LEMBAGA PENELITIAN
SMERU
RESEARCH INSTITUTE
TOWARDS PRO-POOR POLICY THROUGH RESEARCH

WORKING PAPER

Accelerating Poverty and Vulnerability Reduction: Trends, Opportunities, and Constraints

Asep Suryahadi

Umbu Reku Raya

Deswanto Marbun

Athia Yumna

australian volunteers international

MAY 2012

WORKING PAPER

Accelerating Poverty and Vulnerability Reduction: Trends, Opportunities, and Constraints

Asep Suryahadi

Umbu Reku Raya

Deswanto Marbun

Athia Yumna

Editors

Stephen Girschik

Mukti Mulyana

The SMERU Research Institute

Jakarta

May 2012

For further information on SMERU's publications, phone: 62-21-31936336; fax: 62-21-31930850; e-mail: smeru@smeru.or.id; or visit www.smeru.or.id.

Suryahadi, Asep

Accelerating Poverty and Vulnerability Reduction: Trends, Opportunities, and Constraints / Asep Suryahadi, Umbu Reku Raya, Deswanto Marbun, and Athia Yumna. -- Jakarta: SMERU Research Institute, 2012.

iii, 18 p. ; 30 cm. -- (SMERU Working Paper, May 2012)

ISBN 978-979-3872-94-0

1. Poverty

I. SMERU
II. Sim, Armand A.
III. Suryahadi, Asep

362.5/DDC 22

ABSTRACT

Accelerating Poverty and Vulnerability Reduction: Trends, Opportunities, and Constraints

Asep Suryahadi, Umbu Reku Raya, Deswanto Marbun, and Athia Yumna[1]

Despite progress in poverty reduction during the last four decades, Indonesia is still plagued by a high rate of multidimensional poverty and deprivation. The 2009 monetary poverty rate of 14.15% is 5.95 percentage points higher than the government's initial target, while, in other dimensions of poverty, Indonesia lags behind its neighbors. There are opportunities for accelerating poverty reduction in the future by virtue of globalization, demographic dividend, adoption of participatory development approaches, and support from international commitments on the millennium development goals (MDGs). On the other hand, there are critical constraints to reducing poverty and vulnerability in the form of insufficient productive opportunities, weak human capabilities, and inadequate social protection. The strategy for accelerating poverty and vulnerability reduction is to capitalize on opportunities and at the same time effectively address the critical constraints. The current policy objective is to enhance human and nonhuman capital accumulation of the poor to empower them to move out of poverty, while at the same time strengthening the capacity of the near-poor to avoid falling into poverty.

Keywords: poverty constraints, poverty trends, vulnerability reduction

---

[1]Corresponding author: Asep Suryahadi, The SMERU Research Institute, Jl. Cikini Raya No. 10A, Jakarta Pusat 10330, Indonesia; phone: +62-21-31936336; fax: +62-21-31930850; email: suryahadi@smeru.or.id.

This working paper was presented at the Indonesia Update conference at the Australian National University in September 2010. The paper was revised for publication in the book "Employment, Living Standards and Poverty in Contemporary Indonesia" (ISEAS and ANU, 2011). Part of the research for this paper was conducted when the authors were working on an assignment for the Asian Development Bank's RETA No. TA 6397 (REG): Strengthening Country Diagnosis and Analysis of Binding Development Constraints for Selected DMCs. We would like to thank Armand Sim for his assistance on the poverty profiles. We are also grateful to Chris Manning, Sudarno Sumarto, and all conference participants who provided comments and suggestions.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

I. BACKGROUND

Before the onset of the Asian financial crisis in 1997, the Indonesian economy grew rapidly and, as a result of this, poverty was reduced significantly. Other welfare indicators—such as Infant Mortality Rate (IMR), school enrollment ratios, and life expectancy at birth—also improved. However, the Asian financial crisis that engulfed Indonesia during 1997–98, reversed this trend in social improvements, which became particularly apparent in the large increase in poverty in 1999.

The social safety net (JPS) program covering food, education, health, and employment was launched in mid-1998 with the aim of alleviating the negative social impact of the financial crisis. Some components of the JPS program continue today with some changes in their design and targets, and have become the major poverty reduction programs in Indonesia. These programs, together with general economic growth and sectoral development, have contributed to the reduction in the poverty rate observed during the last decade. The poverty rate has decreased from a peak of 23.4% during the crisis in 1999 to 13.3% in 2010.

However, the amount of the population who are poor will more than double if the people who are still vulnerable to falling into poverty are taken into account. Due to these "near-poor" people having per capita household expenditure that is only slightly above the poverty line, they are easily pushed into poverty when negative shocks occur.

In 2008, for example, 15.4% of the population lived below the national poverty line; however, 42.6% of the population lived below the international poverty line of PPP US$2 per capita per day in the same year. This means that 27.2% of the Indonesian population lived above the national poverty line but below the PPP US$2 international poverty line.

These people are vulnerable to falling below the poverty line due to various shocks, such as: job loss, business bankruptcy, crop failure, illness, accidents, natural disasters, social conflict, and other calamities. Social protection is needed to cover these people from the risks of falling into poverty by providing them with the security to access basic services such as food, education, and health.

Another distinct feature of poverty in Indonesia is that while there has been significant progress in reducing monetary poverty, Indonesia still lags behind its neighbors in reducing other dimensions of poverty. Compared to other Southeast Asian countries, Indonesia has relatively low-quality human resources in terms of education and health indicators. More than 50% of the labor force has only a primary school education or less and the country has high rates of infant and maternal mortality.

In addition to this, the distribution of poverty across population groups and regions is unequal. Seven out of ten provinces with the highest incidences of monetary poverty are located in eastern Indonesia, although in terms of the absolute number, most of the poor reside in Java and several provinces in Sumatra. Likewise, there is inequitable access to education, health, clean water, and sanitation across the population, and within groups and regions, indicating the existence of a welfare gap.

The objective of this paper is to analyze the profile and trends of multidimensional poverty and vulnerability in Indonesia and to identify the opportunities and constraints to reducing it. The rest of this paper is organized as follows: Section 2 discusses the trends in multidimensional poverty, Section 3 identifies the opportunities that can potentially support poverty reduction in the future, Section 4 analyzes the critical constraints that have hampered poverty reduction and need to be addressed effectively, and section 5 provides the conclusions.

