



Republic of Indonesia
Ministry of National Development Planning/
National Development Planning Agency

POVERTY REDUCTION IN INDONESIA: A BRIEF REVIEW OF FACTS, EFFORTS, AND WAYS FORWARD

Forum on National Plans and PRSPs in East Asia

Vientiane, Lao PDR

April 4-6, 2006

A. INTRODUCTION

Poverty is a multi-dimensional problem requiring holistic solutions that are sustainable over time. As a country characterized by great diversity in culture, religion, ethnicity, ecology and economies, Indonesia has experienced many challenges in pursuing poverty reduction. Economic growth and increased income are important but not the only routes to poverty reduction. These need to be complemented by better access to basic services, empowerment of the poor, and reduction of social exclusion, insecurity and vulnerability.

Poverty reduction has entered the mainstream of the country's development agenda. Poverty reduction was never explicitly discussed as a policy issue in any official documents until the early 1990s. Since then, it has been articulated in all key policy and planning documents as Indonesia's highest priority objective. In 2001, the government formed the inter-ministerial Poverty Reduction Committee in order to implement a set of comprehensive and harmonized actions in poverty reduction. Under the coordination of this committee, and through various forums and meetings, stakeholders at the national level prepared an Interim-Poverty Reduction Strategy Paper (I-PRSP), a road map for the development of the National Strategy for Poverty Reduction (SNPK).

The current government has made poverty reduction a priority in its medium term and annual plans. The 2004-2009 Medium-Term Development Plan (RPJM) provides broad strategic direction for the government over the next five years. The RPJM incorporates the SNPK and addresses the growth-related aspects of poverty reduction.

In these documents, the government has set poverty reduction targets linked to the Millennium Development Goals. The government stands firm that the MDGs should not just be treated as a declaration of good intentions, but be backed up with definite actions on poverty reduction. Indonesia has faced some recent challenges in poverty reduction, including the tsunami disaster and the reduction of fuel subsidies. There have also been opportunities, however, to refocus policy and budget allocation to achieve better the Government's poverty reduction targets, such as through using savings from the fuel subsidy reduction to finance more progressive social protection programs and improve the poor's access to health and education.

This brief will explain some facts, policies and programs, and possible way forward in relation to poverty and development policies in Indonesia. Section A gives introduction. Section B gives an overview of facts about poverty in Indonesia and highlights the important elements of poverty reduction strategies. Section C presents how the poverty reduction strategy links to national development policies and programs. Finally, section D, discusses some challenges and possible strategies to address poverty in Indonesia.

B. POVERTY AND POVERTY REDUCTION INDONESIA

Indonesia has made significant progress in reducing poverty since the 1970s. The period from the late 1970s to the mid 1990s is considered one of the most "pro-poor growth" episodes in the country's economic history. Through various development policies and programs, such as better food security, agricultural development, the provision of revolving loans, investment in education, health services, and infrastructure, the number of people living in poverty decreased from 54.2 million (40.1%) in 1976 to 34.5 million (17.7%) in 1996. Growth is believed to be the most important determinant of poverty reduction. Increases in agricultural productivity have enhanced rural demand and off-farm employment. Increasing productivity and wages also

allowed for growth in non-agricultural work, which has become another pathway out of poverty. Over the last 20 years, half of those who have moved out of poverty have done so by moving to non-agricultural work, primarily to urban areas.

The economic crisis that broke out in July 1997 had serious impact on people’s lives. The prolonged crisis caused not only a reduction in the quality of public facilities and services but also disruptions to public order and security, and decreasing trust in the state bureaucracy. The crisis also led to an increase in the number of poor to 49.5 million people (24.2%) in 1998.¹ Through macroeconomic stabilization, accompanied by a reduction in inflation and various development programs including social safety net schemes specifically designed for the poor, the number of poor people decreased gradually to 36.1 million people (16.1%) in 2004. Progress was hampered somewhat by the tsunami disaster in Aceh and North Sumatra Provinces at the end of 2004 and several other natural disasters across the country, which increased number of poor. The number of poor was estimated around 35.2 million (15.8%) at the end of 2005. Poverty trends from 1976 to 2005 are shown in Figure 1.

