.025***	0.013***	0.026***
medical08 (d)	0.003	0.012***	0.002	0.014***	0.002	0.014***
govcredit08 (d)	-0.008	0.013	-0.003	0.015	-0.003	0.015
Number of observations	26,133	39,106	21,119	21,933	21,119	21,933

* p<0.05, ** p<0.01, *** p<0.001; (d) denotes a dummy variable.

The same set of control variables are used as before, but the coefficient estimates are not shown to save space.

Source: BPS Panel 2008-2009

Table 3-9 Probability (Marginal Effect) of a Household to be Poor, by Java/non-Java Separately
 (Dependent variable: Dummy of being poor 2009)
 Probit Model

Independent Variable	A		B		C	
	Java	Non-Java	Java	Non-Java	Java	Non-Java
Previous consumption and current income						
Log real per-capita consumption 08	-0.142***	-0.131***	-0.097***	-0.074***	-0.096***	-0.073***
log real per-capita income 09			-0.035***	-0.033***	-0.033***	-0.031***
Village cluster of mean log real p/c income 09					-0.013***	-0.010***
Previous participation in social safety net programs:						
raskin08 (d)	0.026***	0.016***	0.023***	0.016***	0.022***	0.017***
medical08 (d)	0.008**	0.008**	0.009***	0.006**	0.009***	0.006**
govcredit08 (d)	0.003	0.001	0.009	-0.005	0.009	-0.005
Number of observations	29,757	35,482	21,172	21,880	21,172	21,880

* p<0.05, ** p<0.01, *** p<0.001; (d) denotes a dummy variable.

The same set of control variables are used as before, but the coefficient estimates are not shown to save space.

Source: BPS Panel 2008-2009

3-2-1-5 Policy Implications

In this section, a quantitative analysis has been made in order to examine the distributions of the three SSN or poverty alleviation programs (RASKIN, free medical services, and government loans), the transitions of poverty households, and the impacts of the SSN or poverty alleviation programs on household welfare and the probability of poverty, using data from the SUSENAS surveys 2008 and 2009. The most recent financial and economic shock originated in the US in September 2008 and spread to the rest of the world. We were particularly interested in whether the most recent shock negatively affected the Indonesian economy, in particular the poor and the near-poor, and if so, whether the SSN or poverty-reduction programs were effective in alleviating the shock felt by the poor and the near-poor.

First, analysis has been made whether the distribution of each of the three SSN or poverty alleviation programs (RASKIN, free medical services, and government loans) was pro-poor or not. The analysis suggests that the distributions of RASKIN and free medical services were pro-poor and the distribution of government loans was not pro-poor. Of course, this does not imply the advantage of RASKIN and free medical services over government loans as a SSN or poverty alleviation program. However, it is true that the beneficiaries of government loans are more likely to be the non-poor than the poor.

Next, it has been confirmed that a large part of poverty in Indonesia was characterized by transitory poverty. Previous studies repeatedly found this and our findings are consistent with previous studies in this respect. Further, we found that the incidence of poverty declined between 2008 and 2009. This finding is consistent with the declining trend in national poverty as well as positive economic growth between 2008 and 2009 despite the on-going economic crisis in other parts of the world. This seems to suggest that the Indonesian economy was much less affected by the most recent economic crisis than by the previous crisis starting in 1997.

Finally, the impacts of the three SSN or poverty alleviation programs (RASKIN, free medical services, and government loans) on household welfare and the probability of poverty have been examined. However, the econometric models seemed to suffer from some empirical problems of estimation. Thus, we did not interpret the results from the model estimation as they were. Furthermore, in order to explore possible regional differences, we estimated the program impacts separately for: (i) urban/rural areas; and (ii) Java/non-Java areas. Evidence suggests that the distributions of RASKIN and free medical services were more pro-poor in rural areas than in urban areas.

3-2-2 Qualitative Evaluation (Participatory Poverty Assessment)

3-2-2-1 Objectives of PPA

The nature of poverty cannot be fully understood without a thorough knowledge of the perceptions of the poor themselves. Following the seminal work of Robert Chambers in early nineties, perceptions of the poor have been recognized as important elements for poverty diagnostics and analysis. Furthermore, these perceptions are also deemed pivotal to program implementation as well as monitoring and evaluations. Perceptions are obtained from the poor themselves reflect micro-level issues such as the characteristics of poverty, actual problems faced by the poor, and perceived solutions to poverty. It is natural for perceptions to be very subjective since they also reflect the particular socio-economic conditions faced by the poor, which may be different from one location to the next.

Relevant perceptions are not only from poor households and individuals but also from local governments (village or sub-districts), public service providers (local public health service, teachers), as well as local public figures. All of them can contribute to a more elaborative understanding of the nature of poverty and how it can be best alleviated in the particular area.

All of those perceptions are best collected through a Participatory Poverty Assessment (PPA), which places people, especially poor families, at the center of poverty problems, and as the best source for learning about poverty. PPA looks at poverty from the perspectives of the poor individuals and poor families. PPA is recognized as one of best approaches for identifying different perceptions of poverty status, identifying the multidimensional causes of poverty, exploring the perceived solutions to poverty, especially how to cope with “economic crisis”, and evaluating the effectiveness of various anti-poverty program that have been launched by the government and would be of great importance for policy makers in formulating the anti-poverty policies.

For this study, a PPA was conducted in October 2009. Twelve villages were chosen in two provinces; West Java (eight villages) and South Sulawesi (four villages). The locations were chosen from a list obtained from the 2007 Sub-district Development Program of PNPM (PNPM-PPK), and 2007 Urban Sub-District Development Program of PNPM (PNPM-P2KP), a list of urban locations of PNPM 2008, and a list of rural villages of PNPM-PPK 2008. The villages were chosen using criteria such as the different poverty phenomena based on the geographic locations and anticipated causes, the different characteristics of rural and urban areas, any specific areas having specific problems, and a representative sample of the area having similarity in the poverty characteristics. The list of visited villages is presented in the table below.

