

Unleashing the Potential for Poverty Reduction in Indonesia

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1. Introduction

The Government of Indonesia has committed to improve the quality of life of its people. As one of the signatories of the Millennium Declaration in September 2000, Indonesia is committed to achieving by 2015 the Millennium Development Goals (MDGs), namely: (1) eradicating extreme poverty and hunger; (2) achieving universal basic education; (3) promoting gender equality and empowering women; (4) reducing child mortality; (5) improving maternal health; (6) combating HIV/AIDS, malaria and other diseases; (7) ensuring environmental sustainability; (8) developing a global partnership for development.

Initially, in addressing poverty reduction, the Government of Indonesia drafted its National Poverty Reduction Strategy Paper in 2003. Some regional governments have also prepared Regional Poverty Reduction Strategy Papers. In addition, some agencies and institutions have made attempts to combine their programmes with poverty reduction-related issues, and new frameworks have been instituted to address poverty by aligning the social development with macroeconomic policy and strategies.

To date, Indonesia's recent achievements in poverty reduction include reducing the number of people living below the poverty line from 23.4 per cent in 1999 to 16.6 per cent in 2004 (BAPPENAS 2005: 7). With this positive trend, it is expected that Indonesia will be able to achieve a poverty level of 7.2 per cent by 2015. However, poverty reduction efforts to date have not been entirely successful and indeed have been fraught with numerous obstacles and challenges including: mis-targeting of social programmes; lack of proper and adequate monitoring; lack of institutional transparency and accountability; and, most importantly, many local governments are still poorly equipped to implement poverty reduction policies and pro-poor policies.

In terms of accelerating human development through the provision of education and health services within the framework of poverty reduction, Indonesia has made considerable progress. Universal primary education comprising six years, for example, was attained in 1994 as measured by net primary enrolment ratio for all ages, and the gross primary enrolment ratio for ages 7–12 had risen to 93 per cent by 2004 (BAPPENAS 2005: 13). However, there remains a great challenge to reduce the disparities between urban and rural areas.

¹ This synthesis paper is not an official Indonesian document. The opinions and views stated are drawn from discussions during the workshop on 'Unleashing the Potential for Poverty Reduction in Indonesia' (15 December 2005, Jakarta) and therefore are not a definitive statement of the Government of Indonesia's policy or SMERU's views, and should not be regarded as such. This paper was prepared by Sami Bazzi, Ruly Marianti, Akhmadi and Nuning Akhmadi.

By the same token, efforts have been made to provide better access to health services. Policies in advancing the development of the health sector as part of poverty reduction are implemented through *Puskesmas* (public health centres) among others. However, improvements are still needed, including increasing the number and widening the network of *Puskesmas*, improving the quality and quantity of health providers and developing the health insurance system.

Also, to ensure environmental sustainability and conservation, Indonesia must improve its environmental management as well as mitigate or reverse the environmental damages caused by environmentally unsustainable development activities. Finally, monitoring and evaluation are still crucial to assure that Indonesia is meeting its MDGs.

A workshop was held by SMERU Research Institute in mid-December 2005, aiming to address challenges and responses in unleashing the potential for poverty reduction in Indonesia. The workshop was attended by government officials, academics, researchers, CSOs, NGOs and representatives from the private sector. The focus of the three theme issues included:

- Regional imbalance within the country and the impact on social cohesion: policies to adopt to integrate less developed provinces or regions with the rest of the national economy; promotion of development through fiscal transfer, social protection and other poverty-focused programmes; intergovernmental transfer in Indonesia and its implementation problems.
- Service delivery towards human development: access to public services particularly to health and education services; systems to be adopted to meet the need of the poor; and the impact of decentralisation on public service delivery, particularly for marginalised groups;
- Strategies for improving good governance: role of different stakeholders to strengthen good governance practices; accountability of each stakeholder; governance improvement in social sector delivery; and a budgeting process with a pro-poor focus.

This paper attempts to synthesise the theme papers, discussions, views, arguments and questions on various issues raised and identified during the workshop. The paper draws on research findings, official documents and reports from national and international institutions on Indonesia's achievements as well as challenges and responses in addressing poverty reduction. Initially, it addresses the history and performance of poverty reduction and sustainable pro-poor growth efforts. This is followed by a section which addresses in detail, several of the most salient policy challenges to achieve MDG targets and to ensure social protection and the delivery of services while strengthening good governance. The paper concludes by reflecting on Indonesia's achievements thus far and the way forward in achieving the MDGs, highlighting the role donors can play to assist Indonesia in unleashing its potential in poverty reduction.

2. Poverty Reduction and Sustainable Pro-poor Growth in Indonesia: Post-crisis Revival on the Road to the MDGs

2.1. Pre-crisis Growth and Poverty Reduction Track

During the New Order Era, Indonesia experienced rapid growth and a dramatic reduction in poverty. According to a World Bank study led by Peter Timmer (2005), from 1965–90, Indonesia's pro-poor growth index rating was extremely high at 6.56.² In the 1990s prior to the Asian Financial Crisis, GDP grew on average at an annual rate of 7 per cent, and the extreme poverty rate fell 20.6 per cent in 1990 to 10.3 per cent in 1996. In that same period, the Gini coefficient rose from 0.32 to 0.36, suggesting a relatively small increase in inequality, despite high growth rates.³ Despite significant advancements in economic and human development, Indonesia's 'economic miracle' was not built on strong social, political or economic institutions.⁴ Rather, President Soeharto and a small group of technocrats managed a top-down development strategy that paid little regard to issues of governance or institution building. Consequently, the country was ill-equipped to manage and recover from the 1997 crisis and today still remains among the slowest to recover among South-east Asian countries.

2.2 Post-crisis Shocks and Starting Over

The first few years after the crisis witnessed a dramatic increase in poverty on all accounts. The crisis exposed Indonesian society to an economic and political upheaval that its government was unprepared to handle, and the effects on social welfare were devastating. With the help of international donors, the Indonesian government implemented a range of social safety net (SSN) programmes to meet the basic needs of the population in the face of rising food prices, a spike in unemployment and setbacks in education and healthcare provision. Between February 1996 and February 1999, urban poverty increased by 9.12 per cent and rural poverty by 13.55 per cent, but by 2000, the poverty rate dropped significantly to around 15.6 per cent from 27.1 per cent just one year earlier.⁵

2.3 Achieving MDG Targets by 2015

In 2000, after three years of social unrest, economic crisis and dramatic political change, the Government of Indonesia announced its National Development Program (*Propenas*) 2000–4. By signing the MDG agreement in September that same year, Indonesia made a commitment to meeting the specific goals noted above.

² Details on the specific methodology used for analysing pro-poor growth can be found in World Bank (2004).

³ See Booth (2000) for a detailed study of poverty and inequality during the Soeharto era. Booth argues that relative poverty – as measured by expenditure inequality – actually increased in several of Indonesia's largest cities during the Soeharto era.

⁴ See Hofman et al. (2004) paper prepared for 'Scaling Up Poverty Reduction: A Global Learning Process and Conference', Shanghai, 25–27 May, 2004.

⁵ Based on SMERU calculations using *SUSENAS* data (BPS, various years).