Figure 1. Poverty Trends In Indonesia

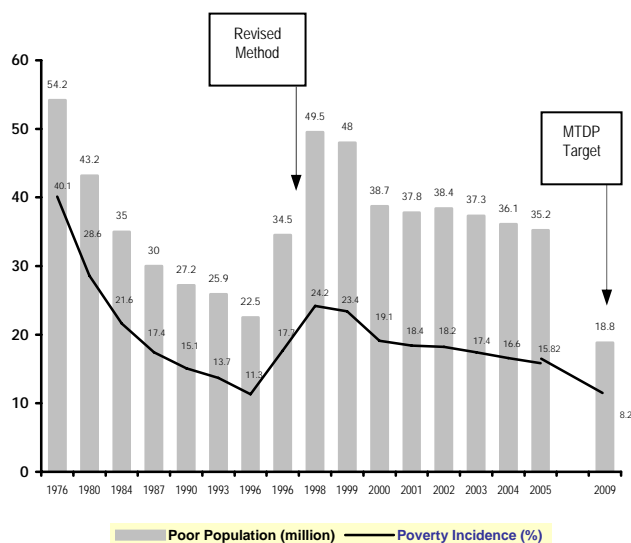
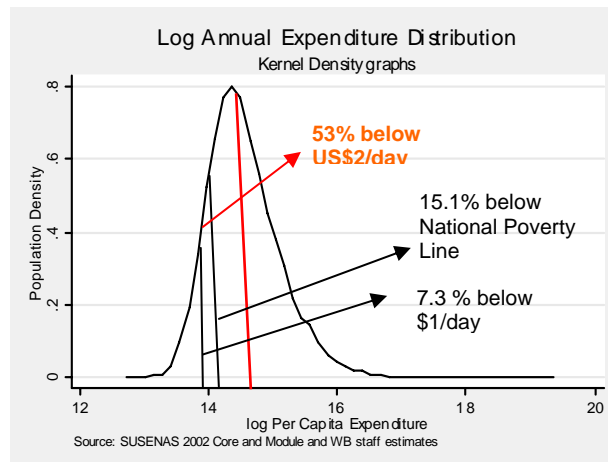


Figure 2. Poverty Rates



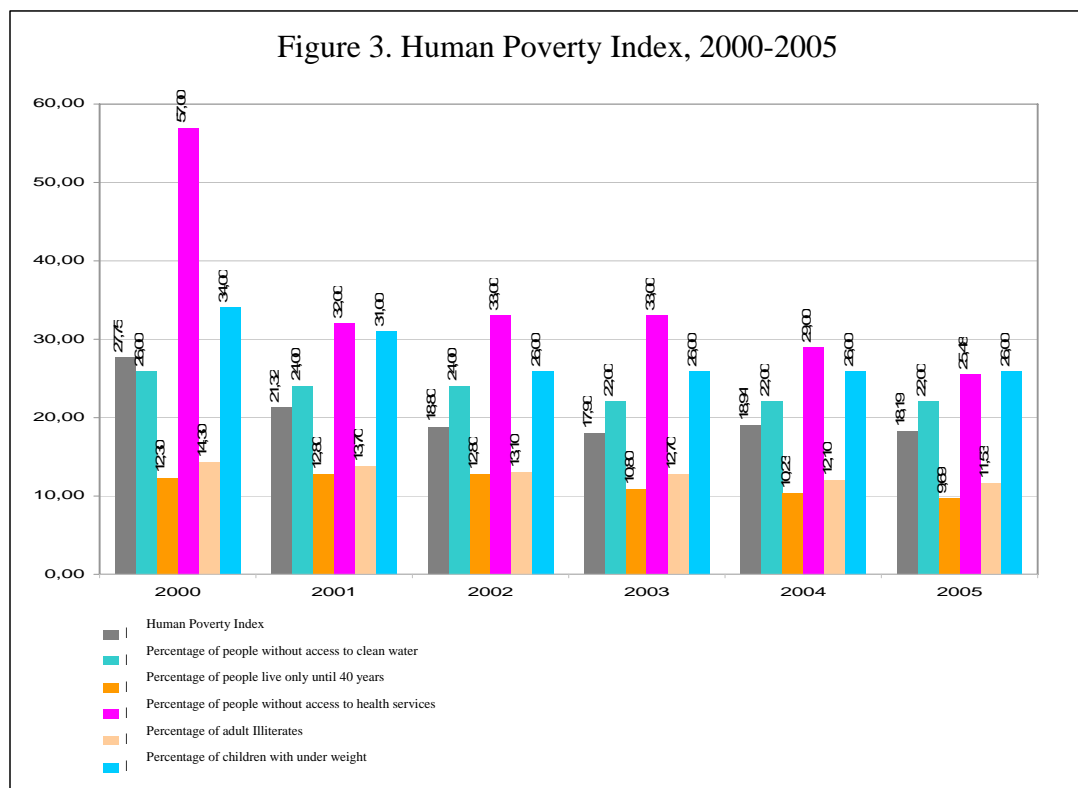
Although the proportion of people living in poverty has fallen below the pre-crisis level, it is important to consider the large numbers of “near poor” (Figure 2). There will usually be a group of more permanent poor, while others drift in and out of poverty. While only some 15% of people live under the national poverty line (of about US \$1.5 a day), close to half of people (over 110 million people) live on less than US \$2 a day (Figure 2). These are people exposed to many kinds of shocks, such as sudden price increases, loses of employment, or illness.