II. MULTIDIMENSIONAL POVERTY PROFILE AND TRENDS

Prior to the Asian financial crisis, Indonesia reached its lowest monetary poverty rate of 11.3% in 1996. The high and stable economic growth during the time period from 1976 to 1996 contributed to a significant decrease in the poverty headcount rate, which on average reached 1.44 percentage points per year. However, the growth level after the crisis (1999–2009) could only be translated into a 1.0 percentage point per year reduction in the poverty headcount rate. Based on the revised method of calculating the official poverty rate implemented since 1998 (and backdated to 1996), the poverty headcount rate was 13.33% in 2010 (Figure 1).[1]

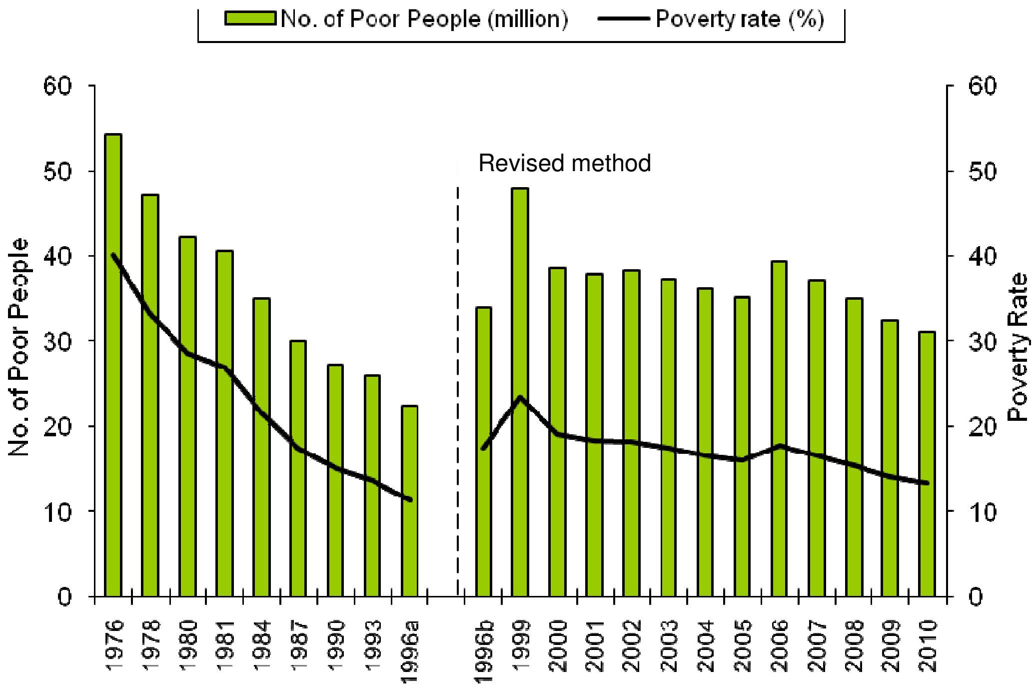

Figure 1: Monetary poverty rate and number of poor people, 1976–2010

Source: Statistics Indonesia (various years).

Although the total incidence of poverty has fallen over the past four decades, there was a widening gap in the incidence of poverty between urban and rural areas. The higher poverty rate in rural areas is the result of, inter alia, the accumulative impact of the national industrial development agenda which over emphasized the role of manufacturing and service sectors in driving economic growth and its ability to continue to absorb more of the labor force, while giving agricultural development a secondary role (Booth, 2000; Thee, 2010). Since 1983 the manufacturing sector has slowly taken over the leading role from the agricultural sector.

[1]In 1998, Statistics Indonesia revised the methodology for calculating the poverty rate. The new method is applied to data starting from 1996.

However, because the rural poor rely mainly on agriculture, which has weak linkages with manufacturing, they have not benefited considerably from the expansion of the manufacturing sector (ADB, ILO and IDB, 2010). Despite the relatively higher incidence of monetary poverty in rural areas, the size of the urban poor has increased two-fold from 18.45% in 1976 to 36.61% in 2009.[2] Taking into account the exclusion from the official data of children in orphanages, street children, beggars, and the homeless—who mostly reside in urban areas—it seems likely that the actual size of the urban poor is much higher than the official estimate.

Furthermore, as shown in Table 1, the rural-urban differences in non-monetary poverty and deprivation are higher than the differences in the monetary poverty measure. While the rural-urban gap in monetary poverty is 6.63%, the gap in non-monetary poverty is two to five times higher. This indicates that the reduction in monetary poverty has not sufficiently translated into improvements in other social indicators. Moreover, despite higher per capita income, Indonesia lags behind other Southeast Asian countries such as Vietnam when it comes to other social indicators such as the under-five mortality rate.[3]

Table 1. Rural-Urban Gap in Multidimensional Poverty and Deprivation

Indicators	Definition	Year	Rural (%)	Urban (%)	Rural-Urban Gap (% point)
Under-5 Mortality Rate	Number of deaths of under-five year old children per 1000 live births	2007	60.1	37.8	22.3
Lack of sanitation (toilet)	Percentage of the population living in a house without a proper toilet	2009	50.42	15.05	35.37
Low education of the head of household (HHH)	Percentage of the population living in a household in which the HHH did not finish 9-year basic education	2009	83.65	50.47	33.18
Lack of access to clean water	Percentage of the population living in a household without proper access to a clean and protected source of drinking water	2009	56.53	30.55	25.98
Low education of youth	Percentage of the population living in a household in which youth/s (18–24 years) did not finish 9-year basic education	2009	40.70	15.97	24.73
Unhygienic floor	Percentage of the population living in dirt-floor housing	2009	15.79	5.03	10.76
Monetary Poverty	Percentage of the population below the official poverty line	2009	17.35	10.72	6.63

Source: Author's calculation based on Susenas 2009 (Consumption Module); Under-five mortality rates are from Measure Demographic and Health Survey (DHS) database (n.d.).

The translation of monetary improvement into an improvement of human development seems to differ between men and women. Although during 2000–07 the decrease in monetary poverty was coupled with an improvement in the human development index (HDI), the gender-related development index (GDI) indicated that women lagged behind men when their purchasing power and human development capabilities were taken into account (Figure 2).

[2]This, however, is lower than the level of urbanization, and therefore does not indicate an urbanization of poverty.

[3]In 2008, Indonesia's per capita gross national income (GNI) was US$2,010 and under-5 mortality rate (U5MR) was 41 while Vietnam's per capita GNI was US$890 and U5MR was 14 (UNICEF, 2010).

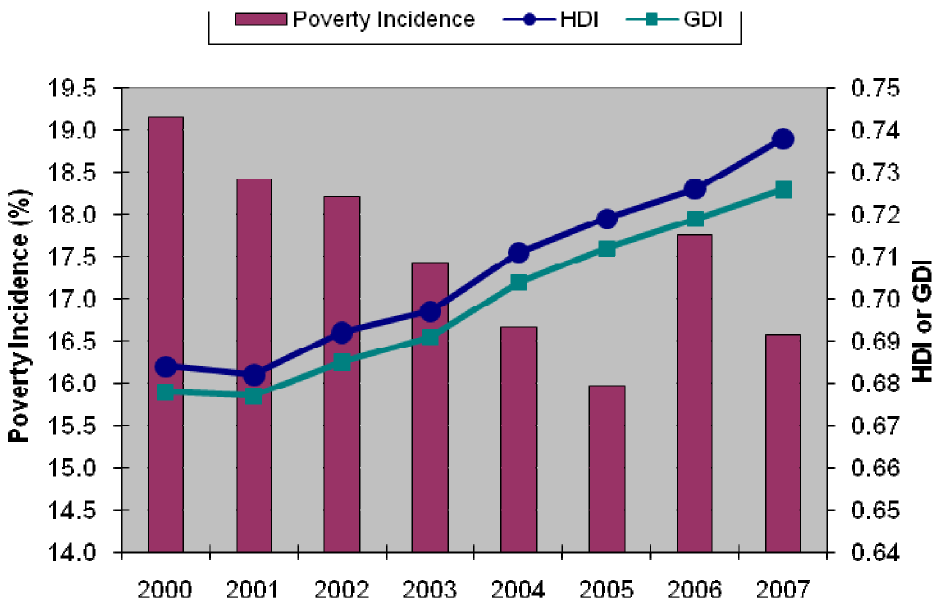

Figure 2. Trends in the poverty rate, human development index (HDI), and gender-related development index (GDI), 2000–07

Source: Coordinating Ministry of People's Welfare (2009); UNDP (2003, 2008, 2009).

