# LAPORAN PENELITIAN
# UNIVERSITAS BAKRIE
# TAHUN 2018

## The Decreasing Target in Poverty Rate in Indonesia: 2018

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# TAHUN 2018

| | | | |
|---|---|---|---|
| 1. | Judul Penelitian | : | **The Decreasing Target in Poverty Rate in Indonesia: 2018** |
| 2. | Bidang Penelitian | : | Terapan (Applied Research) |
| 3. | Peneliti Utama | | |
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| 4. | Lama Penelitian | : | 6 (enam) bulan |
| 5. | Usulan Penelitian tahun | : | Januari 2018 |
| 6. | Total Biaya | : | Rp19.826.000,000 |

Jakarta, 19 Februari 2018

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Dengan ini menyatakan bahwa benar saya yang mengajukan proposal penelitian tahun 2018 dengan judul: **"The Decreasing Target in Poverty Rate in Indonesia: 2018"** dan proposal ini belum pernah dibiayai dan tidak sedang diajukan untuk dibiayai oleh instansi/badan lain. Saya bersedia menjadi peneliti utama dan mendedikasikan waktu untuk penelitian selama 6 (enam) jam/minggu dalam penelitian yang saya usulkan dengan judul tersebut di atas.

Demikian pernyataan ini dibuat dalam keadaan sadar dan tanpa ada unsur paksaan dari siapapun untuk keperluan pengajuan proposal penelitian di Universitas Bakrie.

Jakarta, 19 Februari 2018

Yang membuat pernyataan

Meterai Rp6.000,00

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**ABSTRACT**

The aim of this research is to make an estimate how long Indonesia can decrease its poverty. Between the mid-1960s and 1996, when Indonesia was under the rule of Soeharto's New Order (Orde Baru) government, the country witnessed a significant decline in poverty - both urban and rural - due to robust economic growth and efficient pro-poor programs. During the Soeharto’s period the number of Indonesians that lived below the poverty line eased from over half of the total population to 11 percent. However, when the Asian Financial Crisis rocked the financial foundations of Indonesia in the late 1990s it had a devastating impact on poverty alleviation, causing the poverty rate to slip back from 11 percent to 19.9 percent in late 1998, meaning that much of the New Order's good work had been undone.

One of the impacts of the slowing economic growth in Indonesia is the rise of poverty. About 1.1 million more people from 26 provinces became newly poor (defined as those whose incomes fell below the poverty line) between September 2014 and September 2015. At the same time, 268,000 people from 13 provinces were lifted from poverty. According to Central Statistics Agency (BPS) figures, the total number of people in absolute poverty is now 28.2 million, an increase of 2.8 percent over the same period, but these figures hide the wide differentials of poverty increases among provinces in the country.

The Asian Financial Crisis started on 2 July 1997 when the Thai government, burdened with a huge foreign debt, decided to float its baht after currency speculators had been attacking the country's foreign exchange reserves. This monetary shift was aimed at stimulating export revenues but proved to be in vain. It soon led to a contagion effect in other Asian countries as foreign investors - who had been pouring money into the 'Asian Economic Miracle countries' since a decade prior to 1997 - lost confidence in Asian markets and dumped Asian currencies and assets as quickly as possible.

**Keywords:** poverty - target - decrease - population

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# 1. BACKGROUND

## 1.1. Experiences with Poverty Targeting in Asia: an Overview

Poverty targeting can be thought of as the use of policy instruments to channel resources to a target group identified below an agreed national poverty line. In principle, these resources can be either for protectional (to maintain welfare in the face of adverse shocks) or promotional (to help raise welfare in the long term) purposes. Whilst debates concerning targeting versus universalistic approaches to social benefi ts have a very extensive history, they achieved prominence in the development context only in the later 1980s. At that time with government budgets in many countries under serious pressure, questions were raised concerning the effectiveness of broadly-based subsidy schemes that often benefi ted the poor far less than the better-off (the 'non-poor'). (Weiss, 2003).

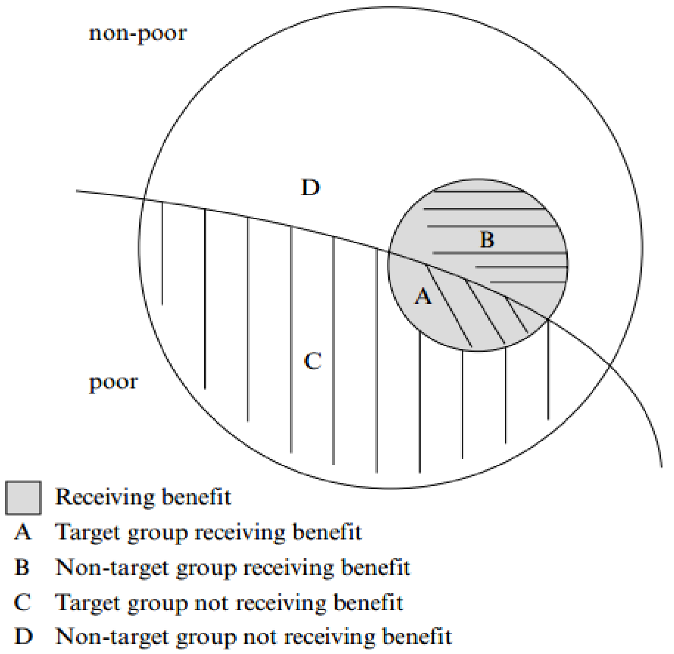
The World Development Report of 1990 (World Bank, 1990) summarized evidence on the degree of leakage from general subsidies and stressed the importance of a labor-intensive pattern of  rowth and the development of the human capital of the poor, combined with targeted social safety net measures, as the long-run solution to poverty. Broadly speaking this view has remained the conventional wisdom. (Balisacan & Pernia, 2003).