Since 2000, several government agencies have made an effort, in coordination with international donors such as the World Bank and UNDP, to incorporate the MDGs into national policy planning. Indonesia's National Development Planning Agency (BAPPENAS) with the support of Statistics Indonesia (BPS) has assumed primary responsibility for monitoring progress on the MDGs and to this end, they published a substantial progress report in early 2004 providing critical and detailed findings for the period between 1990 (the base year for MDG criteria) and 2002 using official BPS data. Additionally, the Committee for Poverty Alleviation was established in December 2001 under the leadership of the Coordinating Ministers for Social Welfare and the Economy.⁶ The Interim Poverty Reduction Strategy Paper (Secretariat-Committee for Poverty Alleviation 2003) produced by this Committee emphasises four priority areas in line with the MDGs: creating jobs and business opportunities, community empowerment, capacity building and social protection. The Committee's most recent publication *National Poverty Alleviation Strategy* (SNPK 2005) provides thorough findings on a range of social and economic indicators and also articulates a set of detailed policies and approaches to further poverty alleviation. Indonesia's latest 2004–9 Medium-term Development Plan specifically aims to achieve sustainable economic growth of 7 per cent annually by 2009 and to halve poverty to 8.2 per cent by 2009. In support of this plan, the Asian Development Bank (ADB) launched a US\$200 million loan programme to help Indonesia achieve the MDGs by improving macroeconomic policy making focusing particularly on fiscal policy.⁷

While the central government has taken steps to make poverty alleviation and human development an organising principle in developing linkages and partnerships between ministries, the incorporation of district governments in the policy formation, planning and implementation of this agenda has been notably lagging. Also, while the BAPPENAS (2004) Progress Report certainly represents a positive step in monitoring progress on the MDGs, not enough emphasis or resources have been devoted to participatory monitoring and evaluation at the local level.

Since decentralisation began in 1999, the district-level governments in Indonesia have assumed primary responsibility for implementing many of the social and economic programmes designed by the central government, yet these governments lack sufficient training and experience to monitor and evaluate the progress of these programmes. What is more, although local governments are granted general grant implementation funds through the Special Allocation Funds (DAU), the correlation between district-level GDP/poverty and the amount of DAU received is quite low (UNDP, BAPPENAS, BPS, 2004: 71), suggesting inefficient allocation and local capture.

2.4. Democratisation and Decentralisation for Poverty Reduction

The main challenges before Indonesian policy makers today are the regional disparities in terms of progress towards MDG targets. Indonesia's National Human Development Index (Indonesia Human Development Report 2004) indicators disaggregated by province and district, reveals the

⁶ Keppres No. 124/2001 and Keppres No. 8/2002 established the committee with Coordinating Ministers for People's Welfare and Economic Affairs. In 2003, this Committee prepared the Interim Poverty Reduction Strategy Paper (Secretariat-Committee for Poverty Alleviation 2003) as a platform of the long-term strategy for poverty alleviation in Indonesia. The paper advocated revising linkages among Propenas, Annual Development Plan, RAPBN, Local Annual Development Plan (Repetada) and RAPBD.

⁷ 'RI gets \$200m for policy reform program', *Jakarta Post* 23 December 2005.

extent of divergence in human development progress across Indonesia. The provinces lagging furthest behind on several indicators include Aceh and several eastern provinces such as Maluku, Papua, East and West Nusa Tenggara and Gorontalo. Yet the real disparities occur not between but rather within provinces – between districts and between rural and urban areas. Such divergence highlights a more crucial policy challenge. Based on administrative expedience and a desire to rapidly achieve the MDGs on a national level, policy makers might target the poor nearest the poverty line leaving the most vulnerable behind.

To some extent, this is a district-level concern in that Indonesia may likely achieve the MDGs on a national level, yet many of the poorer districts are likely to miss them. In Bengkulu, for example, it will take an estimated 148 years to reach the target of providing universal access to clean water (UNDP, BAPPENAS, BPS, 2001: 50). This uneven record on decentralisation suggests that a primary goal and also a fundamental instrument in achieving the MDGs must be to strengthen the quality of governance within and between districts as well as their linkages with the centre. Furthermore, each of the districts has distinct, locally specific programmatic needs, and to implement a single, one-size-fits-all national poverty reduction programme would be not only unfeasible but also imprudent. District and local governments must be empowered to undertake locally specific participatory monitoring and evaluation as well as to design their own social programmes.

2.5. Current State of Social Welfare, Poverty Alleviation and Social Safety Net Programmes

Indonesia has made notable strides in poverty reduction since the crisis. Extreme poverty fell from 20.6 per cent in 1990 to below 10 per cent in 2002 (BAPPENAS 2004). One of the targets put forward in *Propenas* was to reduce the poverty headcount to 14 per cent and the number of absolute poor to 4 per cent by 2004. According to *SUSENAS* figures, the poverty headcount rate in 2004 was 16.66 per cent. Based on SMERU simulations using this data, assuming perfect targeting of the recent cash transfer programme in the wake of the fuel subsidy cuts,⁸ the poverty headcount would rise to 17.87 per cent. Assuming imperfect targeting, which was generally observed in a recent field study by SMERU (2006), the poverty headcount would rise further (e.g. with 50 per cent correct targeting, poverty would rise to 20.05 per cent). Despite significant achievements in reducing poverty, challenges remain when we consider not merely changes in the poverty rate from one year to the next but instead vulnerability to poverty as a richer measure of poverty dynamics over time (Chaudhuri et al. 2002; Pritchett et al. 2000; Suryahadi and Sumarto 2003). Such measures, which make a distinction between chronic and transient poverty as well as vulnerability across groups, provide not only a richer (and often times bleaker) picture of household welfare but also information allowing policy makers to design and sequence social welfare programmes more efficiently.

⁸ In March and October 2005, the Government of Indonesia cut the longstanding subsidies on fuel products to bring them closer to the prices on international markets. After the October subsidy cuts, the government implemented a cash transfer programme, which provides compensation of Rps 300,000 every four months to poor households for one year. Full details and a rapid appraisal study of the programme can be found in SMERU (2006).

Another component of poverty alleviation that has received insufficient attention in Indonesia's MDG literature⁹ is the issue of inequality, both income and non-income measures. The relationship between inequality and poverty is well-documented, and in Indonesia, inequality remains a salient issue although the national Gini coefficient has remained around an average of 0.35 for the past few decades.¹⁰ According to SMERU's findings over the period 1984–2002, reductions in income inequality were a primary determinant in the growth elasticity of poverty, suggesting that considerations of inequality must play a fundamental role in designing poverty reduction schemes in Indonesia (Suryahadi et al. 2005).

Food insecurity is also a vital concern in Indonesia, where approximately two-thirds of the population (64.6 per cent in 2002) consumes less than the minimum level of dietary energy, 2,100 kcal/day (BAPPENAS et al. 2004). Vulnerability to poverty and inequality in Indonesia make the need for improved social protection more urgent in order to help not only poor but also near-poor households to cope with shocks and to manage risk.