The monetary poverty indicator, however, does not provide any evidence of the feminization of poverty. Table 2 shows that the incidences of poverty among males and females are similar, but the difference in mean (median) per capita expenditure between female and male-headed households increased around four times in favor of women, from Rp4,181 (Rp1,889) in 2007 to Rp20,039 (Rp8,198) in 2009. This suggests that we need to look beyond the monetary poverty dimension to explain the inequality between men and women revealed by the GDI and examine, for instance; women's participation in the labor force, the incidence of poverty among women who are working, and the potential deprivation of girls versus boys in terms of households' human capital investment.

Table 2. Monetary Welfare Indicators by Gender of Household Head

Indicators	Year	Female	Male	Total
Share in national poor (%)	2007	50.17	49.83	100
	2009	50.13	49.87	100
Share in total Susenas sample (%)	2007	49.88	50.12	100
	2009	49.89	50.11	100
Average Rupiah per capita consumption	2007	349,385	345,204	345,615
	2009	444,459	424,420	426,520
Median Rupiah per capita consumption	2007	258,029	256,140	256,366
	2009	330,289	322,091	322,901

Source: Authors' calculation based on Susenas 2007 and 2009 Panel—Consumption Module.

While the labor participation rate of women is still lower than that of men, the good news is that the female participation rate grew at 1.7 % per annum on average in 2003–09, 2.0 percentage points higher than that of men (Table 3). Likewise, while the incidence of unemployment and underemployment remains significantly higher among women, both rates tend to fall faster among women than among men.

Table 3. Employment Indicators by Gender, 2003–09

Indicators		2003	2004	2005	2006	2007	2008	2009	Average change (% p.a.)
Labor force Participation Rate (%)	Total	65.7	65.7	65.7	66.2	67.0	67.2	67.2	0.4
	Female	46.3	46.3	46.3	48.1	50.2	51.1	51.0	1.7
	Male	85.3	85.3	85.3	84.2	83.7	83.5	83.7	-0.3
Unemployment rate (%)	Total	9.5	9.9	11.2	10.3	9.1	8.4	7.9	-0.6
	Female	13.0	12.9	14.7	13.4	10.8	9.7	8.5	-3.2
	Male	7.6	8.1	9.3	8.5	8.1	7.6	7.5	1.6
Underemployment rate (%)	Total	28.4	26.9	27.3	27.4	27.6	27.8	27.7	-0.6
	Female	38.5	36.8	36.9	36.0	36.9	36.2	36.6	-3.2
	Male	22.8	21.2	21.9	22.4	22.1	22.6	22.3	1.6

Source: The National Labor Force Survey (Sakernas), 2003–09.

The 2009 Susenas data, as shown in Table 4, reveals that more households are reporting a gender-neutral position in the areas of; education (78.8%), economic work (64.8%), and domestic or household chores (49.3%), but there is still a tendency for female children to be given less preference in education (pro-male 14.17% versus pro-female 2.75%) and economic work (pro-male 32.44% versus pro-female 2.75%) and given more preference in doing household chores (pro-male 2.27% versus pro-female 48.42%).

Table 4. Prioritized Gender for Education, Labor Market, and Domestic Works

Domain	Group	% of Household Giving Priority to		
		Both Sexes	Male	Female
Education	Indonesia	78.8	14.8	6.5
	Q1 – poorest	78.2	15.5	6.3
	Q5 - richest	80.6	13.2	6.2
	Rural	80.4	13.6	6.1
	Urban	78.0	15.4	6.7
Economic Work	Indonesia	64.8	32.4	2.8
	Q1 – poorest	63.4	33.8	2.9
	Q5 - richest	69.2	27.9	2.9
	Rural	69.5	27.7	2.7
	Urban	62.2	35.0	2.8
Household (Domestic) Work	Indonesia	49.3	2.3	48.4
	Q1 – poorest	47.7	2.5	49.8
	Q5 - richest	53.7	2.2	44.2
	Rural	54.01	2.0	43.9
	Urban	46.7	2.4	50.9

Source: Author's analysis based on Susenas 2009 Core—Sociocultural and Education Module.

Another distinct characteristic of poverty in Indonesia is the occurrence of simultaneous movements between those who move out of and those who move into poverty. This phenomenon has resulted in a relatively slow rate of poverty reduction being observed during the last decade. For example, between 2008 and 2009, 53.29% of the poor in 2008 moved out of poverty in 2009, while at the same time almost half of the poor in 2009 were not poor in 2008 (Table 5). This lends foundation to the need to put balanced emphasis on both empowering the poor to move out of poverty and strengthening the capacity of the near-poor to avoid falling into poverty.

Table 5. Poverty Transition Matrix during 2008–2009

		2009			Total row
		Poor	Near-poor	Non-poor	
2008	Poor	**46.71**	**20.28**	**33.01**	**100.00**
		50.98	*26.77*	*6.51*	
	Near-poor	**22.32**	**21.53**	**56.15**	**100.00**
		20.19	*23.58*	*9.18*	
	Non-poor	**5.37**	**7.65**	**86.98**	**100.00**
		28.83	*49.65*	*84.31*	
Total column		*100.00*	*100.00*	*100.00*	

Source: Author's analysis based on Susenas Panel 2008–09 Consumption Modules.
Note: The near-poor line equals 120% of the poverty line. Numbers in bold are row distribution and those in italics are column distribution.

III. OPPORTUNITIES FOR POVERTY REDUCTION

Several factors make the outlook for poverty reduction more promising. These opportunities are provided by: (i) economic expansion due to globalization, (ii) realization of a demographic dividend due to the high proportion of the population of working age, (iii) better identification of, and solution to, the problems faced by the poor through the adoption of a participatory development approach, and, (iv) support from international commitment on the MDGs.