Table 3-10 List of Visited Villages in the West Java and South Sulawesi

No	Province District Subdistrict	Villages (Kelurahan / Desa)	Area Information				
			Area Characteristic	Livelihood	Accessibility	% Poor	Urban/ Rural
1	West Java Bekasi Cabangbungin	Jaya Bakti	Land area. Plain topography	Agriculture, fishermen/ fishpond	Located north of Bekasi, close to sea (behind one village, public transport available.	34,8% at Sub district	Rural
2	West Java Cianjur Sukanagara	Sukanagara	Plain topography on hill	Agriculture	Close to Bogor, located in the middle of Cianjur regency, public transport available	39,8% at Sub district	Rural
3	West Java Cirebon Gegesik	Gegesik Kulon	Land area. Plain topography	Agriculture and plantation	Located in the northwest area of Cirebon, northern coast lane, public transport available.	55,5% at Sub district	Rural
4	West Java Purwakarta Maniis	Pasirjambu	Hilly topography	Agriculture /cultivation field	Southwest area of Purwakarta, close to Plered, public transport available	35,8% at Sub district	Rural
5	West Java Bogor Tajurhalang	Nangerang	Land area. Plain topography	Agriculture, labor, and fishery	Located north of Bogor city, less than 30 minutes from Bogong Gede railway station, public transport available	66,69% at Village	Urban
6	West Java Bandung Majalaya	Neglasari	Land area. Plain topography	Textile industry	Located southeast of Bandung, public transport available	81,49% at Village	Urban
7	West Java Tasikmalaya Sukarame	Padasuka	Hilly topography	Agriculture	Adjacent to Tasikmalaya city at the south/ southwest area, public transport available	83,59% At Village	Urban
8	West Java Garut Karangpawitan	Lengkongjaya	Land area. Plain topography	Agriculture	Close to Garut city in the direction to Tasikmalaya/Cibat, public transport available	65,04% at Village	Urban
9	South Sulawesi Jeneponto Tamalatea	Manjang Loe	Hilly topography	Small industries	Located at the west end of South Suawesi, public transport available	48,1% at Sub district	Rural
10	South Sulawesi Bulukumba Kajang	Batuninglampung	Coastal area	Tourism and fishery	Located about 200 km from Makassar city, public transport available	26,1% at Sub district	Rural
11	South Sulawesi Maros Turikale	Raya	Land area. Plain topography	Agriculture	Public transport available	76,61% at Village	Urban
12	South Sulawesi Gowa Somba Opu	Kalegowa	Land area. Plain topography	Animal husbandry	Located 9 km from Makassar city, public transport available	72,21% at Village	Urban

Source: PPA Report

Perceptions were obtained through several activities during the PPA. The focus group discussion (FGD) was conducted twice in each village. The first was with the village apparatus, basic service providers and civic leader participants. The second was with the selected 15-20 poor households. While FGDs will bring up group perceptions, it is also important to obtain more individualistic perceptions on different issues. These perceptions are obtained during in-depth interview sessions conducted with FGD participants. Many important perceptions obtained in the FGDs and interviews were cross-checked with secondary data review and case studies. Another important activity during the PPA was direct observation through the transect walks.

The PPA fieldwork at eight (8) villages in West Java and four (4) villages in South Sulawesi were conducted by six (6) teams of facilitators. Each team consisted of three (3) facilitators who conducted the

PPA at two (2) villages. The PPAs at villages were conducted from October 7th through October 16th, 2009. The results of the PPA for each site and their synthesis are presented in *the Final Report of Participatory Poverty Assessment Volume 1 and 2*.

3-2-2-2 Indicators of Poverty

Based on the results of the FGD with the community leaders and representatives, and clarified at the FGD with the poor group, the characteristics used as indicators to identify the welfare and poverty conditions at eight villages in West Java and four villages in South Sulawesi were found to be similar. Those characteristics include the type of housing, ownership of natural resource such as land, paddy fields, plantations, fish ponds, cattle, asset ownership, occupation type, sum of income, access to health care, access to education for children, access to clean water and sanitation, and daily meal patterns. The complete criteria and indicators of poverty forwarded by FGDs in West Java and Sulawesi can be found in the table below.

Table 3-11 Criteria and Indicators of Poverty from PPA in West Java and South Sulawesi.

Criteria	West Java	South Sulawesi
Type of house owned	-Small, half masonry and half bamboo or wooden board wall, earth floor or stage -No house ownership, stay at someone's house -A few people have old TV set	-Bamboo or wooden hut of 5x7m ² , <i>nipah</i> , <i>lontar</i> or <i>rumbia</i> roof, earth/bamboo/wooden board floor -No house ownership, rent house, having house at someone's land, or stay at relative's house
Ownership of land, paddy field, plantation, fish pond, cattle	-No ownership -Some own few chicken and ducks -Some take care someone's sheep with profit sharing	-No ownership -Cultivate someone's farm, take care of someone's cattle
Ownership of vehicle	-No ownership -Some own bicycle -Some own old motor cycle	-No vehicle ownership
Occupation	-Farming coolie, construction worker, factory worker, waste recycling collector -Cultivating farm -Unemployed	-Farm coolie, carrying worker, sand quarry worker, factory worker, washing worker, tricycle worker
Income	-Rp.15,000-Rp.30,000/day sporadic -No income	-No fixed earning, wage below Minimum Regional Wage (UMR) -IDR150,000 - IDR 500,000/month -IDR15,000 – IDR 20,000/day
Health Care	-Community Health Center with PUSKESMAS -Not able to buy medicine even from shop, use traditional herbal medicine -Vulnerable to illness due to bad nutrition	-Community Health Center with JAMKESMAS, Community Health Center Branch (PUSTU) -Indigenous medical practitioner (dukun)
Child Education	-Elementary schools maximum	-Maximum elementary school
Access to Clean Water and Sanitation	-From dug well -No toilet/WC, waste feces at paddy field, or river -Public bath, wash and toilet -Buy clean/drinking water from water trader	-Waste feces at the farm or other place -Slum environment -People at a certain place need to get clean water by walking 2 km away
Meal Pattern	-Twice a day with vegetables and once at farm -Once a day with insufficient nutrition	-Once to three times a day, rice with instant noodle or any meals -Some places eat rice mixed with corn or corn only, with fish and vegetables
Others	-Old, disable -Not able to buy clothes/dress -A lot of debt at shops or unable to get credit -Many children -Receiving donation	-Own nothing, no waste basket/place, narrow mind set no strategic vision -Electricity from neighbor -Buy clothes/dress once a year under IDR 100,000 -No saving