At the heart of achieving the MDGs must be continued improvement in the provision of public services and social safety net programmes. Although Indonesia's public expenditures on education remain significantly below the 20 per cent target stipulated in Indonesia's constitution, the country has made quite significant strides in improving access to basic education since the early 1990s. In 2005, approximately 9 per cent of the budget was spent on education, yet Indonesia spends a far lower proportion of its GDP on education than most other Asian countries (UNDP 2004). Nevertheless, in 1994 Indonesia adopted the Nine Year Compulsory Basic Education Program, which aims to achieve a gross enrolment ratio of 90 per cent through junior secondary education by 2008 – a benchmark that is in fact more ambitious than MDG targets.

Net and gross junior secondary enrolment ratios have consistently exhibited little difference between genders or between income quintiles; instead, the largest disparities are between provinces, ranging from 38 per cent in East Nusa Tenggara to 80.2 per cent in Aceh (BAPPENAS et al. 2004). Nevertheless, Indonesia has shown remarkable success in achieving educational equality between boys and girls as evidenced both by enrolment rates and a near unity (99.8 per cent) literacy gender parity index for ages 15–24.¹¹ Primary enrolment ratios are much closer between regions. The primary net enrolment ratio was over 90 per cent and the primary gross enrolment ratio above 60 per cent by 2002, reflecting significant progress since the early 1990s. Not to mention the 81.7 per cent net enrolment ratio for ages 7–18 in 2003 (BAPPENAS et al. 2004).

In Indonesia, the main problem lies not in the quantity of education in terms of enrollment but rather in the quality of education. Universal education is a necessary goal in and of itself, but in

⁹ Inequality is not explicitly mentioned once in the BAPPENAS report on Indonesia aside from a few tables in the appendix broken down by income quintiles.

¹⁰ See Booth (2000) and UNDP (2004) for graphs showing this trend.

¹¹ This is arguably the most relevant age group for literacy, but even when increasing the upper age to 40 years, there is still relative parity, suggesting that the literacy gap between men and women in the population as a whole is largely an old-age phenomenon and hence does not reflect the successes of the past 20 years.

Indonesia, greater emphasis has recently been placed on strengthening the quality of education. Debates in official policy circles have begun to address educational reform issues such as better teacher training and curriculum reform. The largest teachers associations in Indonesia recently filed a case with the Supreme Court contending that the budget for 2006 is unconstitutional as it only allocates 8 per cent of the budget to education instead of 20 per cent as stipulated in the Constitution. With 8,000 schools across the country in utter disrepair, they are demanding greater budgetary support from the government (Rukmantara 2006).

In health, Indonesia has made notable strides towards achieving the MDGs but still has a long way to go. Maternal and neonatal health indicators suggest that nationally, Indonesia has achieved a significant decline in infant and under-5 mortality, and the maternal mortality ratio has dropped slightly but will require substantial efforts to reach the MDG target by 2015. Like other MDG indicators, there is significant variation between regions and particularly between the eastern and western provinces. Although Indonesia still lags behind other countries in the region, its achievements in health cannot be underestimated, and the success of its National Family Planning Agency (BKKBN) remains a model for the developing world. Also notable are the three national health programmes established in *Propenas*: (1) Healthy Environment, Healthy Behavior and Community Empowerment Program, (2) Health Promotion Program and (3) Nutrition Improvement Program. In addition, Law No. 23/2002 on Child Protection specifies policy initiatives targeting children's health.

In terms of combating HIV/AIDS, malaria and other infectious diseases, the government had undertaken several programmes with variable success,¹² but the pressing demands of the crisis made it difficult to continue with such programmes. While Indonesia's Malaria Control Program has taken a proactive approach to combating the spread of the preventable disease, more than 90 million Indonesians live in malaria endemic areas with infection rates as high as 10–20 per cent in some of the eastern provinces (BAPPENAS et al. 2004). Tuberculosis also has a high rate of prevalence in Indonesia, but the government has had some success in improving both the detection and treatment of the disease. Indonesia has established an epidemiological surveillance system that could potentially serve to strengthen the pre-emptive public capacity in tackling infectious diseases, especially emerging threats such as avian flu.

Environmental and gender issues play a vital role in health at the community, family and individual level in Indonesia. Ensuring environmental sustainability in the world's fourth most populous nation is no short task. According to a World Bank study (2003), Indonesia has the poorest air quality and weakest sewage and sanitation coverage in Asia. Access to safe drinking water represents a difficult challenge with only 48.2 per cent of the population having access and considerable water shortages with an additional 93,000 litres/second of water production needed to meet the MDG target of 168,000 litres/second (World Bank 2003). The main challenge facing the Office of the State Minister for the Environment today is two-fold: the lack of awareness among the Indonesian population and the lack of political commitment and sense of urgency among public officials. The

¹² A National AIDS Committee was in place from 1988 to 1994 but has not been reactivated since. The World Bank launched an AIDS project in 1996, but it was suspended in the wake of the crisis.

2006 national budget allocates a mere US\$11.2 million to a Special Allocation Fund for the Environment targeting 330 districts – an initiative which environmental groups deem insufficient and too restrictive (Rukmantara 2005).

While female educational achievement remains high relative to other Asian countries, Indonesia only ranks 91 out of 144 countries on UNDP's Gender Development Index, and gender remains a vital issue at the forefront of development challenges. Gender empowerment has been emphasised through Presidential Instruction No. 9 of 2000 on Gender Mainstreaming. In a country where the female labour force participation rate is 50.1 per cent and females are significantly over represented in unpaid labour (32.7 per cent of female workers and only 6.5 per cent male workers; Timmer, 2005: 100–1), strengthening the role of women in the Indonesian economy and polity at all levels of economic activity and governance is a key to poverty reduction.

In the midst of the crisis, the Government of Indonesia implemented a wide range of social safety net programmes targeting poor and vulnerable households. The government's primary food security initiative has been the Rice for the Poor (*Raskin*) programme, which has provided subsidised rice at below market prices at the village level from 1998–2003. Several government agencies implemented the labour-intensive (*padat karya*) work programmes that provided employment and generated income among that sector of the labour force most adversely affected by the crisis from 1998–2000. In line with its decentralisation programme, the government's PDM-DKE community fund programme provides block grants for public works and revolving credit funds. In health, the government provided subsidies for medical services, family planning, nutrition, and operational support for health centres and midwives as well as health cards to poor families to utilise healthcare services (1998–2002/3). In education, scholarships ranging between Rps10,000–30,000 were provided to students in primary and lower/upper secondary schools as well as block grants to selected schools.

While the targeting of these programmes has been called into question by numerous authors,¹³ the fact remains that without such programmes, poverty levels would not have recovered from the crisis as noted above. In designing programmes, like the health and education subsidies, policy makers have the challenge of targeting both the demand and supply side of social service provision. Today, as Indonesia's budgetary allocations to social and human development priorities are among the lowest in South-east Asia, its policy makers face a critical tradeoff between repairing the state budget and making necessary social investments.