This surveys is the experiences with poverty targeting in a number of large economies in South Asia (India) and South East Asia (Thailand, Philippines and Indonesia) as well as in the People's Republic of China (PRC). In some of these countries poverty targeting has a relatively long history stemming from longstanding social welfare concerns (India and to some extent the Philippines and PRC), whilst elsewhere it originated principally in the late 1990s in response to the impact of the regional Financial Crisis (Thailand and Indonesia). The focus is principally on measures that provide subsidized food, employment, access to health and other social facilities and occasionally cash transfers. The use of microfinance is considered separately in “Microfinance and Poverty Reduction in Asia: *John Weiss, Heather Montgomery and Elvira Kurmanaliea*. (Balisacan, Edillon & Duncanes, 2002).

The country studies present the information on these interventions in considerable detail. In India and Indonesia there is a very extensive ‘grey cover’ literature on the impact of targeted interventions, and the country studies survey these official or quasi-official evaluations. In the Philippines, PRC and Thailand there are fewer official evaluations of targeting measures available and the country authors draw heavily on their own work in assessing poverty impact. This opening paragraph brings together the results from the selected country cases and also draws on the wider literature on poverty and development. To clarify some of the issues it begins with an introduction to the theory and practice of targeting. (Weiss, 2003).

**1.2. The Theory and Classification of Targeting**

A basic distinction in the targeting literature is between two forms of error, that of undercoverage, that is the failure to reach some of the target group, and of leakage, that is where benefi ts accrue to those outside the target group. Following statistical terminology these are termed ‘Type 1’ and ‘Type 2’ errors, respectively. Practical application of targeting measures inevitably involves some trade-off between these two errors. For example to minimize undercoverage or ‘Type 1’ error, more generous means of assessing eligibility may be used, whilst to minimize leakage or ‘Type 2’ error, stricter criteria may be applied, and if these are not specifi ed or applied correctly they may serve to exclude some of the target group. The social costs of the two types of error need to be compared and arguably the poorer a society, the more serious will be errors of omission or undercoverage relative to the costs of leakage (Cornia and Stewart, 1993).




*Note*: Targeting ratio is share of non-poor in benefits divided by share of non-poor in total population, or B/(A+B) divided by (D + B)/(A + B + C +D).

*Figure 1.1 Two types of error in poverty targeting*

Figure 1.1 illustrates the alternative possibilities with the areas labeled "C" and "D" corresponding to "Type 1" and "Type 2" errors, respectively. Another way of expressing this information is to identify the targeting ratio, that is the share of the non-poor (or non-target group) in benefi ts, relative to their share in total population. The closer this ratio gets to unity, the weaker will be the effectiveness of targeting. In terms of theory, the comparison between a universalistic and a targeted approach has been analyzed by Besley and Kanbur (1991) and here we follow their presentation. If the poverty line is set at income level $z$ and individuals have incomes of $y$ then an ideal targeting solution would be transfer amounts of $z–y$ varying between individuals depending upon their initial income level. In this way all would be brought to the poverty line. The costs of transfers would have to be borne by those above the poverty line.