There are also variations in poverty levels across Indonesia’s regions. In 2004, the income poverty rate, for example, ranged from only 3.2% in Jakarta, the capital, to almost 39% in Papua. While most of Indonesia’s poor live in the densely populated western part of the archipelago, poverty incidence is higher in eastern Indonesia. It

¹ In 1998, the method for calculating poverty was revised. The revised method has been used for 1996 data to present. The revision is based on number of consumption commodities and price standardization that has been calculated relative to Jakarta, the capital city. With this consumption-based poverty line method, poverty is defined as individual’s ability to fulfill their minimum basic need of 2100 kilo calorie per capita per day and other basic needs such as clothes, shelter, and access to education, health, drinking water, and sanitation.

should also be emphasized that, for income poverty, the number of poor in 2004 living in rural areas is 24.6 million (19.5%) while around 11.5 million (12.6%) live in urban areas.

Some common characteristics of poor households highlight the importance of focusing priorities as an important element in poverty reduction strategies. For example, in 2004 most poor people (58.8%) relied heavily on agriculture and had an elementary or lower level of education (80%). The Human Development Index in the last five years shows that there is still a significant number of people who have poor nutrition and health status, lack of access to drinking water and health services. These indicate that education, health, nutrition and basic infrastructure are among sectors that should receive more attention in a poverty reduction strategy.



Following the structural adjustment policies to stabilize economy after the 1997 economic crisis, the government reviewed existing poverty targeted programs such as the Rural Areas Infrastructure Development Program (RAIDP) and Poverty Alleviation through Rural-Urban Linkages (PARUL). The government also initiated some new programs such as the Community Recovery Program (CRP), and the Kecamatan Development Program (KDP) and Urban Poverty Program (UPP) to address poverty in rural and urban areas through building community-based approach to generate income and infrastructure development.

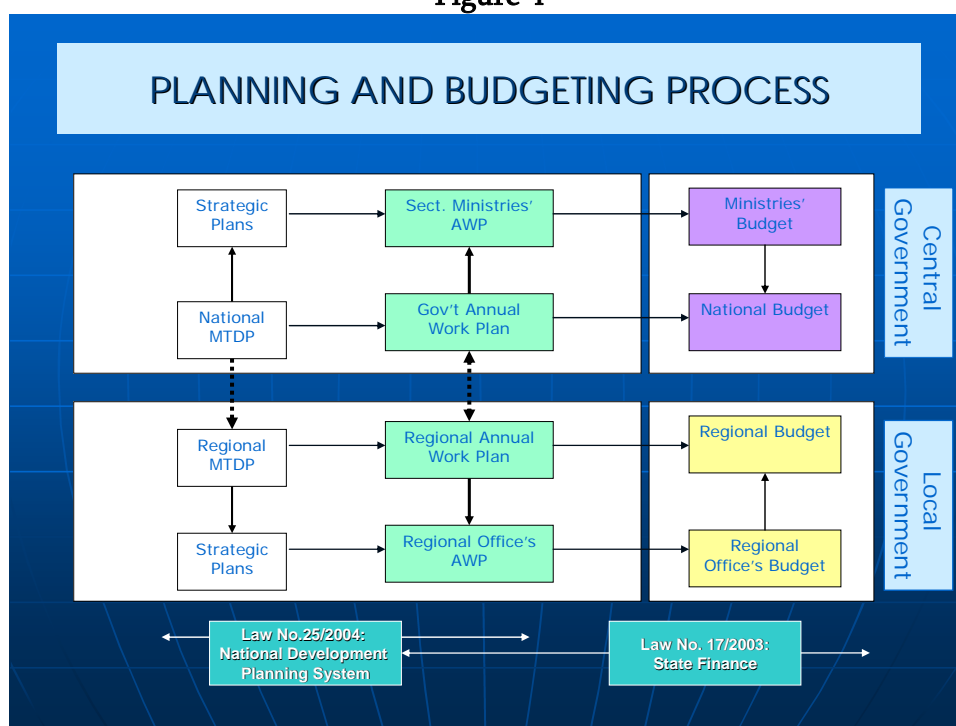
In 2002 Indonesia formulated an Interim Poverty Reduction Strategy. It laid out a road map for undertaking a participatory process to develop a Poverty Reduction Strategy, which took place over the following two years, 2003 and 2004. Indonesia's PRS was prepared through consultation with, and input from, regional government's NGOs, and academics in two phases: (1) four multi-stakeholder task forces who undertook regional consultations and prepared reports on creating opportunities, empowering communities, building human development capacity, and enhancing social protection; followed by, (2) a multi-stakeholder group who actually drafted the PRS (SNPK). In practice, as is the case in many other countries, the task forces suffered from weak or inconsistent participation from many of the relevant sector ministries. The final