3. Policy Challenges

3.1. Rural-urban Disparities: Challenges and Policy Directions

The majority of poor in Indonesia are in the agricultural sector. From 1993–2003, the number of households in the agricultural sector increased from 20.8 million to 25.6 million. In the same period, the number of small peasants, which usually belong to the poor section of the population, also has

¹³ See Sumarto et al. (2004); Perdana and Maxwell (2004), among others.

increased from 10.8 million to 13.7 million households.¹⁴ Thus, problems in this sector (e.g. low growth, the decrease in productivity, the increasing importation of various commodities, and environmental degradation) are at the core of poverty. With regard to this, the rural economic growth is important for poverty reduction, especially when it focuses on small-scale farming. In order to achieve this, it is also important to develop a better irrigation system, to strengthen economic organisations in rural areas, to introduce suitable agricultural inputs and technologies that can enhance the quality of commodities, and to improve human resources quality and skills of farmers.

Research has shown that 37 cities in Indonesia, which constitute only 9 per cent of the total administrative area, contribute 40 per cent of the total GDP. The huge extent of these 37 cities' contribution to GDP indicates the large imbalance between cities and districts in contributing to the GDP. In fact, the 14 largest cities contribute 30 per cent of national GDP.¹⁵ This situation suggests a large imbalance between large and small cities and also between districts. These interregional disparities cause rural areas to be left behind urban areas. This situation is exacerbated by the limited provision of job opportunities in rural areas and limited infrastructure supporting the development of human resources in villages; not to mention that the agricultural sector remains less profitable compared with other sectors.

The emergence of the above disparities resulted from unbalanced development in the past, when growth efforts were concentrated in large cities. One factor influencing the allocation of development funds is the number of population, and therefore development has been concentrated in large cities especially in Java, leading to vast urbanisation since the early 1970s.

One solution for addressing these problems lies in government policy and commitment including revitalising agriculture, stimulating non-agricultural rural economies, and local capacity building. The programme for backward villages (IDT) in the mid-1990s provided direct grants for development projects to poor villages identified by the central government, and in the era of decentralisation after 1998, the *kecamatan* development programme (KDP) has provided grants to sub-district governments which then allocate funds to villages in a competitive proposal process for a range of small-scale infrastructure, economic and social activities. Today, the Government of Indonesia should continue with such rural development initiatives in the context of not only strengthening local government capacities but also fostering partnerships between local governments and the private sector.

3.2. Fiscal Disparities: Challenges and Policy Directions

Fiscal decentralisation is one mechanism for transferring funds from central to regional governments in accordance with national fiscal policy. This is aimed at developing sustainable fiscal security and providing a stimulus for economic activity in that region. Decentralisation was,

¹⁴ SMERU calculations based on BPS data.

¹⁵ Wuryanto, Luky Eko (2005) '*Pengurangan Kesenjangan Kota-Desa di Era Otonomi Daerah: Prospek dan Tantangan*' (Reducing Urban-Rural Disparities in the Era of Regional Autonomy: Prospects and Challenges). Paper presented at the SMERU Research Institute Workshop, 'Unleashing the Potential for Poverty Reduction in Indonesia', 15 December 2005, Jakarta.

therefore, expected to create the equal distribution of financial capabilities between regions, matching the scale of authority in government affairs that was devolved. In reality, however, the capability of each region varies, resulting in the emergence of inequality. Fiscal inequality is one problem faced in the implementation of public services. The other cause, apart from inequality, is the formula for general allocation funds (DAU) that are not yet calculated on the basis of the fiscal gap concept.¹⁶ Brodjonegoro argues that revenue sharing created significant interregional fiscal disparities and enriched only a small number of districts, but fiscal disparity has actually improved significantly in the past several years with the (*per capita* based) coefficient of variation falling from 1.12 in 2001 to 0.9 in 2005 (Brodjonegoro 2005).

There are at least three problems that have emerged with the onset of decentralisation, namely: (a) the distribution of authority between central, provincial and district governments is not yet clear; (b) not all sectoral laws are yet in accordance with Law No. 32 of 2004 on Regional Government and (c) fiscal capacity is not equal between regions and general allocation funds are not yet functioning as an equalisation mechanism.

One means to determine the interregional disparity was a survey conducted by the Department of Finance on fiscal transparency, using four criteria: (a) clarity of roles and responsibilities; (b) public availability of information; (c) open budget preparation, execution, and reporting and (d) assurances of integrity (Prijadi 2004). Other research by Tri Wibowo (2004) argues that broad financial management authority for regions needs to be balanced with reliable human resources in the planning, allocation and implementation of regional budgets. Regulations on the use of general allocation funds as block grants that have been fully devolved to regional heads are viewed as needing 'road signs' in their implementation, so the objective of even distribution of financial capability can be achieved. For that reason, inequality needs to be handled through a strategy and policy of regional development via equalisation, area development and capacity building. The general allocation grants (DAU) have been relatively successful in equalising fiscal capacity between regions, with the coefficient of variation stable around 0.65 in the period 2001–5 (Brodjonegoro 2005).

Equal distribution is undertaken by (a) increasing or optimising the equalisation function (balancing factor) of general allocation funds; (b) by applying the concept of fiscal gap to correct interregional inequality; (c) government commitment for developing isolated, left-behind districts via special allocation funds (DAK), public service obligation (PSO), universal service obligation (USO) and pioneering programmes; and (d) developing minimum service standards, especially for the strategic sector associated with basic services.

Regional development is undertaken by (a) enhancing the relationship among inter-regional economic activities; (b) accelerating the development of small- and medium-sized towns as the engine of district development; (c) supporting provincial government to facilitate inter-regional cooperation; and (d) supporting an increased role for the private sector in infrastructure in their district.

¹⁶ Fiscal gap: The difference between the fiscal need and the fiscal capacity.

3.3. Health Sector: Challenges and Policy Directions

3.3.1. The Reform Setting

Similar to other sectors, the health sector in Indonesia could not avoid the growing pressure for reform in the wake of the economic crisis and political upheavals in the late 1990s. Health reform is a necessary component of the overall national development. The following factors make the need for health reform more urgent.

- First, although in terms of health status Indonesia has made great progress between the 1960s and 1990s, the overall level of public health still lags behind its Asian neighbours. Critics point out that health development is still not within the mainstream of national development planning.
- Second, there are still disparities in health outcomes across different provinces and districts, between the poor/vulnerable and the better off, and between rural and urban areas. For example, between 1998 and 2000, West Nusa Tenggara had an infant mortality rate of 74 per 1,000 live births, while Yogyakarta's was 20 per 1,000.
- Third, Indonesia has undergone a fundamental demographic transition. Indonesia's population has grown from 147.5 million in 1980 to 210.5 million in 2000, and today is estimated at 214 million. This growth is combined with changes in the age structure in which there has been a shift from a young to old population age structure. Yogyakarta, Central Java, East Java, Bali and West Sumatra are provinces with the largest elderly populations. In such regions, sufficient information on health status and healthcare needs of older populations should be an important foundation of health policies. However, in many developing countries including Indonesia, health policies and programmes have been more oriented towards fighting infectious disease and addressing the needs of mothers and children than caring for the elderly population (Hermalin et al. 2002). The demographic transition requires adjustments in policies, programmes, initiatives and financing priorities in the health sector.
- Fourth, there are many environmental changes that affect public health. As discussed below, severe air pollution in large cities, for example, has caused respiratory diseases and high blood lead level among children that can negatively affect their cognitive development.