3.1 Economic Expansion Due to Globalization

In the long run, exposure to globalization in the form of trade liberalization, capital inflows, foreign direct investment (FDI), and global production networks will bring economic expansion and thus rapid growth to developing countries (Dollar and Kraay, 2001; Henderson, 2005; Winters, 2001).[4] It has been recorded for centuries that global trade has proven to open the way for creating jobs, reducing prices, increasing the variety of goods for consumers, and helping countries acquire new technologies. It is also increasingly evident that the flow of FDI in developing countries has contributed to faster economic growth, the

[4]Due to limited space, we focus here on trade and FDI. Nonetheless, it is important to note that there are other inherent features of economic globalization that directly or indirectly bring actual benefits to poverty reduction. These include: international flows of low-skilled labor, and the availability of low cost information through the spread of information and communication technology (ICT), and the impact of global production networks, which have all become important topics in the current development research on the poverty-globalization nexus.

transfer of technologies, and increases in domestic investment (Borensztein, De Gregorio, and Lee, 1998; Bosworth and Collins, 1999; Kis-Katos and Sparrow, 2009).

It should be noted that the linkages through which trade liberalization could reduce poverty, occur when complementary policies are in place (Harrison, 2006; Harrison and McMillan, 2007). This includes flexible labor laws, investment in human capital and infrastructure, access to credit, and the provision of technical assistance. Similarly, the way FDI has an impact on poverty reduction depends on several factors, such as the quality of the host country's policies and institutions, the quality of investment, the nature of the regulatory framework, and the flexibility of labor markets (Mayne, 1997). In the Indonesian context, by looking at two different periods, i.e., the pre- and post-crisis eras, the line of argument above finds relevance.

In the pre-crisis era, strategic economic policies were directed at export-based manufacturing sectors, as a response to the decline of the oil boom in the 1970s. These economic policies took place in the form of: tariff reduction, liberalization of export-import procedures, an "openness" to more FDI, a relatively undistorted labor market, a devaluation of the exchange rate, and widespread deregulation in the domestic economy (Fane, 1996; Fane and Condon, 1996; Hill, 1996; Suryahadi, 2001; Suryahadi et al., 2003; Thee, 1991). They were accompanied by large public investments in education, health, family planning, and infrastructure. These policies managed to "pull up the bulk of Indonesia's poor and assist them to move out of poverty (Duflo, 2001; Lucas and Timmer, 2005; World Bank, 2006).

In the post-crisis era, however, Indonesian exposure to the global economy has slowed. Since 1997, Indonesia has been the only crisis-affected economy to register negative flows of FDI (Aswicahyono, Bird, and Hill, 2008; Tambunan, 2005). As far as exports are concerned, other than Indonesia's underperforming growth compared to its neighbors, export growth has mainly benefited from favorable world prices rather than volume expansion (Athukorala, 2006). The absence of a conducive investment climate (Tambunan 2005), unfriendly labor market regulations (Suryahadi et al., 2003), and political and policy uncertainty (Aswicahyono, Bird, and Hill, 2008) are among the factors identified as contributing to this situation.

Surprisingly, given this unfavorable business-enabling environment, the Indonesian poverty rates, as explained in an earlier section of this paper, have continued to decline in the post-crisis period; albeit moderately compared with the pre-crisis era. Nationwide social protection programs, which were initiated from the onset of the 1997–98 financial crisis and now formally included in the Medium Term Development Plan 2010–14, have been identified as an important contributing factor (Suryahadi et al., 2010). However, the lessons from Indonesia's own past experience clearly show that it is through strategic exposure to economic globalization, coupled with complementary social development policies, that pervasive poverty can be effectively tackled.

3.2 Demographic Dividend

The demographic dividend in Indonesia can be briefly explained as follows. Indonesia experienced its first baby boom from the 1950s to the 1970s as a result of high fertility rates coinciding with lower mortality rates. Many couples who had postponed their marriage in the 1940s due to the independence war were having children in this time period. Moreover, the invention and increased use of antibiotics significantly increased the survival rates of children born during this time (Adioetomo, 2005).

With the intensive family planning program during the 1970s until the 1990s, the fertility rate dropped, which then resulted in a decrease in the proportion of the population aged under-15 years. This decrease in the proportion of the young population, coupled with an increase in the working-age population, and the slow growth of the older population, Indonesia faced a demographic transition where the age dependency ratio (the proportion of the population not in the labor force to the proportion in the labor force) has declined steadily. As a result, Indonesia is gaining the so-called "demographic dividend", where the working-age population is roughly twice of the size of the population aged under-15 years. Adioetomo (2005) predicts that the age dependency ratio decreased steadily from 86/100 in the 1970s, to 54/100 in 2000, and will hit the lowest point of 44/100 in the 2020–30 time period.

With such a large number of people of working age or those entering the labor market, the country is at an optimal time to accelerate efforts to utilize the country's workforce to its full capacity to an attempt to reduce poverty. Moreover, with a low age-dependency ratio, there is potential for a higher rate of savings as more households shift their consumption expenses to savings. If these savings are invested in children's education, the quality of Indonesia's human capital will rise, lifting more people out of poverty.

3.3 The Adoption of a Participatory Development Approach

The changing political landscape since the fall of Suharto in 1998 has created more options for the government to address poverty. Democratization and decentralization has lead to the opening of more doors to participate in the development process, in particular through the multi-stakeholder consultation forums known as *musrenbang* (*musyawarah perencanaan pembangunan*). These forums involve both state and non-state actors, as well as communities to voice their aspirations and produce development programs in accordance with their specific needs.

Law No 25/2004 on National Development Planning institutionalizes *musrenbang* at all levels of government (village, *kecamatan*, *kabupaten/kota*, provincial, and national levels) over different time frames (short term, medium term, long term). In addition, a Joint Ministerial Decree of Bappenas and the Ministry of Home Affairs (No.0008/M.PPN/01/2007) states that development planning recommendations made at the village level must be accommodated by higher levels of government, to ensure a "bottom up" development planning process.

Despite the benign intention of accommodating the voice of the poor through *musrenbang*, at least two identified factors are hampering the effectiveness of this type of participatory development planning. First, there is a risk of elite capture at the village level which reduces the effectiveness of *musrenbang* as a voice-channeling mechanism (Bebbington et. al., 2004; Fritzen, 2007; Plettau and Gaspart, 2003). This results in the needs of the poor being neglected an only those of the elite groups are accommodated by the government. Second, there is also a risk of an absence of local government political commitment and willingness to support the process of participatory development. This then leads to poor quality or insufficient information being provided to the *musrenbang* process. This limited acceptance of the *musrenbang* process is caused by: a narrow understanding of the role and importance of public participation, a failure to appreciate the long-term benefits of good governance for sustainable development, and a general inability to distinguish between political and public participation.

A study by USAID and the Local Government Support Program (LGSP) (2007) confirms this assessment of the effectiveness of the *musrenbang* mechanism. It finds that despite its potential to accommodate community voices in determining needs-based project interventions, and as an effective tool in participatory budgeting, it suffers from a lack of political support from local government and from the limited role of civil society in the development planning process. In short, there is an urgent need to improve the *musrenbang* process.