drafting team experienced difficulties in identifying and prioritizing specific interventions. The operationalisation of the SNPK became, therefore, part of the annual planning and budgeting process (see below).

C. LINKING POVERTY INTO THE PLANNING AND BUDGETING SYSTEM

The existing planning and budgeting system has the potential to be improved in order to increase the poverty focus and results orientation of government plans and budgets. Synchronization of the State Finances Law (Law 17/2003) and the National Development Planning System Law (Law 25/2004) will lead to better allocation of resources in line with government priorities through: (i) revitalizing the long-term development plan to guarantee sustainable national development; (ii) synchronizing the objectives and political contract between the executive and legislative through creating a medium-term plan and budget framework; (iii) using internationally accepted economic and functional budget classifications; (iv) unifying the former “routine” and “development” expenditures; (v) linking government and ministry plans to expenditure budgets; (vi) incorporating a multi-year perspective into budget estimates; and, (vii) requiring work plans and budgets to be reoriented toward what is delivered and what results are achieved. The planning and budgeting scheme is described in Figure 4.

Figure 4



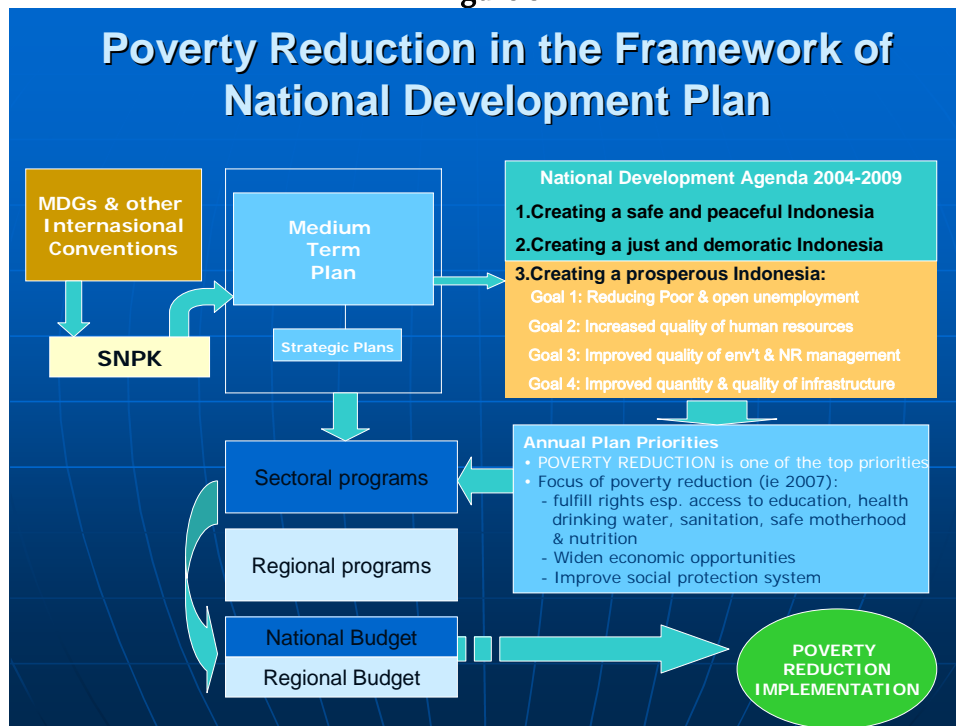
The Medium Term Development Plan (RPJM) provides policy guidance and programs for five years for both national and local governments, based on the vision and mission of the elected president. The RPJM has the target of reducing the number of poor to 8.2% by the end of 2009 as a top priority. Multi-dimensional poverty reduction has been integrated into the RPJM’s three priority agendas:

- *Prosperous Indonesia*: reduce the number of people who are poor, focus on pro-poor growth and creating employment opportunities, whilst improving access to quality health and education services, reducing regional disparities, and improving natural resource and environmental management

- *Just and Democratic Indonesia*: improve justice and law enforcement, with a priority to eradicate corruption, improve the implementation of decentralization, and enhance people's participation in the development process
- *Safe and Peaceful Indonesia*: enhance a sense of safety, security and peace as reflected in the reduction of tension and threats among disparate groups, and the actual reduction of the crime rate in urban and rural areas.

The RPJM is binding on central government departments and local governments.

Figure 5



To achieve the poverty reduction targets we have set for ourselves by the end of 2009, the RPJM is implemented through the annual government work plan, sectoral ministry work plans and district/municipal sectoral work plans. The National Development Planning Agency (Bappenas) and the Ministry of Finance recommend indicative ceilings at the sector and program level to Cabinet at the commencement of the budgetary process.

Expenditure allocation also reflects government prioritization of poverty reduction. This has been carried out primarily through strengthening alignment of intra-sectoral allocations and the link between national priorities and line ministry programs and activities. The responsibility is appropriately on ministries to justify their expenditure requests, and so they should identify how the proposed plan and programs have or are expected to contribute to achieving the government's priorities. To ensure ministries receive consistent technical guidance on the preparation of plan and budget proposals, the Ministry of Finance and Bappenas are enhancing their collaboration, particularly in the substance of the technical guidance and on the forms/templates and software that is developed for use by ministries. In the process, Bappenas analyzes ministry work plans and provides constructive feedback as appropriate to line ministries.

Decentralization creates opportunities and challenges for better implementation of poverty reduction. There has been strong political will in Indonesia since decentralization in 2001 to shift the development paradigm

from a top-down, state-centered, supply-driven process, to a bottom-up, local demand-driven approach. There is also need for transparency and good governance so that the planning forums should ensure that proposals coming from villages and communities are accommodated appropriately into the development plan and budget. With some 40 percent of total public spending in the domain of sub-national governments, the pro-poor focus of total public spending depends on the degree to which there is a pro-poor focus in the planning and budgeting processes at the sub-national level. Although at present there is not always a pro-poor focus at the sub-national level, most regional governments have or are preparing regional poverty reduction strategies or otherwise making efforts to develop more pro-poor budgets and programs.

D. IMPLEMENTATION OF THE CORE PRINCIPLES

The process by which policies, priorities, and expenditure allocation decisions made matters tremendously in ensuring a consistent pro-poor focus to government policies, programs, and public resource allocation. The core principles are: a strong poverty focus; results orientation; and, broad participation and transparency. Indonesia's experience aligning poverty reduction objectives into the planning and budgeting process and development programs demonstrates that these core principles are critical.

a. Strong Poverty Focus

To address poverty reduction effectively, it is important to understand the particular nature of poverty and conditions of the poor, and to use this understanding and other empirical information to develop appropriate policies and programs. It requires establishing priorities consistent with budget constraints. It also means ensuring that the overall government plan is translated into associated poverty reducing sector programs and the allocation of expenditures in the budget, following through to implementation. Some efforts that reflect a strong focus on poverty reduction priority include:

- 1) **In moving from the medium-term plan to the government annual work plan, not only was the poverty focus maintained, but also it was reinforced, particularly through greater prioritization.** Poverty reduction has been the first priority of government's work plan in both 2006 and 2007. Moreover, these "first order" priorities were used in determining sectoral budget ceilings. The 2007 government work plan and budget focuses on the following poverty reduction strategies:
 - a) To meet basic needs, predominantly in health, education, basic infrastructure, drinking water and sanitation, food and nutrition.
 - b) To expand employment and business opportunities for the poor so their bargaining power and participation in development processes increases.
 - c) To improve the social protection system (including for isolated communities, natural disaster victims, and vulnerable poor)
- 2) **The poverty focus can also be enhanced if plans and budgets are based on poverty diagnostics.** Some figures presented in the earlier section indicate key sectors that should receive more attention in poverty reduction strategy such as education, health, nutrition and basic infrastructure (for example drinking water) and agricultural development. Other poverty diagnostics also show that blanket subsidies, such as the fuel subsidy, take funding away from pro-poor development sectors that mainly benefit the non-poor. In 2005, therefore, the Government took a bold move by reducing fuel subsidies, which resulted in a 160% increase in fuel prices over the course of the year. These subsidies had ballooned to more than the amount spent in total for all key development

sectors. The government reallocated savings from the fuel subsidy reduction of about \$2 billion in 2005 and \$3 billion in 2006 to four major poverty programs:

- a) social protection, through an unconditional cash transfer to protect poor households from the impact of the fuel price increase;
- b) education, through a program to lower fees and increase access to basic education for all;
- c) health, through a program to provide free access to basic health care and in-patient hospital care for the poor; and,
- d) village infrastructure, in the form of a block grant given to almost 13,000 poor villages.

The central government and the National Bureau of Statistics (BPS) provided regional stakeholders with standardized statistics on key poverty and social data for this purpose.

- 3) In addition to ensuring poverty reduction priorities are articulated in their medium term and annual plans, **a major focus of attention of sub-national governments is building institutional and other capacity to ensure that the plans are linked to the budget.** District and municipal governments have made formal commitments to poverty reduction by means of local regulation and MoUs with central government (for example, the 2003 Yogyakarta Declaration) and through the establishment of poverty reduction committees in several provinces and districts/municipalities. Closer links are also needed between development planning agencies (Bappeda), and budget preparation bodies at the sub-national level.
- 4) The government's redoubled focus on poverty reduction has benefited from community driven development programs, which tell a positive story about the pro-poor focus of decentralizing spending to the community level. Currently, they include village infrastructure programs, Sub-District or *Kecamatan* Development Program (KDP), and the Urban Poverty Program (UPP). Evidence from community driven development projects and other participatory planning experiences suggests that having a facilitated process encourages non-elites to participate in determining their actual needs. The poverty focus of spending at the local level could be improved by providing block grants to villages and/or sub-districts to directly assess needs, and develop and implement well-designed and transparent community-based development activities.

b. Results Orientation

Articulating the poverty reduction results that government wants to achieve through its policies and programs is also fundamental. Defining and publicizing intended outcomes can help focus those responsible for implementation on achieving the results. Moreover, it increases public sector accountability to achieve these stated results. It can also enhance the consistency of implementation of plans vis-à-vis their intended results. Changing to a results orientation requires monitoring implementation and evaluating program and policy outcomes, and feeding findings back into the planning and budgeting cycle. Some efforts to enhance result orientation of poverty reduction strategy include:

- 1) **The new planning and budgeting system necessitates a strong performance or results-based orientation.** Importantly, the Annual Government Work Plan (*RKP*) includes targeted outcomes, including for poverty reduction. This is a significant step, and even though the quality of performance targets and indicators is mixed, they can be improved in future years. The

Government is placing increasing emphasis on evaluating government funded development programs. For example, following the rapid design and rollout of the four main programs funded by reallocated fuel subsidy funds, the Government commissioned qualitative assessments of each of these programs. A rapid appraisal of the unconditional cash transfer (UCT) in the first months of implementation, which was subsequently used to adjust implementation of following rounds of disbursements of the UCT, stands-out as an example of good practice in using program assessments to improve design and implementation. These assessments indicate that despite targeting problems, the UCT program has cushioned the economic impact of the fuel price increase for the majority of poor households, and enhanced the acceptance of the unpopular fuel price increase.