Source: PPA Report

It is important to acknowledge here that the indicators and characteristics of poverty forwarded by the FGD participants are part of the indicators used by the BPS as has been described in previous chapter.

3-2-2-3 Welfare Change

The PPA also asked of the perceptions regarding the perceived welfare changes. In particular, the FGD tried to compare current conditions with those of ten years ago. The results show that 9 out of 12 visited villages felt an increasing trend of welfare conditions from 1999 to 2009, while three others felt a deprived of welfare (as can be seen from Figure 3-2). Several factors have influenced these trends. Facilities and infrastructures such as road, education, water and sanitation, health, communication, irrigation have become the most visible indicators of welfare change. In addition, livelihood variable such as employment opportunity, prices of nine basic necessities (sembilan bahan pokok- SEMBAKO), farm ownership, and wage of workers have become important factors affecting welfare changes.

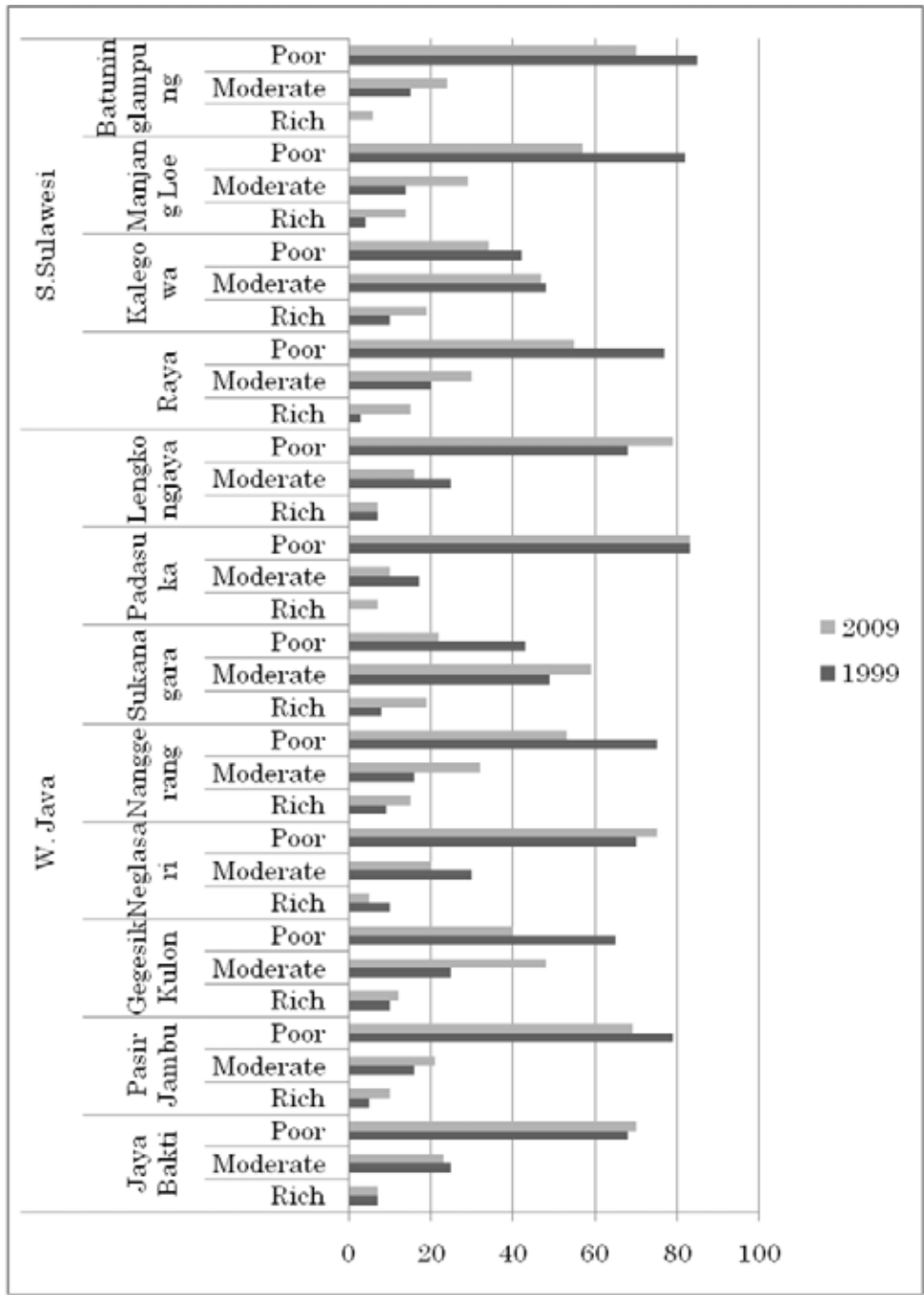


Figure 3-2 Welfare Change in the Villages (West Java and South Sulawesi)
Source: PPA Report

Among the factors that result in the deprivation of welfare, deteriorated irrigation water systems, water pollution, and difficult access to fertilizer have been recognized as important determinants of a downward shift in welfare as this reduces farm income. Another cause is the negative externality from one of the most beneficial government programs, which is the conversion of kerosene to gas, has made some kerosene sellers lose their livelihood as demand for kerosene sharply decrease. Dividing land ownership among children and business bankruptcy are also a source of welfare deprivation.