The *musrenbang* are, of course, not the only channel through which the poor can participate in development programs. The Indonesian government also implements one of the biggest community driven development programs in the world, the National Program for Community Empowerment (*Program Nasional Pemberdayaan Masyarakat*, PNPM). Covering all *kabupaten* and *kota* across the country, it has a considerably huge potential to increase the opportunities available to the poor to take an active role in the national development program.

3.4 Global Commitment to Poverty Reduction

Indonesia is receiving increasing support from the international community for its efforts to deliver development and reduce poverty. In 2008, the OECD's Development Assistance Committee allocated a total of US$119.8 billion in net official development assistance (ODA), representing 0.30% of member countries' combined gross national income, the highest amount ever (OECD, 2009). Even in the midst of the global financial crisis, the international community managed to maintain the total ODA commitment, which declined only slightly to US$119.6 billion in 2009 (OECD, 2010).

For Indonesia alone, net ODA and official aid increased by 34% between 2007 and 2008, from US$391 million to US$593 million respectively (World Bank, 2009a). The level of aid reached its highest point in 2005, when US$2.2 billion was allocated to Indonesia, mainly to support the rehabilitation and reconstruction of Aceh after the devastating tsunami that struck in December 2004. Of all members of the Development Assistance Committee, Australia is the single biggest contributor of ODA to Indonesia, particularly grant disbursement, followed by Japan, the United States, Germany, and the Netherlands.

However, it is important to note that Indonesia is not an aid dependent country. Aid represents less than one percent of Indonesia's GDP. The country receives approximately US$11 of ODA per capita, compared with US$23 for Vietnam and US$38 for Cambodia. Furthermore, in 2005 Indonesia was classified as a middle income country for the purposes of Development Assistance Committee's reporting of ODA. This means that the country is considered to have sufficient fiscal resources to finance much of its own expenditure on poverty reduction and the achievements of its Millennium Development Goals (MDGs).

IV. CONSTRAINTS IN ACCELERATING POVERTY REDUCTION

The slower rate of poverty and vulnerability reduction in Indonesia during the past decade has been the subject of several analysis. These studies have identified several constraints as the reasons behind this slower rate of poverty reduction. Using a framework adopted from the growth diagnostic framework of Hausmann, Rodrik, and Velasco (2005), in Figure 3 we have identified three critical constraints to poverty reduction: (i) insufficient productive opportunities for the poor and near-poor, (ii) weak human capabilities among this group, and (iii) inadequate social protection for the poor and near-poor.

4.1 Insufficient Productive Opportunities for the Poor and Near-Poor

Several underlying factors cause insufficient productive opportunities for the poor and near-poor. The first one is the relatively low level of economic growth. Before the onset of the Asian financial crisis, the high and sustained rates of economic growth had brought rapid reductions in poverty. It can be seen from Figure 4 that between 1976 and 1996, the economy grew at around 7.5% annually, bringing the poverty rate down from 40.1% in 1976 to 11.3% in 1996. Between 2002 and 2009, on the other hand, economic growth stayed at a moderate level of 5.2% annually, or around 70% of the average growth during the pre-crisis period, resulting in a slower pace of poverty reduction. The poverty rate decreased from 18.2% in 2002 to 14.2% in 2009, at only 40% of the speed of poverty reduction during the pre-crisis period.

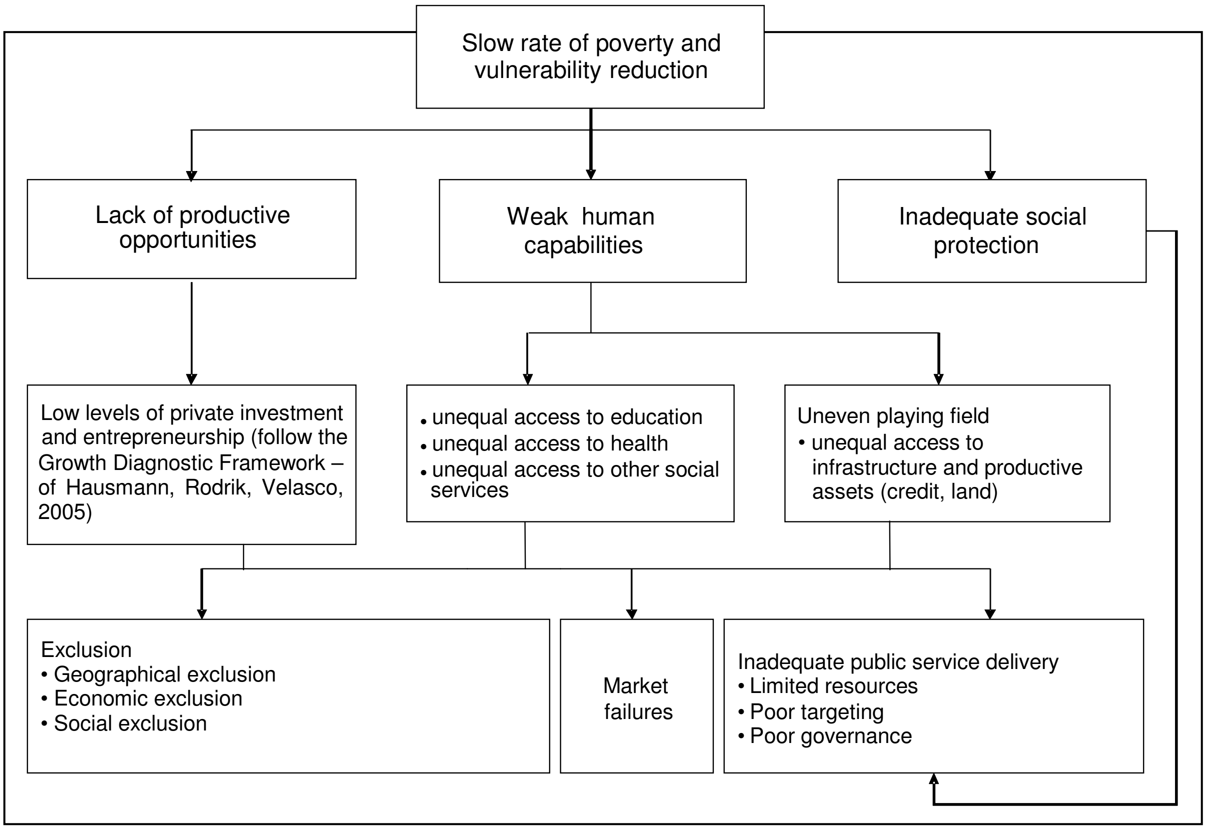

Figure 3. Diagnostic framework for the slow rate of poverty and vulnerability reduction

Source: Adopted from Hausmann, Rodrik, and Velasco, 2005.