3.3.2. The Threat of Major Infectious Diseases

Similar to other Asian countries, the spread of HIV/AIDS infections is one of the most serious problems of public health in Indonesia. Up to 2003, 4,091 cases were reported, but it is estimated that the real number of cases ranges between 90,000 and up to 130,000.¹⁷ The Ministry of Health (MoH) has developed a policy to combat HIV/AIDS infection that focuses on the productive age group of 20–49 years. Although this policy has been criticised as mere formality, there are cases where local government officials are successfully promoting HIV/AIDS awareness and prevention.

¹⁷ Kebijakan Depkes Dalam Penganggulangan HIV/AIDS di Tempat Kerja. Circular subsequent to Minister of Labor and Transmigration Decree No. 68/2004.

In South Sulawesi, for example, government officials have conducted the campaign in close collaboration with high-risk groups such as the transgendered males (the *waria*) (Graham 2003).

Nevertheless, there are other infectious diseases such as malaria and tuberculosis, which still have to be brought under control. Indonesia has also faced the threat of other infectious diseases such as the severe acute respiratory syndrome (SARS) and avian flu. Considering that the Indonesian health sector is still weak in many aspects, the danger of an outbreak is more than real. Efforts to deal with these epidemics in terms of mitigation, preparedness and response must receive higher priority among public policy makers.

3.3.3. The Basic Health Services: Quality and Performance¹⁸

In theory, basic health services, especially the *puskesmas*, are the most important for the majority of people in Indonesia. However, *puskesmas* are often the last choice for getting medical treatment because they are seen as having a low quality of service. In the *puskesmas*, patients are mostly taken care of by nurses and midwives, as the only doctor available in *puskesmas* is burdened with administrative duties and therefore has less time for consultation with patients. Consequently, patients who wish to get better quality services and medication often choose to visit private doctors although they have to pay a higher charge. This contradicts the function of *puskesmas* as the place to obtain better and affordable medical treatment.

Limited operational funds, facilities and difficulties recruiting qualified doctors to lead *puskesmas* also impede the performance of *puskesmas* in providing health services. Recent study demonstrates that especially after the implementation of regional autonomy, *puskesmas* have received minimal funds from regional governments. Before regional autonomy, 80 per cent of *puskesmas* funds came from the central government in the form of block grants, so they could allocate funds according to their own needs and priorities. Due to these barriers, *puskesmas* generally only perform a curative function and are barely able to carry out its promotive and preventative functions (SMERU 2004a).

3.3.4. Financing the Health Sector

The Indonesian health sector usually receives a relatively low allocation of resources, especially when compared with other Asian countries. In 1990, the public and private share of GDP allocated for health in Indonesia was 2.5 per cent compared with 4.5 per cent in other Asian countries (World Development Report 1990 1991). Despite relatively low figures for health expenditure, Indonesia's commitment to the health sector has been rising as a share of all public spending. In 1987/8 the health budget was 2.23 per cent of total government spending while in 1997/8 the budget was 4.55 per cent. Most people still pay for health services in a 'fee for service' model, and only 14 per cent of Indonesians are covered in the health insurance programmes. During the economic downturn in the late 1990s, the health sector made greater use of donor assistance. However, this kind of

¹⁸ There are five types of health services in Indonesia: (1) basic health services including community health centers (*puskesmas*, *pustu*, *pusling*), village maternity houses (*polindes*) and integrated health posts (*posyandu*); (2) secondary health services including public and private hospitals and special clinics; (3) tertiary health services including hospitals specializing in pediatrics, women's health, cancer treatment and cardiology; (4) mass health services such as immunization programmes and (5) traditional healers.

assistance is not a reliable source for the sustainability of health financing. In the long run, Indonesia must mobilise other resources in the country and design a proper health financing mechanism (Santoso 2003).

3.3.5. Decentralisation in the Health Sector

When decentralisation policies were enacted, the reaction from the Ministry of Health was positive. During 2000, the MoH began to clarify its own role in decentralisation, and it designed policies and strategies of health decentralisation.¹⁹ For this purpose, the MoH placed a high priority on developing sectoral vision and formulating it into a policy agenda. Major steps taken included:

- First, the MoH established its Decentralisation Unit (DU) with its main function being to facilitate health decentralisation and advise regional health offices on decentralisation policies. However, the DU's performance was disappointing. It failed to carry out some important tasks such as making a strong case for health grants to the Ministry of Finance and BAPPENAS. Moreover, there was a long disagreement within MoH about where this unit should be placed and what its Terms of Reference should cover.
- Second, the MOH focused on provincial level interventions that aimed at building cross-district capacity including Joint Health Councils (JHCs), comprising district heads and civil society representatives. Nevertheless, there is actually hesitance within the MoH to decentralise its power to the provinces. This hesitation may be due to central officials' preoccupation with preserving their commanding position within the health system. Local governments, especially at the provincial level are seen as rivals, rather than legitimate actors and possible coalition partners with their own rights and obligations in the health sector.

3.4. Education: Challenges and Policy Directions

Education is one means of breaking the vicious cycle of poverty. With an adequate education, individuals can obtain better work and earnings or open a business that can improve their income, enhance their prosperity and finally break free from the cycle of poverty.

Community education commences with basic education, and it is obligatory for the government to provide this basic education. The government and the (private sector) community undertake its implementation. In 1984, the government inaugurated six years of compulsory basic education, and the nine-year primary and junior secondary compulsory education initiative began in 1994.

During the last few years, the government has prioritised various programmes, including improving access and broadening educational opportunities for students. The condition of basic education at the start of the economic crisis (1998–9) showed that the gross participation rate (APK) as well as the net participation rate (APM) at the primary school level declined initially but increased in the following years (Departemen Pendidikan Nasional 2003). The APK rate also increased at the junior high school level from 65.7 per cent in 1995 to 81.1 per cent in 2003, nearing the 90 per cent rate target to be achieved by 2008 (BAPPENAS 2005: 14). However, the APM rate still varies

¹⁹ SK. Menteri Kesehatan Republik Indonesia No: 004/Menkes/SK/2003.

considerably between rural and urban areas as well as between the rich and poor. In 2004, the APM rate for junior high school reached 72.7 per cent in urban areas but only 60.1 per cent in rural areas, while the APK rate for the lowest income quintile was a mere 63.8 and the highest income quintile at 97.2 per cent (BAPPENAS 2005: 15). These disparities suggest that significant effort must be devoted not only to achieving national targets but also to reducing sub-national disparities.

Various policies, programmes and implementation strategies have been prioritised, so that the target of nine-year compulsory education can be achieved.

With the introduction of regional autonomy, the implementation of basic education became the responsibility of district governments. Nevertheless, it needed the cooperation of central, provincial and district government, as in (a) improving access and broadening learning opportunities in remote and isolated regions; (b) increasing the participation rate of women and children; (c) improving the quality and relevance of basic education; (d) managing efficiently the use of education resources; and (e) supporting the participation of the community.