On the other hand, working as migrant workers has been recognized as a faster way to increase welfare. Nevertheless, some villagers mentioned this livelihood as a risky job as some households may be broken apart as a result from either the husband or the wife working for long periods outside of the home.

Infrastructure improvement such as access to markets and irrigation, and the utilization of new methods for fishing and cultivation are positively correlated with welfare

Based on the result from PPA, the communities were not significantly affected by the recent global crisis as shown by the fact that the proportions of households in each welfare category (as shown in above figures: rich, moderate, and poor) in each village in 2009 is similar to that of 2008.

3-2-2-4 Causes and Effects of Poverty

Poverty correlates with many socio-economic factors such as health, education, income, and infrastructure, which are all interconnected. As such, to identify which of those factors serve as the causes and which of those as the effects may not be straightforward. On the other hand, understanding about the causes and effects constitutes an important knowledge basis for policy formulation. Communities often have difficulty in differentiating causes and effects so that the two are used interchangeably. For example, an effect of poverty is ill health due to poor nutrition, overwork, and the inability to afford medical treatment. In turn, ill-health causes poverty as the ability to work productively is compromised and medical expenses drain limited household finances.

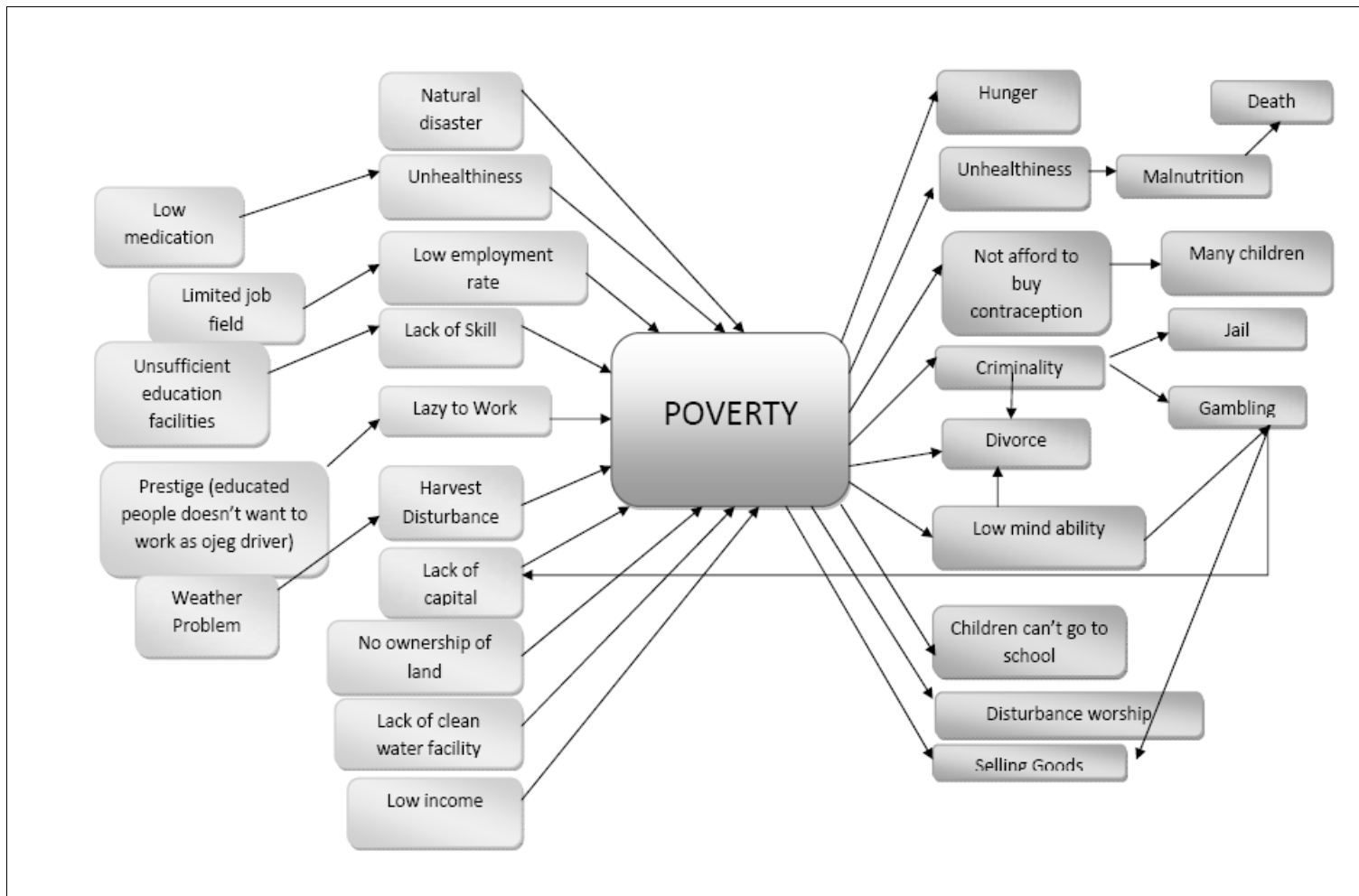


Figure 3-3 Causes and Effects of Poverty

Source: PPA Report

FGD and cause and effect diagrams were used to analyze the relationships of influencing factors on participants' lives. Figure 3-3 shows the perception of the community member, particularly the poor one, on cause and effects of poverty in one of the villages visited. Based on the FGDs and confirmed by in-depth interviews and the observations at the researched villages in West Java and South Sulawesi, the causes of poverty include the groups of deficiencies in education and skills, employment opportunities, health care, land ownership, willingness to work, business capital, land fertility, facilities and infrastructures, gender equity, and family planning. The effects of poverty include the fact that children cannot go to school, and family has insufficient and irregular meals patterns³⁴ and food availability, and frequent illness occurs among family members.