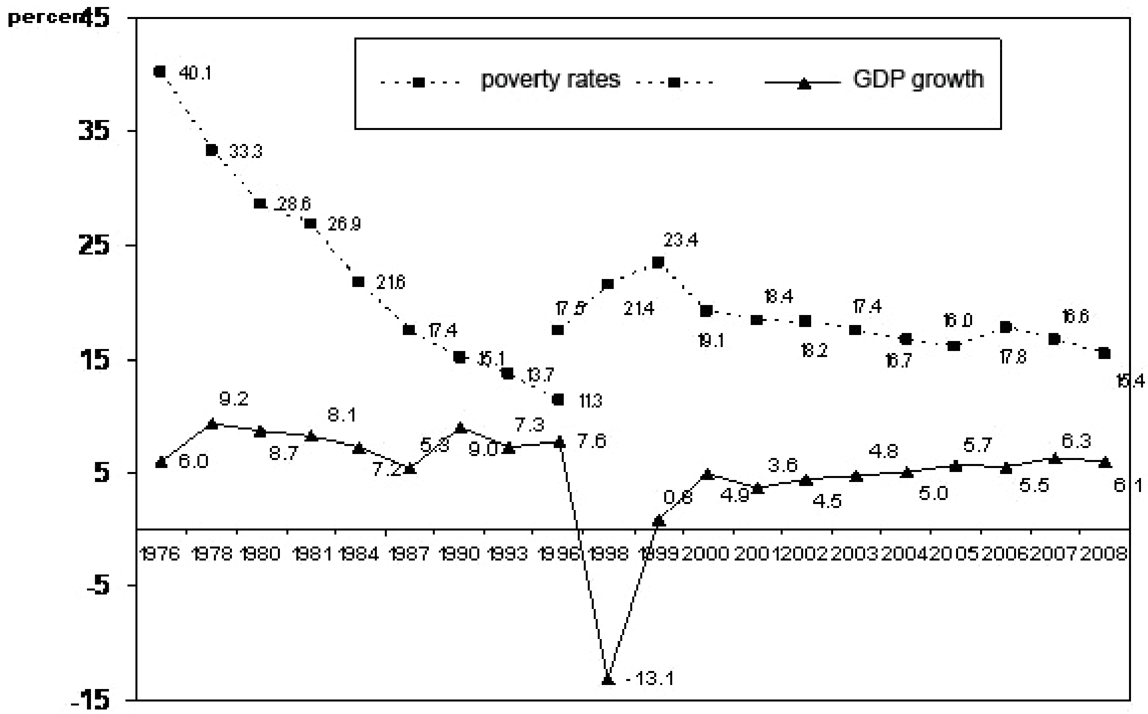

Figure 4. GDP growth and poverty rates, 1976–2009 (%)

Source: Statistics Indonesia (various years) for poverty rates; World Bank, 2009b for GDP growth.

The slower pace in poverty reduction during the post-crisis period is clearly related to the lower economic growth. In addition, each percentage point of economic growth now has less power to reduce poverty, which is technically termed as less growth elasticity of poverty. One of the reasons for this lower elasticity is the changing composition of growth. The dominance of the industrial sector is shown by its contributing share of GDP which doubled from 20% in the early 1970s to around 40% in the 1980s, and has remained relatively constant since then. Contrary to this, the share of the agricultural sector, the main source of income for the majority of the poor, dropped substantially from 45% in the early 1970s to 25% in 1980, and has stayed constant at around 15% ever since. In other words, the agriculture sector has shrunk by 30 percentage points during the last four decades. The services sector experienced a relatively small increase in its share of GDP over the same period, from 35% in the early 1970s to 46% in 2008 (Suryahadi, Suryadarma, and Sumarto (2009) and Statistics Indonesia (various years)). It is clear from these numbers that the share of the agricultural sector, which absorbs the majority of the poor, has lagged behind the other sectors, reducing its capacity to contribute to further reductions in poverty.

Another reason for insufficient productive opportunities for the poor and near-poor is labor market distortions. These distortions are caused by excessive regulation of minimum wages, hiring and firing mechanisms, contract work, severance pay, and outsourcing, as set out in Law No. 13/2003 on Labor. Employers now have less discretion over the size and composition of their workforces, severely reducing labor market flexibility (Manning, 2004). As the labor market becomes more rigid, labor intensive investments are likely to become less attractive to employers, encouraging them to adopt more capital and skill-intensive technologies. This in turn reduces the demand for unskilled workers, who constitute the majority of the poor.

4.2 Weak Human Capabilities

Weak human capabilities have put the poor and near-poor in a disadvantageous position when competing with the non-poor. Unequal access to basic services such as education, health, nutrition, sanitation, and clean water has hampered the poor in moving out of poverty and caused the near-poor to easily fall back into poverty. In terms of education, only 55% of 16–18 year-old teenagers from the lowest income quintile completed junior high school. This low level of education not only prevents them from gaining the skills and access to information they need to move out poverty, but it also reduces the likelihood that the next generation will able to do so (World Bank, 2006).

Low access of the poor and near-poor to education and health services is due to both supply-side constraints (which mainly affect rural areas) and demand-side constraints (more common in urban areas). Both types of constraint are equally important, but in different ways. In the case of education, the supply-side constraints include poor infrastructure and the insufficient quantity and poor quality of teachers. Half of the areas where most of the poor dwell do not have a senior secondary school. On the demand side, lack of financial capacity is the main reason for poor households not to enroll their children in school. It needs to be acknowledged that the opportunity cost of sending children to school, rather than sending them out into the workforce, is higher for the poor.

Similarly, in the case of low access of the poor and near-poor to health services, the main supply-side contrast is the limited availability of health facilities and health workers. In rural areas, where most of the poor dwell, such facilities are likely to be scarce or even non-existent. The most widely available health facility in underdeveloped villages is the village maternity post (*pondok bersalin desa,* polindes), staffed by village midwives (*bidan di desa*) who usually provide only pre-natal, delivery, and neo-natal care. It is difficult in such circumstances for the poor to receive adequate medical treatment, let alone preventive health care. The demand-side constraint is the cost of health services. To receive proper medical treatment by a doctor or nurse in a health facility, the poor would need to travel to a *kecamatan* community health center *(puskesmas)* or to a *kabupaten* public hospital. In addition to the cost of the medical examination and medicine, the poor would need to pay for transport to and from the facility and take time off work, thereby missing out on much needed income.

The poor also face severe problems in terms of a lack of access to sanitation and clean water. Sanitation facilities are seriously inadequate as only 1.3% of the population are connected to a sewerage network, and 80% of the rural poor as well as 59% of the urban poor do not have access to either plumbed sewerage or a septic system. Many poor people do not have access to clean water, particularly in rural areas. According to the 2009 Susenas, only 48% of the poorest 20% of households have access to safe water in rural areas, compared with 78% in urban areas.

4.3 Inadequate Social Protection for the Poor and Near-Poor

No matter how good the government's policy in creating a conducive environment for the poor to participate in the process of economic growth, there will always be some groups that are left out. It is therefore important to develop a social protection system that is able to maintain people's standard of living above the socially agreed minimum level. This includes guaranteed access to basic services such as education, healthcare, clean water, and sanitation.