This policy is spelt out in various programmes. Improving access and broadening learning opportunities has been undertaken by: (a) the development of new schools and classrooms; (b) the rehabilitation of primary and junior high school buildings; (c) the retrieval and re-integration of children who have dropped out; (d) empowering and enhancing the quality of services in open junior high schools; (e) improving education programmes outside school; (f) optimising the implementation of basic education; (g) consolidating small primary schools; (h) improving education services for children aged 7–15 years; (i) giving rewards to successful young people. Programmes within the framework of improving the quality and relevance of education include, among others, improving the quality of learning, strengthening the curriculum, improving the student-teacher ratio, advancing the qualifications/competence/professionalism of the education workforce, school equipment and infrastructure, enhancing the quality of text books. Meanwhile, the programme for improving the efficiency of educational management includes the consolidation and revitalisation of schools, improving the management of education, empowering school boards, the participation of the community, the development of an information system on education management as well as systematic monitoring and evaluation.

To implement these various policies and programmes, the government allocates its budgets in a collaborative way with regional governments and the community. Although the government already had a policy and some programmes for reaching the MDGs and compulsory basic education, other supportive efforts are needed, such as: (a) committing to concrete targets and necessary resource allocation; (b) alleviating the burden borne by poor families in schooling their children, primarily female children, in terms of covering school fees, providing study books and uniforms; (c) compensating families whose children are breadwinners in order to lessen the incidence of child labour and (d) bear mutual respect for the rights of female children to schooling.

3.5. Environmental Protection: Challenges and Policy Directions

3.5.1. The Changing Setting

Indonesia is one of the most populous countries in the world. During the period of demographic change over the last 40 years, various environmental and natural resource legislation was enacted.

The monetary crisis in 1997–8 worsened Indonesia's environmental problems. Because of the crisis, Indonesia set aside legislation for environmental protection in order to strengthen local enterprises. 'The costs [of environmental conservation] that are not expended by producers are only shifted to the people living in the vicinity in the form of health disorders or negative side effects, water scarcity, respiratory diseases and so forth' (Makarim 2005). The conflict of 'environmental protection versus economic interests' existed before the financial crisis and has caused hesitation over whether to develop and support environmental conservation. Recently, there are concerns about decreasing political interest and support on the issue of sustainable development in policy making. The State Minister for the Environment has also been criticised as having a weak bargaining position vis-à-vis the president and industry.

In addition, Indonesia has also undergone a series of political changes that affected environmental policy making. In 2002, for example, President Megawati Soekarnoputri dissolved the environmental impact management agency without clearly assigning another institution to assume its responsibilities. Although it can be assumed that the office of the State Minister for the Environment is the most suitable institution for such work, there has been no specific legislative mandate to this effect.

3.5.2. The Most Important Environmental Challenges in Indonesia

Air pollution, especially in the large cities, is probably the most serious environmental problem in Indonesia. It has severe impacts on public health (e.g. respiratory illnesses, a high blood level lead that can adversely affect cognitive development of young children) and imposes costs of at least US\$400 million on the Indonesian economy every year. The main causes of air pollution in Indonesia are motor vehicles, forest fires and industrial activities (chemical, petroleum, coal, plastic and rubber products and food industries).

Water quality in Indonesia is also deteriorating. One of the main problems of water pollution is the lack of sufficient sewage systems. As a result, most Indonesian households have to rely on private septic tanks or to dispose their waste directly into rivers and canals. This has led to significant contamination of Indonesia's surface and ground water, imposing direct economic costs on poor families. Polluted wells in a residential area in Surabaya, for example, forced the inhabitants to buy water for their daily needs (costing around 20% of total income), whereas they previously could get water free of charge from their own wells. Recently, there have also been many problems in the maritime and coastal environment, which are caused by oil spills or dumping of tailing waste.²⁰

²⁰ The latest case of serious coastal pollution is the Buyat Bay pollution (Minahasa, North Sulawesi).

In the forestry sector, illegal logging activity is the most pressing problem in Indonesia. Illegal logging reduces government revenue, decreases the income of local communities, stimulates bad governance, and above all, destroys the natural forest. About 55–75 per cent of industrial wood production is thought to be illegal and causes a loss of US\$1–2 billion in tax revenue.²¹ With the aim to strengthen local communities, the Government of Indonesia legalises small-scale logging in production forests (up to 100 hectares for a short duration, mostly one year). Nevertheless, this policy change has not had the desired effects. Other roots of problems that need to be addressed in combating illegal logging are broad-scale and chronic corruption, weak surveillance, bad governance and political patronage. The problem is made more complex by the fact that a wide range of actors are implicated, including concession companies, logging operators, saw mills, local authorities, central and district governments, and the military.

3.5.3. Environmental Conservation and Development

Ideally, the implementation of sustainable development would strengthen environmental management. Until now, the achievement of development has only been measured in terms of macroeconomic growth without calculating the cost of environmental degradation and destruction. As a result, environmental protection policies still receive a low priority from the government. The existing legislation related to environmental conservation also has a lot of inherent weaknesses. 'Many regulations do not contain clear stipulations. Even if the stipulations are clear, the government regulations, standard operating procedures and technical guidelines have not yet been formulated' (Jhamtani 2005).

3.6. Pro-poor Growth and Decentralisation Policies

Pro-poor growth policy has become very well known in developing countries, especially those receiving assistance from the World Bank. This institution has introduced the concept of quality growth, in which economic growth is gauged not only in terms of the scale but also the quality of growth, and particularly whether such growth led to a reduction in poverty. The figures given earlier in this paper suggest that Indonesia's growth record has been considerably pro-poor. Today, the economic and social planners in the Government of Indonesia should continue to base their development strategies on the principles of pro-poor growth.

Several indicators that show whether a policy is pro-poor are classified into two categories: qualitative indicator and quantitative indicator (Ade et al. 2005: 23–6). Qualitative indicators cover aspects of budget formulation, accessibility, impact analysis and responsiveness. In regard to budget preparation, whether it follows participatory principles, transparency, accountability and control by the community. In regard to this budget and policy, whether the community can easily access information and data and whether the results of this budget preparation process are published. Meanwhile, the quantitative indicators cover budget allocation, budget receipts, fair distribution of general allocation funds and appropriate targeting. Budget allocation shows the commitment of government, in the sense that high budget allocations show high government commitment to the poverty reduction effort.

²¹ Cited in the 'Illegal Logging in Indonesia' brief by the Center for International Forestry Research (CIFOR), www.cifor.cgiar.org/docs/_pf1/_ref/publications/newsonline/30/illegal-logging.htm.

In general, it is certain that decentralisation, including fiscal decentralisation, will enhance social welfare. One reason that is given is that decentralisation brings public services closer to the community. In reality, however, this has not necessarily been the case in Indonesia, because most regional governments responded to fiscal decentralisation by raising regional incomes through taxes and distribution without balancing it with increased effectiveness in budgetary spending (Brahmantio and Wibowo 2002). Instead of focusing solely on taxes, regional governments could increase locally raised revenue by improving the performance of regional government-owned enterprises (BUMD) and optimising the assets of the regional government.

3.7. Beyond the Technocratic Approach: Crucial Issues in Future Poverty Reduction Efforts

Poverty reduction in Indonesia is a fragile and ongoing process. It is susceptible to various social, economic and political shifts. As the indicators noted earlier in the paper suggest, Indonesia has been successful in eradicating extreme poverty, but still has some way to go in eradicating moderate poverty.