3-2-2-5 Importance and Closeness of Institutions to Community

There are many institutions and programs within the villages, which are intended to provide benefits to the communities. During the FGDs, cross-checking was done using in-depth interviews, transect walks and other sources of information, the benefit of the institutions and programs at the village were assessed from the perception of the participants of FGDs. The institutions were measured in terms of their importance and closeness from the opinion of the FGD participants.

The closeness level of an institution with the community was determined based on the community experience in interacting with the institution. A narrow definition of institution is used herein as institution may represent a board, organization, or even an individual who has an important role in the community. The ease with which a community accesses a service from an institution indicates its closeness to the community. In some villages, village offices and heads of the village are recognized as institutions that are both close and important for the community.

3-2-2-6 Benefits of Programs to the Community

The PPA also asked for opinions concerning the government's anti-poverty programs. In particular, the FGD explored which programs were felt to be the most and least beneficial to the poor. The programs commonly felt most beneficial by FGD participants at several villages in West Java were RASKIN, BLT, PNPM/ Program Penanggulangan Kemiskinan Perkotaan (P2KP or UPP), and JAMKESMAS. The program commonly felt less beneficial by FGD participants at several villages in West Java was BLT. The benefits of a program may be felt differently by different participants at the same FGD within the same village. For example, BLT was felt most beneficial by certain participants as well as felt less beneficial by other participants at the same FGD within the same village. The opinions of the participants were dependent upon their conditions for the BLT; whether they received it or not. Not all BLTs were distributed properly. The programs commonly felt most beneficial by FGD participants at several (3-4) villages in South Sulawesi are RASKIN, BLT, JAMKESMAS, and PNPM/P2KP. Every program written above was felt less beneficial by at least one village in South Sulawesi.

An important finding concerning BLT was that the program came up when FGD participants are asked which program they think of as the most beneficial; but also receive the most answers when the participants were asked which program they think is the least beneficial. That fact reflects the on-going debate about the effectiveness of BLT. The fact that BLT in principle raises consumption rather than production (or productivity) of the poor may be the reason why some think that the program is of least benefit to PA.

³⁴ Irregular meal patterns refer to the condition of household that may have three meals yesterday, but only twice today.

3-2-2-7 Experiment on Individual Behavior on Group Lending Practice

An experiment that replicates the group lending mechanism was conducted in each of the visited villages. The main objective of the experimental game was to observe the behavior of the people in credit repayments when they are localized in groups, and to test whether social capital would affect the outcome of credit repayment. Another important objective of the game was to make the respondents participate in a group lending environments so that they would learn the principal idea of group lending mechanisms. This second objective is particularly important for villages that had never heard about group lending previously.

In the game, participants were given a small amount of credit with no collateral needed, the only thing they were asked to do was to form a small group that will repay their debt as a group. Participants will decide whether they will repay their credit or not, however in the case that one member of the group fails to fulfill its duty in paying the debt, the other member of the group should compensate the loss. Such loss will be shared evenly among all member of the group. There are several rounds in the game and the participants were asked to repay their debt in small amounts of money in each round. In each installment, different rules were implemented, such as participants may communicate with other member of group or not and the name of the one who fail to pay the debt would have to be announced or kept secret.

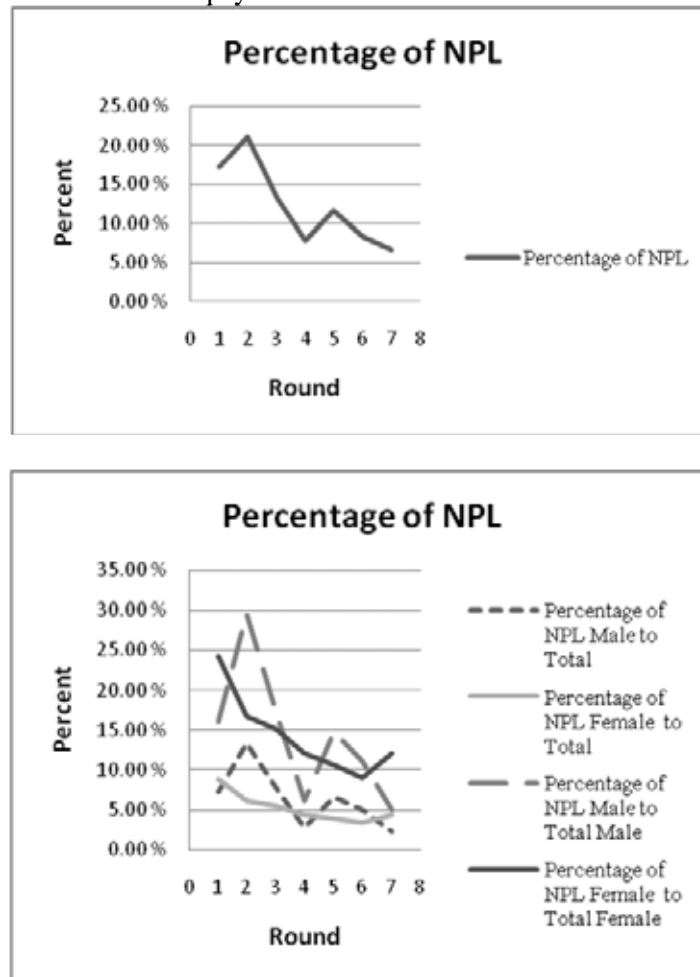


Figure 3-4 The Percentage of Non Performing Loans in Each Round Total and By Gender

Source: JICA Study Team

As shown in the figure above, the non-performing loan (NPL) in each installment is different, showing that there is a correlation between the different rules in each installment with the outcome of the NPL.