2) **There is significant room for institutionalizing and strengthening efforts, particularly with regard to using empirical evidence from monitoring and evaluation to drive program design and expenditure allocations:**

- **There is a need for a major push to strengthen data monitoring systems relevant to multi-dimensional poverty, both through the National Bureau of Statistics (BPS) and through line ministries.** Indonesia is facing a deteriorating information and monitoring system following decentralization. The elimination of deconcentrated central government agencies at the provincial and the district/municipal levels has led to deterioration in the quantity and quality of administrative reporting and routine program data at the sub-national level. The previously well-established and solid reputation BPS created in terms of the number and quality of its statistical products has fallen victim to significant budget tightening after the financial crisis and a zero-personnel growth policy. To strengthen the regular data monitoring system, a systematic assessment of data is required to identify gaps in quality, reliability and frequency; in order to support results-oriented planning and budgeting. Data should be collected, in consultation with sub-national governments, for a fixed set of key performance indicators for MDGs and poverty-related sectors to allow for comparability across regions. It then needs to be determined how best to collect and disseminate the information, and who is responsible for each task.
- **Ministries are legally mandated to evaluate every program once every five years.** Due to limited funding and capacity, not all programs can be rigorously evaluated. Ministries will need to strategically select major programs to assess, draw lessons from, and to inform decisions on whether to expand, modify or eliminate programs.
- **The key elements required for enhancing pro-poor planning within results-oriented planning and budgeting is weak at the sub-national level.** In general, neither plans nor budgets have incorporated measurable targets or indicators, nor has there been any significant monitoring or evaluation of results. The law concerning performance-based budgeting at the sub-national level has been enacted, but there was insufficient socialization of the principles and concepts, or training and support for its practical application. Evidence from various districts/municipalities suggests that, even where the medium term and/or annual plans specified results-oriented targets, regional offices had difficulty specifying how their proposed programs and activities would contribute to the achievement of the goals and targets. The emphasis largely remains on ensuring the paperwork on inputs and standard unit costs is in order. Even when sub-national government monitors programs or project implementation, there is no measurement of effectiveness in contributing to the achievement to outcomes. Efforts to apply a result

orientation require: (i) clearer specification of program objectives; (ii) developing measures for outputs; (iii) defining overall priorities in a results-oriented manner, with measurable targets and performance indicators; and, (iv) regularly collecting and compiling relevant data.

- **Strengthening monitoring processes is particularly important if the central government is to make greater use of specific purpose conditional transfers (DAK), especially if they were to be performance based.** To the extent that the central government can start a process of increasing incentives and moving to resource allocation through block grants that are conditional on performance, it will require the associated monitoring mechanisms.

c. Broad Participation and Transparency

Plans and programs are more likely to be directed to meet the priority needs of the poor if their views are sought out during plan preparation and program design. This can also help to improve the effectiveness of government programs by expanding citizens' access to information on the issues and programs that concern them. Effective participation directly influences the priorities reflected in development plans and creates a synergy of purpose between government and citizens. Consultation and participation should also include involving citizens or clients in the monitoring and feedback process regarding the effectiveness of planned public interventions. Some efforts reflecting a principle of broad participation and transparency include:

- 1) **The Indonesia PRS (SNPK) was prepared in an open, participative manner through consultation, with input from sub-national governments, NGOs, and academics.** The process began in 2003 when the Poverty Reduction Committee issued and approved an Interim Poverty Reduction Strategy Paper (I-PRSP) to serve as a guide for formulating the national poverty reduction strategy. The process of formulating the SNPK was supported by several activities designed to encourage participation and use principles of transparency. This included:

- **Participatory Poverty Analysis (PPA)**

A poverty analysis was undertaken for eliciting the views of the poor, concerning the poverty issues they face, and accommodating their views in policy formulation. The steps involved included:

- (a) Conduct of PPAs in 40 locations under the coordination of the Office of the Coordinating Minister for Social Welfare;
- (b) Consolidation of these and other PPA findings by the SMERU Research Institute;
- (c) KIKIS (Independent Committee against Structural Poverty) carried out PPAs in very poor areas, participants in which included, among others, fishers, laborers, plantation workers, farmers working non-irrigated land, forest-fringe communities and the urban poor.

- **Policy Review**

Several universities in cooperation with Bappenas and Japan International Cooperation Agency (ICA) carried out reviews of policies, in particular with respect to the economy and growth. This was supplemented by other policy reviews.