3.7.1. The Importance of the Rights and Voices of the Poor

In order to accelerate the process of poverty eradication, the Government of Indonesia developed its Interim Poverty Reduction Strategy Paper. 'The I-PRSP underlines that the full PRSP will be developed based on a combination of the theoretical analyses and empirical evidence from the community, and that the formulation of the PRSP will use a participatory approach' (SMERU 2003). The PRSP is especially interesting because it acknowledges the importance of the rights-based approach to poverty reduction – the perceptions, opinions and voices of the poor compiled in participatory poverty assessments (PPAs). According to this view, national development in general and poverty reduction in particular should respect, protect and fulfil the basic social, cultural, economic and political rights of the disadvantaged and vulnerable citizens. The emphasis on respect, protection and fulfillment of basic rights is at the core of the rights-based approach in the PRSP.

This approach has major implications for policy makers because when developing poverty reduction strategies, policies and programmes they have to ensure that all stakeholders are able to participate actively with sufficient access and information in various stages of formulation, implementation, monitoring and evaluation. Of course, in practice, not all related stakeholders have the capacity to do this. Nevertheless, these barriers do not justify placing them outside the process. On the contrary, poverty reduction efforts should aim to deal with these barriers from the very beginning. Even though it will require considerable time and effort, the capacity of the poor to articulate their interests and needs must be built. As experience demonstrates, poverty reduction efforts, which were dominated by the central government using a top-down approach that did not accommodate the opinions of the poor, suffered from inefficiency, mis-targeting and misuse. In this context, the PPAs become extremely relevant for poverty reduction.

The PPAs are not only used as a means of assessing poverty but also to help poor communities identify their capabilities and opportunities. Several national as well international NGOs have

conducted PPAs in various regions of Indonesia. Results of these assessments bring to the fore some issues that can be important for the revision and improvement of poverty reduction efforts in Indonesia:

- First, poverty is a complex phenomenon, and hence poverty reduction cannot merely be based upon a collection of programmes that are aimed at dealing with elements of poverty individually.
- Second, the poor are far from being a homogeneous category. Sub-groups among the poor – based on gender, age, rural-urban setting, types of livelihood – have different perceptions on the causes and experience of poverty, and hence on the ways to move out of poverty. Different groups also have different opportunities and limitations. As a consequence, different groups will benefit differently from particular programmes. Therefore, this heterogeneity needs to be accommodated when designing, implementing and evaluating poverty reduction programmes.
- Third, powerlessness manifested in the lack of capabilities to influence decisions remains a dominant cause of poverty and the problems faced by the poor. Providing direct aid for the poor will not be sufficient in reducing poverty. Policies and legislation that can enhance the capabilities of the poor to influence decisions that affect their lives are even more crucial and relevant for long-term welfare improvement.
- Fourth, informal institutions such as family and neighbourhood relationships, networks based on religion or ethnic ties, and rotating savings and credit groups (*arisan*), have a major role in the lives of the poor. These are often considered as important sources of information and assistance. Therefore, instead of using the formal institutions that are considered as far removed from the lives of the poor, poverty reduction efforts should focus greater attention on informal institutions (SMERU 2004b).

3.7.2. The Importance of Gender

The connection between gender and poverty is very complex and has been examined elaborately. In relation with poverty, it is argued that women are in general poorer than men, and therefore special attention should be given to prioritising poverty reduction efforts for women and reducing gender inequality. In Indonesia, however, household consumption data does not necessarily support this view. In 1996, for example, the level of poverty in male-headed households (27.6 per cent) was actually higher than in female-headed households (25.8 per cent). 'Nevertheless, the argument that women are indeed poorer than men has recently continued to strengthen, in parallel with the development of a poverty conceptualization that no longer views poverty only from dimension of household consumption, but also from the perspective of limited access and capabilities as well as opportunities for self-development to enhance well-being' (SMERU 2005).

Women living in poverty are often among the most vulnerable members of communities. In Indonesia, women with low and unstable income are major participants of the informal economy.

They generate their income from activities such as micro-enterprises and cleaning services. In this informal sector, women tend to receive lower wages than men. Although the population of women of productive age is almost the same as men, Indonesian women only represent around 35 per cent of the total workforce. In addition, at all education levels, women tend to have fewer opportunities to obtain work. When economic crisis hit Indonesia, female workers were among the most severely affected. Between 1997 and 1998, the number of women who earned wages below the poverty line doubled from 11 per cent to 22 per cent.²²

It is clear that women are generally most vulnerable to chronic poverty because of gender inequalities in the distribution of income, in access to credit schemes, in control over property and natural resources, and due to biases in the labour market (UNDP, BAPPENAS, BPS 2004). Therefore, it is urgent to link gender issues into broader strategies for economic development in Indonesia. To achieve this, policy makers must improve the national policy framework for gender mainstreaming.

3.7.3. The Importance of Ageing

Indonesia possesses one of the fastest ageing populations in the world. It is estimated that between 1990 and 2025 Indonesia's elderly population will have increased by 400 per cent and that the country will have 32 million individuals over 60 years old by 2025. However, mere generational numbers are insufficient to reveal the implications of these shifts. Economic imbalances, cultural differences and patterns of population movement mean that elders and their families in many parts of Indonesia are increasingly exposed to marginalisation, social exclusion and poverty. This represents pressing concerns:

1. The demographic transition has outpaced economic development. Unlike in Western Europe, where population ageing began only after a certain level of prosperity had been reached, a country like Indonesia cannot afford the expenses for social security and healthcare that are needed. Additionally, institutional frameworks for formal provision of welfare and healthcare are weak and, when available, need to be transformed to cater for the needs of the elderly.
2. In spite of all the rhetoric about the value of the 'extended family' and 'Asian values', there are fewer children to care for more elderly, and due to increasing migration, many elderly do not have their children living nearby anymore. During 1980–2005 the average household size declined from 5.2 to 3.8, and today almost half of the Indonesian population is living in an urban area. Support provided by families and communities, while critical for present-day elders, is incapable of securing the welfare of major sub-groups, especially the large numbers in lower economic strata, the childless and child poor.
3. Despite this, ageing has not yet been identified as an important policy issue in Indonesia. In the health sector, the few existing programmes for older populations are limited in terms of types, funds and resources. Moreover, they tend to be fragmented according to different

²² Cited in 'Equal in Every Way: Support for Mainstreaming Gender in Development Policies and Programmes', UNDP, January 2004, www.undp.or.id.

sectors. These sorts of programmes usually fail to recognise the heterogeneity of the older population. Implementation is too often based on standardised guidelines and does not respond to the various problems of the elderly. One of the programmes managed by Ministry of Social Affairs is the nursing home for the poor and neglected elderly. In 2000, there were approximately 141 nursing homes for the elderly throughout Indonesia, covering 8,308 persons. The Ministry of Health, the Population and Family Planning Coordinating Board and the Ministry of Man Power also have programmes for the elderly, but it seems that each sector works in isolation. As a result, these programmes have a narrow scope and are fragile in terms of sustainability. During the economic crisis, all programmes subsidised by the government, including those for the elderly were severely affected. Some were stopped and many were reduced in scope and coverage (Do-Le and Rahardjo 2002).