Lessons that are drawn from the micro credit game is that it is highly suspected that changing the rules of the game to incorporate different types of social relations will also change credit repayment behavior and it should be noted that men and women might respond to the same rules differently and that men are more responsive to the changing rules. Second, and most importantly, is the observation that social sanctions apparently can play a significant role in reducing non performing loans.

This study has set groundwork for a study on group lending practice in Indonesia in search of the feasible model of group lending practice. Nevertheless, this study on group lending behavior using a micro credit game is subject to considerable bias, thus this research is not intended for a generalization of all micro credit borrowers in Indonesia.

3-2-2-8 Policy Implications

Based on above results of the PPA at twelve villages in West Java and South Sulawesi, some policy implications and lessons have been drawn:

1. It is important that the government reviews the indicators of poverty from time to time to ensure that the official indicators conform with people's perceptions. The PPA shows that the currently used official indicators, both the expenditure-based as well as proxy means indicators, are still relatively close to what are deemed as poor conditions by the people.
2. The national government and the local governments need to plan and implement poverty eradication programs based on the local poverty and needs assessments. Local economic development will create jobs for various degrees of skills and education levels, which will provide the required income to village population allowing a higher quality of life. Public services should be provided to maintain the productive conditions of the village population including health care, education, water and sanitation, roads, communication, basic needs availability, as well as other necessities. The education and skills of the people also need to be improved. The PPA shows that priority areas for poverty reduction intervention includes the development of feeder roads, primary health care, and the improvement of agriculture to increase productivity, water, and sanitation, all depending on the local conditions.
3. While it is clear that poverty needs to be alleviated by promoting income-generating activities, PPA also shows the need for livelihood assistance. This assistance should be provided for a limited period of time (i.e. through BLT and RASKIN) or through JAMKESMAS, PKH, and PNPM for longer term assistance and empowerment.
4. It is important for the Government to conduct more careful research on the behavior of micro credit borrowers in Indonesia. A better tool for isolating possible bias with a better statistical representation is needed to study group lending practices. This is important as the Government will use PNPM as an important program for poverty alleviation.

Case Study 3: From the Lessons of Social Protection in Cambodia

Traditional Social Safety Nets

Similar to most of South East Asia, Cambodia possesses a largely familial and community-based, traditional SSN structure utilizing primarily social capital and in-kind-assistance.³⁵ Customarily, and currently, the majority of Cambodian families reside with extended family (typically including parents, siblings, grandchildren, and in-law wives) or within direct proximity of family relations. Family resources are pooled collectively for expenses, and often use a revolving support system for capital and human capital investments wherein one family member receives support for, per se, technical schooling for two years by all other family members, and upon completion would be liable to provide substantial support for the next family member in line for their education.

Much redistribution of wealth within the traditional setting occurs in a form similar to, yet distinct from, begging. In a traditional sense, it is considered acceptable for individuals in the community to make known certain hardships and for better-off individuals to provide some level of monetary or in-kind support. The beneficiary then provides a traditional display of thanks and a blessing based on Buddhist customs. It is important to note that in the Cambodian context, the role of Theravada Buddhism, and social and familial interactions cannot be disentangled. Together they form a double tiered, reinforcing mechanism for traditional social support.

Traditional Familial Support of the Elderly

Support of the elderly within Cambodia, not surprisingly, is based largely on the familial structure. Elderly family members continue to reside with extended family as described in the earlier section and, as such, are able to receive both care and necessities from working relations. Though no official pension system exists in the traditional structure, children and relations are encouraged to provide monthly payments similar to a tithe, and, in turn, the elderly family member provides a prayer and blessing upon the individual or couple. In this manner, children and direct relatives of elderly individuals provide a de facto pension through monthly tithing to the elderly in the family unit.

Traditional Support of Extended Family

While the familial unit as described provides a great deal of social security for individual members, it is prone to disruption by economic and social shocks. Should a familial unit be unable to sustain itself due to some type of external or internal shock, in effect breaking the first level traditional SSN, the obligation of assistance falls upon extended relatives and their corresponding familial units.³⁶ This assistance has many forms in the traditional context from direct financial or in-kind assistance to the semi-adoption of children out of one familial unit and into another distantly related, financially stable familial unit, and by doing so reducing the burden on the distressed family. Should conditions change, the child would return to his/her original family.

Traditional Support by Religious Institutions

Under the traditional Cambodian social structure, should both familial and extended family SSN fail, the final assistance alternative lay within the Buddhist pagoda. Should a family be unable to support a child and no relatives are able to assist in that child's rearing, the local Buddhist pagoda would arrange for the child's acceptance as an initiate within that or another pagoda. Similarly, should a child be orphaned,

³⁵ Chanphal, N. (2009). "Developing Effective and Affordable Social Safety Nets for Cambodia." Council for Agricultural and Rural Development. Phnom Penh, Cambodia, Ministry of Interior.

³⁶ Damme, W. V. (2004). "Out-of-Pocket Health Expenditure and Debt in Poor Households: evidence from Cambodia." *Tropical Medicine and International Health*. 9(1): 273-280.

the local pagoda would take in the child and rear him in the same manner. For the elderly, a widow class of monks existed within the pagoda with the primary task of caring for the initiates and the facilities. Should a widow fall upon hard times and not have the support of family or extended family, traditionally the option of entering the pagoda existed.

Collapse of Traditional Support Structure

With the rule of the Khmer Rouge and the Pol Pot Regime from 1975 to 1978, the traditional Cambodian support structure for the most part ceased to exist. This collapse was largely the result of the Pol Pot Regimes direct efforts to breakdown the familial structure by relocating family members to differing regions and linguistic efforts to alter the Khmer language to eliminate all familial and status based pronouns and references.³⁷ The final blow to the preexisting traditional SSN structure came with the emptying of the Pagodas and elimination of the time honored Khmer Theravada Buddhist system, which formed the backbone of Khmer society. At the time of the Vietnamese invasion in 1978, little of the traditional social infrastructure remained with the spreading of individuals, irrespective of family ties, across the country and globe, and roughly 20% of the population succumbed in the process.³⁸ Alternative social protection institutions were instituted during the Vietnamese occupation though these largely ceased to exist by the mid 1990s due to decreases in the financial support of socialist nations for such institutions. With the return to stability over the past decade, elements of traditional society are reinstating themselves and traditional support structures are beginning to reemerge.