The 1997–98 financial crisis caused almost 15 million people in Indonesia to become poor. Similarly, the sharp increase in the domestic fuel price due to a reduction in the fuel subsidy in the last quarter of 2005 caused poverty to increase significantly in the following year. This led to higher transport costs: which in turn lead to increases in the prices of staple goods such as rice. The World Bank (2006) pointed out that the increase in the rice price between February 2005 and March 2006 was particularly hard on the poor because rice is one of the largest components of their household expenditure. This provides a salient lesson that poverty reduction efforts should be aimed not only at reducing the number of people living below the poverty line, but also at reducing the number of people who are vulnerable to falling into poverty, i.e., the near-poor.

Another lesson learned from past experience is that there is a need for integrated rather than ad hoc social protection programs. When programs are scattered across different institutions, the results are often uneven outcomes, poor targeting, and problems of undercoverage and leakages. Moreover, monitoring and evaluation mechanisms are varied across programs. The newer programs apparently have better monitoring and evaluation instruments, but effective methods for evaluating the overall impact of the programs is still generally lacking. The National Program for Community Empowerment (PNPM) and the Family of Hope Program (PKH), are examples of the few programs that do incorporate monitoring and evaluation into their program design.

Consequently, efforts to integrate the plethora of anti-poverty programs into a national social protection system faces significant challenges, including, not least, a general lack of administrative and fiscal capacity. Indeed, Cook (2009) emphasizes that institutional arrangements, in terms of joining up fragmented systems, is one of the big challenges faced in implementing an integrated social protection system. Fragmentation exists among government agencies and service providers. In Indonesia, several ministries are responsible for managing unconditional and conditional cash transfer programs. While social insurance is delivered through four different programs for different groups such as civil servants, military personnel, private sector employees, and the poor. The same story applies in China, where an estimated 17 government agencies are responsible for different social protection programs, often competing for resources and programs (Cook, 2009).

A critical issue in ensuring the effectiveness of social protection programs is the accurate targeting of beneficiaries. Since the potential benefits of effective targeting are considerable, it always features prominently in the design of such programs. The targeting performance of various safety-net and poverty reduction programs is generally poor because they are only slightly pro-poor. Both the exclusion error (the proportion of the poor not included in the program) and the inclusion error (the proportion of beneficiaries who are non-poor) are high. Therefore, improving the effectiveness of targeting is a crucial issue that must be addressed effectively.

The results of evaluation of various social assistance programs suggest that their implementation suffers from a number of weaknesses, such as: they are too narrowly focused on a single sector, there is a lack of coordination across programs, and there is a high degree of leakage and undercoverage. This has resulted in some sections of the poor being only partially benefited or not benefited at all by such programs. Furthermore, most of the programs seem to be fairly ineffectual in lifting the poor out of poverty and increasing the welfare levels of the near-poor.

V. CONCLUSION

Indonesia has made considerable progress in reducing poverty over the last four decades. Despite this, poverty remains a significant problem in Indonesia today and will continue to be the case in the future. There are at least three reasons for this. First, no matter how fast the economy is growing, there will always be some groups in society who are left behind and are unable to reap the benefits of growth. Second, as the economy develops and becomes more modernized the causes and impacts of poverty become more complicated and more difficult to untangle, making poverty an even more complex issue and, therefore, more difficult to resolve. Third, as the economy grows and standards of living increase, people's expectations also rise, pushing up the threshold that separates the poor from the non-poor.

Nevertheless, there are opportunities to accelerate the pace of poverty reduction. These opportunities are provided by: the current economic expansion due to globalization; the realization of a demographic dividend due to the favorable age dependency ratio; the improved identification of the problems faced by the poor and better solutions, following the adoption of more participatory development approaches, and; international support for the MDGs. However, the realization of these opportunities naturally depends on the ability to capitalize on them.

There are also, of course, factors that tend to hamper the effectiveness of Indonesia's poverty reduction strategies. The critical constraints are: insufficient productive opportunities for the poor and near-poor, weak human capabilities among the poor and near-poor, and inadequate social protection for the poor and near-poor. In order to be able to reduce poverty, strategies to address these constraints need to be formulated carefully and implemented effectively. This requires cooperation among the various actors involved in poverty reduction, including the central and local governments, civil society, the private sector, international agencies and, not least, the communities themselves.

The first required action is to expand productive opportunities for the poor and near-poor. This will necessitate the reform of labor laws, the provision of critical economic infrastructures to support the development of micro and small enterprises, and other initiatives to promote the growth of labor intensive industries as well as micro, small, and medium-sized enterprises.

The second required action is to strengthen the human capabilities of the poor and near-poor. This will require investment in social infrastructure, careful and gradual expansion of the conditional cash transfer program (PKH), and the development of an incentive mechanism to encourage service providers to improve the quality of their services.

Finally, the third required action is to strengthen social protection for the poor and near-poor. For this to take place the government must improve the targeting of social assistance programs to ensure that the poor are properly included. It needs to commit to allocating a portion of the state budget to food, education, and health subsidies for the poor, and to persuade local governments to become more actively involved in the implementation of social protection programs.

LIST OF REFERENCES

ADB, ILO, and IDB (Asian Development Bank, International Labor Organization, and Islamic Development Bank) (2010) *Indonesia: Critical Development Constraints,* Country Diagnostics Studies. Manila: ADB, ILO and IDB.

Adioetomo, Moertiningsih (2005) 'Bonus Demografi: Menjelaskan Hubungan antara Pertumbuhan Penduduk dengan Pertumbuhan Ekonomi.' [Demographic Bonus: Explaining the Relationship between Population Growth and Economic Growth.] Population Economics Professorial Inaugural Speech, Faculty of Economics, University of Indonesia, Jakarta.

Aswicahyono, Haryo, Kelly Bird, and Hal Hill (2008) 'Making Economic Policy in Weak, Democratic, Post-crisis States: An Indonesian Case Study.' *World Development* 37(2): 354–370.

Athukorala, P.C. (2006) 'Post-crisis Export Performance: The Indonesian Experience in Regional Perspective.' *Bulletin of Indonesian Economic Studies* 42 (2): 177–211.

Bebbington, Anthony, Leni Dharmawan, Erwin Fahmi, Scott Guggeheim (2004) 'Village Politics, Culture, and Community-Driven Development: Insights from Indonesia,' *Progress in Development Studies* 4 (3): 187–205.

Booth, Anne (2000) 'Poverty and Inequality in the Suharto Era: An Assessment', *Bulletin of Indonesian Economic Studies* 36 (1): 73–104.

Borensztein, E., J. De Gregorio, and J.W. Lee. (1998) 'How Does Foreign Direct Investment Affect Economic Growth?' *Journal of International Economics* 45 (1): 115–135.

Bosworth, B.P and S.M. Collins (1999) 'Capital Flows to Developing Economies: Implications for Saving and Investment.' *Brookings Papers on Economic Activity* 30 (1): 143–80.

Cook, Sarah (2009) *Social Protection in East and South East Asia: A Regional Review*. Sussex: Institute of Development Studies.