3.8. The Centrality of Governance Reform

The Government of Indonesia has recently taken a number of measures in its 'war against corruption' launched in the late 1990s. However, according to Transparency International's Corruption Perception Index, Indonesia has annually ranked among the five most corrupt countries in the world even after the fall of Soeharto. The main problem has been that the government lacks an integral strategy in terms of prosecution, prevention and education. To confront this deficiency, the government established in 2002 an interagency Corruption Eradication Commission (KPK), and in December 2004 the government founded the National Movement for the Eradication of Corruption – an initiative led by BAPPENAS targeting corruption at all levels of governance from local village leaders to the police force to the judiciary. Several researchers have found that corruption has a negative impact on growth rates over time in addition to the more obvious welfare losses. While the full social costs of corruption are quite difficult to measure, governance indeed matters²³ and Indonesia's road to recovery has provided substantial evidence of the positive relationships between good governance and pro-poor growth (Arifianto et al. 2004; Henderson and Kuncoro 2004; Olken 2005). Corruption eradication must not simply be viewed as a means of improving investor confidence but rather as a vital instrument in economic recovery, the improvement of public services and the efficiency of the state budget. The primary burden of responsibility most certainly lies with the government, but there are now a range of non-governmental actors, such as Corruption Watch, that have stepped up the pressure on the government to take more concerted action against corrupt private and public sector officials.

3.9. Debt and the Development Financing Constraints: Empowering the Indonesian Budget to Lead Investment

According to many Indonesian policy makers and analysts that attended the 15 December 2005 conference at SMERU, the debt burden remains the fundamental obstacle to the country's sustainable growth and poverty alleviation. Between 1997 and 2003, Indonesia's public external debt increased from US\$54 billion to US\$80 billion. By 2002, the ratio of external debt servicing to

²³ Several researchers from the World Bank have constructed governance indicators for 199 territories and countries in a series of studies initiated in 1999. The studies cover six dimensions of governance and provide a unique barometer for Indonesia where the indicators show variable rate. For a list of the publications in the 'Governance Matters' series, see www.worldbank.org/wbi/governance/govdata/.

development expenditure reached 140 per cent (Chowdhury et al. 2004: 42). As of September 2005, the government's outstanding external debt had reached approximately US\$78.5 billion, and with the Paris Club agreement in March 2005 to delay US\$4.7 billion in Indonesian debt payments due in 2005,²⁴ the government's total Official Development Assistance (ODA) external bilateral and multilateral debt reached US\$28.3 billion and US\$26.7 billion, respectively.²⁵ The national budget for 2006 allocates US\$9.25 billion to debt repayments.

To many observers outside the government, the discussion of poverty reduction and sustainable growth strategies must begin first and foremost with the explicit recognition that the country's 'odious' debt burden is *the* fundamental factor keeping Indonesia from realising its potential for poverty reduction. Prominent non-governmental organisations such as the Anti-Debt Coalition (KAU) and the International NGO Forum on Indonesian Development (INFID) argue that debt rescheduling or further soft loans from the World Bank are insufficient means of solving the debt crisis and that outright debt cancellation is the only means of enabling Indonesia to achieve the MDG targets.

Many believe that the burden of this debt on the social priorities of national budgeting has not been sufficiently addressed by the donor community. First of all, the government has become increasingly dependent on ODA for development financing with 48 per cent of development finance between 1986 and 1996 supported by ODA and 67 per cent since the crisis (Chowdhury et al. 2004: 38). Additionally, the majority of ODA funds to Indonesia each year flow back to donor countries in the form of debt servicing. In 2004, Indonesia received US\$10.5 billion in gross aid financing, yet US\$7.6 billion went to debt repayment while only a total of US\$2.9 billion went to development programmes and projects (Bahagijo 2004). While foreign aid certainly helped maintain spending on essential social services during the crisis, ODA for debt relief should be additional to and not in place of programme and project aid (UNDP 2003).

4. Conclusion

The many policy challenges noted above present Indonesian policy makers with difficult choices in terms of funding priorities and implementation strategies. Further effort is needed to reach the consensus necessary to forge productive partnerships across ministries and between various actors in the public, private and NGO sectors. There are of course several different voices with a range of different opinions on how to tackle the salient socioeconomic challenges Indonesia faces today. Where the various actors agree, however, is that the demands of macroeconomic stability have placed fundamental constraints on public spending for MDG-related programmes. Many NGOs and analysts outside the government such as KAU and INFID argue that debt cancellation is the only acceptable and sustainable solution to catalysing Indonesia's growth and human development. In general, government officials have placed greater emphasis on deepening the national tax base and restructuring various price-distorting subsidy programmes as the means of generating greater fiscal resources and balancing the budget. Most policy makers and analysts

²⁴ This decision overruled the previous agreement on 12 January 2005 to suspend indefinitely Indonesia's public debt repayments.

²⁵ These figures are from the Bank of Indonesia.

agree, however, that debt sustainability should be more directly linked with the attainment of the MDGs in order to create greater fiscal space for policy makers. One area of sure concurrence among policy makers is the belief that local and regional governments must continue to play larger roles in the provision of public services like education, health, and environmental protection. As demonstrated by the evidence in sections two and three, Indonesia has made significant progress towards several of these MDGs thus far. With greater coordination among Government of Indonesia policy makers as well as between the Government of Indonesia and its donors, Indonesia's chances for achieving the MDGs can only improve.

In terms of the donor-recipient relationship, several recent developments and policy positions are noteworthy. First of all, debt-for-equity swaps could provide an alternative solution to the outflow of ODA for debt servicing. For example, since December 2000, the German government has taken an innovative approach with its Indonesian debtor by launching three separate debt-for-equity swaps in education and environmental programmes stipulated by the German government. The primary concern of most donors in undertaking these swaps is the problem of fungibility whereby funds may potentially be diverted to uses other than those specified in the swap agreement. The German government, however, found a practical solution to this concern by ensuring that the Indonesian government spend half of the agreed upon debt amount before the debt will actually be written off. In October 2002, the German government and the Government of Indonesia signed a contract stipulating that if Indonesia spent 11.5 million Euros on new school construction the German government would cancel 23 million Euros in bilateral debt. For its part, the Indonesian government should continue to strengthen its anti-corruption and governance reform efforts to signal to donors its preparedness to efficiently manage debt-for-equity swaps.

Another positive development was the Government Regulation No. 107 of 2000 that has enabled the decentralisation of foreign aid. Regional governments can obtain foreign loans directly after having approval from the central government. Foreign donors along with the central government should publicise the specific details of why the recipient district government received assistance so as to stimulate positive responses in other districts to poverty alleviation efforts. The full implications of this stipulation have yet to be tested, but one practical policy recommendation for donors would be to target those regional administrations most receptive to poverty alleviation programmes. Lastly, the improvement of donor coordination remains central in Indonesia. A primary complaint from those both outside and inside government has been that the Consultative Group on Indonesia chaired by the World Bank basically micromanages Indonesia's policy reforms and development planning. Offering Indonesia a stronger leadership role in the CGI working groups would be in both the donors' and recipient's best interests. In the final analysis, the main goal of Indonesian policy makers and foreign donors should be to empower the Indonesian budget to lead investment towards further developing the country's real economy, the human and physical capital on the road to sustainable, pro-poor growth.

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