Current Demographics

Poverty Rates and Vulnerabilities

Due to various insufficiencies in available data concerning poverty in Cambodia, data sets and surveys concerning poverty rates and distribution in Cambodia only date up to 2004. Despite this limitation, the data does present a picture of the Cambodian situation and context that fits with anecdotal evidence seen at present. Per the last official record, the Cambodian poverty rate, defined as individuals at or below the poverty line of KHR 1,826 per person per day (KHR 9,130 per day for a family of five) or about USD 0.45 per person per day (or USD 2.25 per day for a family of five) at 2004 exchange rates, stood at 35% of the population.³⁹

Based on the 2004 per capita household consumption data, a substantial proportion of the population is clustered near the poverty line, as shown in Figure 3-5 below. Nearly 7% of households are within the 10% above the poverty line segment, meaning that, with only a 10% decline in income, the poverty rate would increase from 35% to 42%. Sadly, data concerning the dynamics of risk and vulnerability in Cambodia is severely limited, complicating any efforts to identify and assist this at risk segment.⁴⁰

³⁷ World Bank (2006). "Managing Risk and Vulnerability in Cambodia: An assessment and strategy for social protection." The World Bank Reports. June, 2006

³⁸ Chanphal, N., loc.cit.

³⁹ World Bank, loc.cit.

⁴⁰ *ibid*

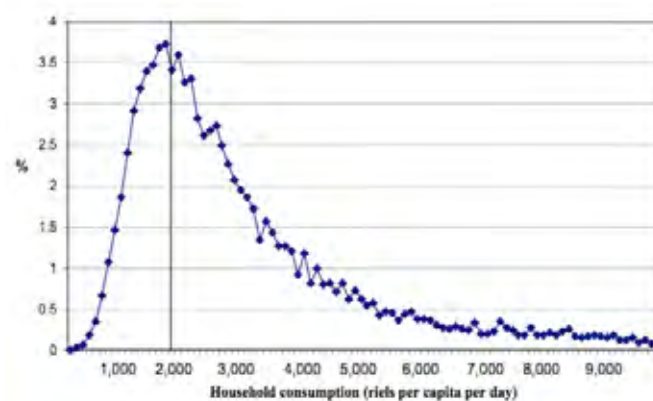


Figure 3-5 Distribution of Household Consumption 2004

Source: National Institute of Statistics Cambodia

Geographical Distribution

While the urban regions of Cambodia have witnessed significant development over the last 15 years, this has done little for the majority of the country’s poor as approximately 94% of those categorized as poor live outside of urban centers and suburbs, and mainly within rural regions far removed from urban infrastructure and support systems.⁴¹ With the vast majority of this 94% involved in single-income subsistence agriculture activities, little gain has been seen by the segment despite GDP growth and urban development. This fact, in turn, accounts for growing inequality with the nation’s Gini Coefficient rising from its 1990s average of 0.35 to 0.42 in 2004. Moreover, experiences in the intermittent years between the 2004 data and present have shown the population to be at risk of both idiosyncratic and covariant shocks, often pushing households below the poverty line status of Government Social Protection Efforts.

Social Protection under the Law

Under the Cambodian Constitution, promulgated in 1998, social protections for the population are clearly defined; including rights to healthcare, education, and pensions.⁴² Limitedly, some of these rights and obligations have been codified in a number of laws including the Labor Law, Insurance Law, and the Law on Social Security Schemes. Despite the revolutionary nature of these legal steps, in actual practice little improvement has been witnessed. One key cause of this outcome is the fact that the codified rights, to date, primarily relate to the formal wage labor sector, which comprises only 20% of the population. This is further compounded by the second issue, that being the fact that, to date, none of the codified rights have been enforced and that objects such as universal health access remain largely conceptual with no immediate plans for implementation.

Current Government Social Protection Efforts

Chapter 31 of the Cambodian Budget Implementation Plan pertains to “Social Interventions”, specifically pensions, scholarships, and assistance, which in 2003 comprised 10% of total expenditure or .71% of GDP. Moreover, the National Poverty Reduction Strategy made specific provisions for social protection in terms of action plans in the following areas: (i) social protection (USD 14 million), which covers areas such as labor inspections, prevention of substance abuse among juveniles, and vocational training for prisoners; (ii) social safety nets (USD 2 million), which involves the review and piloting of an employment guarantee scheme; and (iii) combating child labor and trafficking and child protection (USD

⁴¹ World Bank loc.cit.

⁴² Sotharith, C. (2008). "Urban Poverty and Social Safety Nets in Cambodia." Cambodian Institute for Cooperation and Peace. East Asian Development Network Regional Project on Urban Poverty and Social Safety Nets in East Asia 2008

26 million), which includes support to awareness raising programs in poor areas and promotion of law enforcement. Efforts towards these goals are made through governmental ministries, according to law primarily through the Ministry of Social Affairs, Veterans, and Youth Rehabilitation (MOSVY) and the Ministry of Labor and Vocational Training (MLV). However, in practice, Chapter 31 falls far below the levels stipulated under the Budget Law for the vast majority of ministries, with gross over representation of the Ministry of Economics and Finance (MoEF), and the Ministry of the Interior (MoI), which overran their stipulated budget allotments for Chapter 31 spending by 8063% and 438%, respectively, accounting for 61.5% of all national spending within that category. Moreover, the budget was recorded as exceeding the budgeted expenditure by USD 7 million in the 2003 recorded period. The budgeted spending for these ministries almost entirely correlates to required allocations to programs run out of other ministries (e.g. veterans' pensions are paid through funding provided by MoEF through the providing of funds under Chapter 31 to the Department of Veterans' Affairs, which then administers the funds), and, as such, if the spending past the budget allotment were to have been allocated to these projects, it would have been reflected in exceeding of allotments in the other administering ministries and departments, which is not the case. To date, no substantial explanation has been made for these overruns while the allocation of the funds classified under Chapter 31 for MoEF and MoI have been completely opaque with no details of the spending being available.⁴³

Of the Chapter 31 spending accounted for, the majority went towards the payment of civil servant pensions, and military pensions covering less than 15% of the Cambodian population.⁴⁴ The remainder of the spending in the category went mostly towards implementation and administration costs with some residuals being disbursed to vocational training programs though limitedly.