Coordinating Ministry of People's Welfare (2009) 'UNHDR 2009: HDI dan GDI Indonesia 2007 Membaik [UNHDR 2009: Indonesia's HDI and GDI is Improving] [online] http://data.menkokesra.go.id/content/unhdr-2009-hdi-dan-gdi-indonesia-2007-membaik [16 August 2010].

Dollar, David and Aart Kraay (2001) 'Trade, Growth, and Poverty' *Policy Research Working Paper No. 2615*. Washington D.C.: World Bank.

Duflo, Esther (2001) 'Schooling and Labor Market Consequences of School Construction in Indonesia: Evidence from an Unusual Policy Experiment.' *American Economic Review* 91 (4): 795–813.

Fane, George (1996) 'Deregulation in Indonesia: Two Steps Forward, One Step Back.' *Agenda* 3 (3): 341–350.

Fane, George and Timothy Condon (1996) 'Trade Reform in Indonesia, 1987–95.' *Bulletin of Indonesian Economic Studies* 32 (3): 33–54.

Fritzen, Scott A. (2007) 'Can the Design of Community-Driven Development Reduce the Risk of Elite Capture? Evidence from Indonesia.' *World Development* 35 (8): 1359–1375.

Harrison, Ann (2006) 'Globalization and Poverty.' *NBER Working Paper No. 12347*. Cambridge: National Bureau of Economic Research.

Harrison, Ann and Margaret McMillan (2007) 'On the Links between Globalization and Poverty.' *Journal of Economic Inequality* 5 (1): 123–134.

Hausmann, Ricardo, Dani Rodrik, and Andres Velasco (2005) *Growth Diagnostic*. Mimeo. John F. Kennedy School of Government, Harvard University. Cambridge, MA.

Henderson, Jeffrey (2005) 'Global Production Networks, Competition, Regulation, and Poverty Reduction: Policy Implications.' Paper presented at the Centre for Regulation and Competition Workshop, University of Manchester, Manchester 22–24 June 2005.

Hill, Hal (1996), *The Indonesian Economy since 1996: Southeast Asia's Emerging Giant*. Cambridge: Cambridge University Press.

Kis-Katos, Krisztina and Robert Sparrow (2009) 'Child Labor and Trade Liberalization in Indonesia.' *IZA Discussion Paper No. 4376* Institute for the Study of Labor (IZA), Bonn.

Lucas, Sarah and Peter Timmer (2005) 'Connecting the Poor to Economic Growth: Eight Key Questions.', *CGD Policy Brief*. Washington D.C.: Center for Global Development.

Macro International Inc. (2010) '*Measure DHS: STAT compiler*.' [online] <http://www.measuredhs.com> [16 August 2010].

Manning, Chris (2004) 'Labor Regulation: Poverty Alleviation or Poverty Creation?' In Armida S. Alisjahbana and Bambang P.S. Brodjonegoro (eds.) *Regional Development in the Era of Decentralization*. Bandung: Unpad Press.

Mayne, K. (1997) 'The OECD Multilateral Agreement on Investment (MAI).' Oxfam UK/I.

Measure Demographic and Health Survey (DHS) database (n.d.) [online] <http://www.measuredhs.com> [16 August 2010].

OECD Report (2009) [online] <http://www.oecd.org/document/13/0,3343,en_2649_34487_42458595_1_1_1_1,00.html>[31 August 2010].

OECD Report (2010) [online] <http://www.oecd.org/document/0,3343,en_2649_34447_44981579_1_1-1_1,00.html>[31 August 2010].

Platteau, Philippe Jean and Frédéric Gaspart (2003) 'The "Elite Capture" Problem in Participatory Development.' Namur: Centre for Research on the Economics of Development (CRED).

Statistics Indonesia (various years), *Statistik Indonesia* [Statistical Yearbook of Indonesia] Jakarta: Statistics Indonesia.

Statistics Indonesia (2003–09), *Survei Angkatan Kerja Nasional* [National Labor Force Survey] Jakarta :Statistics Indonesia.

Suryahadi, Asep (2001) 'International Economic Integration and Labor Markets: The Case of Indonesia.' *Economics Study Area Working Papers 22*. Honolulu: East-West Center.

Suryahadi, Asep, Athia Yumna, Umbu Raya, and Deswanto Marbun (2010) 'Binding Constraint to Poverty Reduction in Indonesia.' *SMERU Working Paper,* Jakarta: The SMERU Research Institute.

Suryahadi, Asep, Daniel Suryadarma, and Sudarno Sumarto (2009) 'The Effects of Location and Sectoral Components of Economic Growth on Poverty: Evidence from Indonesia.' *Journal of Development Economics* 89 (1): 109–117.

Suryahadi, Asep, Wenefrida Widyanti, Daniel Perwira, and Sudarno Sumarto (2003) 'Minimum Wage Policy and Its Impact on Employment in the Urban Formal Sector.' *Bulletin of Indonesian Economic Studies* 39 (1): 29–50.

Tambunan, Tulus (2005) 'The Impact of Foreign Direct Investment on Poverty Reduction: A Survey of Literature and a Temporary Finding from Indonesia.' Paper presented at consultative meeting on "*Foreign Direct Investment and Policy Changes: Areas for New Research*," United Nations Conference Centre, Bangkok, Thailand, 12–13 March.

Thee, Kian Wee (1991) 'The Surge of Asian NIC Investment into Indonesia.' *Bulletin of Indonesian Economic Studies* 27 (3): 55–58.

Thee, Kian Wee (2010) 'A Brief Overview of Growth and Poverty in Indonesia during the New Order and after the Asian Economic Crisis.' In Joan Hardjono, Nuning Akhmadi, and Sudarno Sumarto (eds.) *Poverty and Social Protection in Indonesia*. Singapore: ISEAS and SMERU Research Institute.

UNDP (United Nations Development Programme) (2009) *Human Development Report 2009. Overcoming Barriers: Human Mobility and Development*. New York: UNDP.

———. (2008) *Human Development Report 2007/8. Fighting Climate Change: Human Solidarity in a Divided World*. New York: UNDP.

———. (2003) *Human Development Report 2003. Millennium Development Goals: A Compact among Nations to End Human Poverty*. New York: UNDP.

USAID and LGSP (United States Agency for International Development and Local Governance Support Program) (2007) 'Musrenbang as a Key Driver in Effective Participatory Budgeting: Key Issues and Perspective for Improvements.' *Good Governance Brief Volume I/June 2007*. Jakarta: USAID and Local Governance Support Program.

Winters, L. Alan (2001) 'Trade, Trade Policy, and Poverty: What are the Links?' *Working Paper No.2382*, London: Centre for Economic Policy Research.

———. (2009a) [online] <http://data.worldbank.org/indicator/DT.ODA.ALLD.CD?cid=GPD_54> [31 August 2010].

World Bank (2009b) *World Development Indicators (WDI)* [online] <http://data.worldbank.org/data-catalog/world-development-indicators [10 August 2010].

———. (2006) *Making the New Indonesia Work for the Poor.* Jakarta: The World Bank.