- **Consultation**

Various consultative exercises were undertaken, including:

- (a) A Grass Roots Community Joint Review that was conducted by the Office of the Coordinating Minister for Social Welfare in eight cities across Indonesia;
- (b) Workshops to review and get feedback on the poverty diagnostics, the policy reviews, options for improved poverty monitoring, and pro-poor planning at the sub-national level.

By October 2004, the draft SNPK was completed and widely disseminated to ministries/departments, the private sector, NGOs, donors and other international agencies. A series of consultations then followed. Input from stakeholders was used to draft an action plan for the strategy, which was also given significant scrutiny in a series of focus group discussions. Results from the public consultations, comments from critical readers and focus group discussion, were used to improve the draft and create the final SNPK.

- 2) **Indonesia has a “bottom-up” planning process, which tries to accommodate proposals determined at the community level.** Some studies show, however, that participation of civil society organizations and citizens in decision-making processes remains limited and most consultations are in fact a token effort of socialization of government’s positions or plans. Some improvements have already made in the design and structure of the forums and in the material. Information on plans and budgets is also widely available through websites and publications. The facilitation of the existing community driven development programs at village level enables participation of poor in influencing priorities in plans or budgets. At the village and sub-district level, the perspective of the poor can be sought using methods and techniques developed for participatory rural appraisals (PRA) and participatory poverty assessments (PPA). At the district/municipal level, increasingly the proposals developed through community driven programs are incorporated into regional government annual work plans.
- 3) In addition, the interaction with the House of Representatives or Parliament is also an important form of consultation and participation. Significant fiscal authority rests with the parliament, and it plays an increasingly active role in budget formulation. The Budget Committee has overall responsibility for the parliament’s consideration of the budget, while sectoral commissions examine expenditure estimates in their respective functional areas. They have several formal opportunities to provide input to government --- initially in discussions between the Budget Committee and the central agencies on macroeconomic assumptions, fiscal policy, and government priorities, and subsequently, between central agencies and the Committee to discuss the draft budget.

E. WAY FORWARD: CHALLENGES AND LESSONS LEARNED

Some challenges to make further progress in getting large numbers of its people out of poverty and destitution include the following:

1. Accelerate growth for the poor. While growth alone is not sufficient to eliminate poverty, slow economic growth since the financial crisis is one of the main factors contributing to lack of progress in reducing poverty in Indonesia. The number of poor cannot be reduced substantially without further, faster growth that benefits the poor. This may require connecting the rural poor to urban markets and getting the poor into better jobs. In addition, a concerted effort is required to improved the regulatory environment, both in rural and urban areas, so that the poor can get better jobs and in the formal sector.

2. Investment in education, health and infrastructure, especially in rural areas, continue to be key levers for poverty reduction, however, they require substantial funding. Remoteness and travel times to urban centers have a strong affect on poverty. Efforts to keep kids in school—and improving the low transition rate to junior secondary school - will increase income of the poor. Maintaining health, particularly mother and children under five years, and increasing the quantity and quality of basic infrastructure such as drinking water and sanitation will also increase the quality of life of the poor.
3. To improve on social development outcomes, Indonesia must solve problems related to weak social services delivery. Between 2000 and 2004, spending has been increased in social sectors such as education (from 2.3% to 2.9% of GDP) and health (from 0.6% to 0.8% of GDP). Spending more is not enough in itself, however, the quality of spending matters, and efforts to monitor expenditures should be encouraged. Government commitment to undertake assessments of poverty programs that were funded by the fuel subsidy reallocation with a view to improving their effectiveness are a positive step in this direction.
4. It is also important to improve the institutional and legal framework, including the relevant aspects of decentralization so that service providers know their responsibilities and are held accountable by citizens and government for the quality of services
5. Protect the poor. Indonesia has taken an important step toward a more efficient and effective program to protect poor by moving from the regressive fuel subsidy to developing a targeted cash transfer program for the poor. The current household targeting system will need to be refined and assessments made of the capacity of the public sector to supply the expected increased demand in services. The political sensitivity of the program will also require sensitive handling.
6. Indonesia has to find the best way to manage its two main challenges: globalization (the continuing integration into the world) and localization (the desire for self-determination and the devolution of power into the regions) that will affect directly to poverty problems. It is also in this new spirit that poverty reduction should be accomplished through a comprehensive, integrated, and sustainable framework.