Leakages

The greatest set back encountered in the Cambodian governments' limited efforts in SSN implementation has originated from the overall issue of corruption within the bureaucratic and governmental system. Leakages, as they are referred to in this context, usually arise in disbursement situations through the inclusion of an informal broker in the payment process. This broker usually intercedes at some level of the administration of the assistance to expedite the delivery of the assistance to the final recipient. A typical example of such leakages can be found in the administering of veteran's pensions. As most retired soldiers live within rural regions, difficulties arise with pension a delivery, which takes place in urban or provincial seats that are often great distances from the recipient. Moreover, payments often are delayed resulting in the recipient needing to make multiple trips to the administration center before finally receiving payment. Due to distance, inconsistent delivery, and the fact that payments are made monthly, recipients often sell off their rights to such pension payments to officials within the administration who pay the recipient 50% of the yearly value upfront and then collect monthly payments on the recipients "behalf", pocketing that monthly amount. The official hired as a broker often plays a significant role in the processing of the payments, thus guaranteeing that greater delays and obstacles will occur if the recipient does not retain the official as a broker. Despite the widespread understanding of this leakage, no official actions have been made to address the issue.⁴⁵

Leakages of this nature exist within all levels of government implemented SSN structures, though the approaches vary between broker based leakages, as seen in the pension system, to leakages arising out of "unofficial" fees as seen within the hospitals and vocational training institutions for the poor. This issue in itself has had a crippling effect on most government programs leading to withdrawal of external support and non-participation by target populations.

⁴³ Chanphal, N., loc.cit.

⁴⁴ Chanphal, N., loc.cit.

⁴⁵ World Bank loc.cit.

Rectangular Strategy

The Cambodian Government's Rectangular Strategy, introduced after the formation of the new Government in July 2004, was a direct response to the inefficiencies and setbacks experienced in prior SSN implementations. The Strategy outlined the current Government's economic policy agenda during its remaining term in office. The strategy has been conceptualized as a structure of interlocking rectangles and sub-rectangles for major sectors, with the sub-rectangles most closely linked to social protection being: i) enhancement of agricultural sector; ii) private sector growth and employment; and iii) capacity building and human resource development. Within these areas, greater attention to the informal sector, land and family support as social protection mechanisms, health insurance for the poor, and increased rule of law to ensure equity in use of resources have been identified as important priorities. The RGC's policies implicitly recognize that social protection measures need to match with Cambodia's level of development, which may require greater initial emphasis on establishing basic social safety nets rather than on developing a full-fledged pension system, as an example. However, to date little tangible manifestations of this strategy have been seen with no programs to form any SSNs having come to fruition. Moreover, the crippling effect of leakages within the system remains unaddressed under the Rectangular Strategy, which in itself leads many to believe that even if implemented, the Rectangular Strategy would still experience the same crippling limitations as current SSN efforts though on a wider scale.⁴⁶

It is important to note, however, that though the Rectangular Strategy can be found to be lacking in practical implementation, it represents a sharp shift in the Cambodian Governments perception of SSN and government responsibility thereof. It is hoped that this will lead to greater involvement and consideration in the future.

Status of NGO Efforts

Role of NGOs in Cambodian Social Protection

Due the many inherent obstacles and limitations of the Government's efforts at SSN implementation, much of the country's social protection efforts have been made through external contribution and NGO programs and administration. Developmental assistance has continued to increase over the years of available data to the point where governmental expenditure is dwarfed by externally provided funds flowing into the NGO and aid system. As a result, many sectors, particularly the Health, and Social Development sectors, have come to be de facto NGO institutions with support and implementation having been largely left to the foreign aid community.⁴⁷ This in turn has led largely to estrangement of recipients from the process as NGO organizations are incentivized to respond to donors, and the government lacks the capacity to administer the sector and thus remains largely on the sidelines of project and service administration.

Coordination Issues and Limitations

Unlike governmentally administered programs, NGO administration has the inherent attribute of being segmented with a propensity for overlaps. This risk is evident throughout the Cambodian system with program overlaps occurring frequently within all sectors. Consequently, lessons are often learned individually by each organization leading to greater overall inefficiency and redundancy. Moreover, the majority of NGOs remain headquartered in the capital, Phnom Penh, resulting in most resources being provided in urban areas. This has resulted in insufficient health and social protection coverage in the rural regions with most services only reaching the well-off poor who have the means to go to urban areas when necessary; a common targeting setback.

⁴⁶ World Bank, loc.cit.

⁴⁷ Chanphal, N., loc.cit.

The Fungibility Effect

Due to the dominant efforts of NGOs and the role of foreign aid in most sectors, less pressure and accountability has been placed on government resources. This, as noted in the World Bank 2006 study, has led to increased fungibility of government resources, especially in health and social assistance areas, which does in part account for the cause of discrepancies in government budget allocation seen in the prior discussion of Chapter 31 spending. The influx of foreign aid can be said to have created this externality, which will likely further inhibit any future efforts to return the sectors to direct government administration.⁴⁸

⁴⁸ World Bank, loc.cit