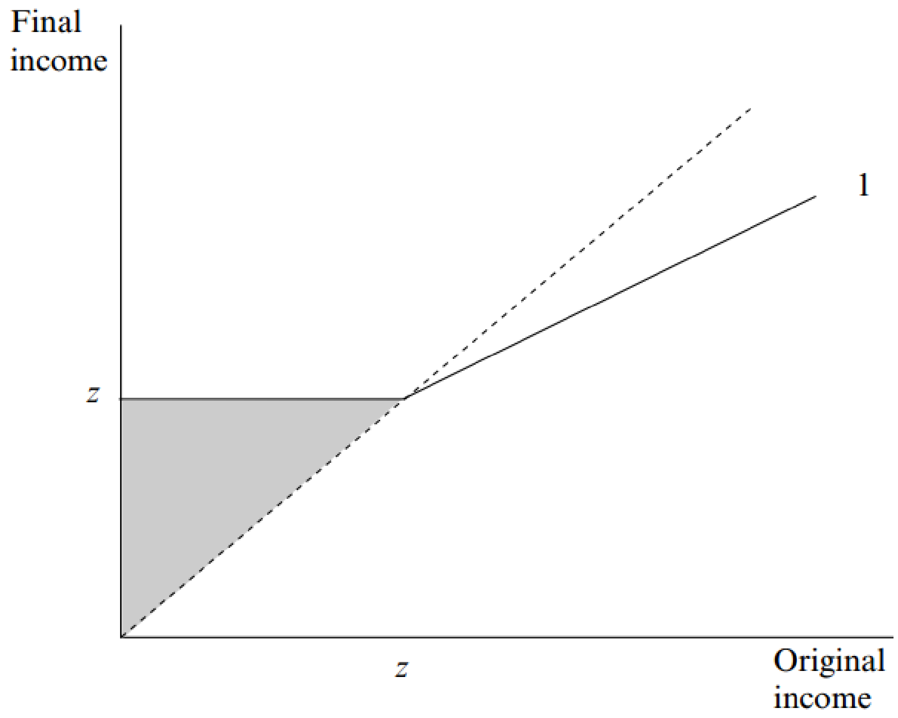



*Figure 1.2 'Perfect targeting': the ideal solution*

Figure 1.2 illustrates this, showing initial income on the horizontal axis and income after the transfer on the vertical. For points on the 45-degree line initial and post-transfer income are equal. "Line 1" shows the post-transfer outcome in relation to initial income. Those below the poverty line $z$ receive a total transfer equal to the shaded area and those above face a tax, as their post-transfer income is below their initial income. The fiscal cost will be the sum of $z - y$ for all in poverty initially. In contrast a universal approach transfers the same sum to everyone. If poverty is to be alleviated fully and the marginal poor person has zero income (because they rely on a share of the family income) the transfer will be $z$ per person and this will entail a much higher fiscal cost, which will be $z$ times the population.

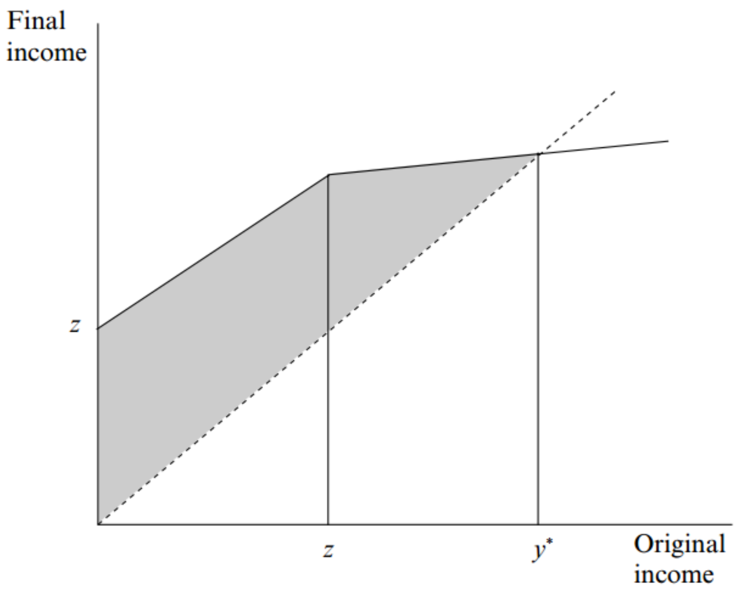



*Figure 1.3 A universal scheme*

Figure 1.3 illustrates this case with (as before) the shaded area giving the amount of transfer. Those with initial incomes below *z* gain the full transfer, whilst taxes are imposed on those above the poverty line, so their gain is *z* minus the additional tax they must pay; at income level *y** individuals will start to lose from the scheme as extra taxes will exceed *z*. There is leakage to the non-poor at income levels between *z* and *y**. Such leakage is the "Type 2" statistical error in the poverty literature, but undercoverage (or "Type 1" error) will be zero, as all are brought up to the poverty line.

Given the relatively high leakage and the fiscal costs involved, universal transfers may appear obviously unattractive. However in any real world situation there are also difficulties with the 'ideal solution' of Figure 1.2.

- There are practical problems of lack of information concerning beneficiaries, so that the initial incomes (the *y*'s) are not known accurately. Hence the need for indicators of poverty that should be correlated with income. We discuss below approximate ways used in the past in the country cases to identify the poor. Where not all of the poor can be identified and reached, there are potentially serious problems of omission from targeting schemes (the undercoverage rate), which by definition should be absent in universalistic approaches. Hence, as noted above, the social costs of errors 1 and 2 need to be compared.

- There can be costs to individuals of their participation in targeted programs – for example psychic costs arising from social stigma or cost in terms of time for travel or in the provision of information. In terms of the ideal solution in Figure 1.2 , if costs are *c* per person, then those of the poor with an income above *z–c* will choose not to participate in a targeted program, so that those with an income between *z* and *z–c* will remain below the poverty line. Universal schemes may also impose costs, and individuals may choose not to participate, but the expectation is that such costs will be lower per dollar of benefit.
- Incentive effects can undermine the impact of a finely targeted program since in the 'ideal solution' the marginal tax rate is 100 per cent for the poor. This arises since any shortfall in income below the poverty line is to be covered by a transfer, and if incomes rise the transfer will fall to match this. Hence, if marginal tax rates infl uence the poor in their productive activity there is a serious problem of dependence.

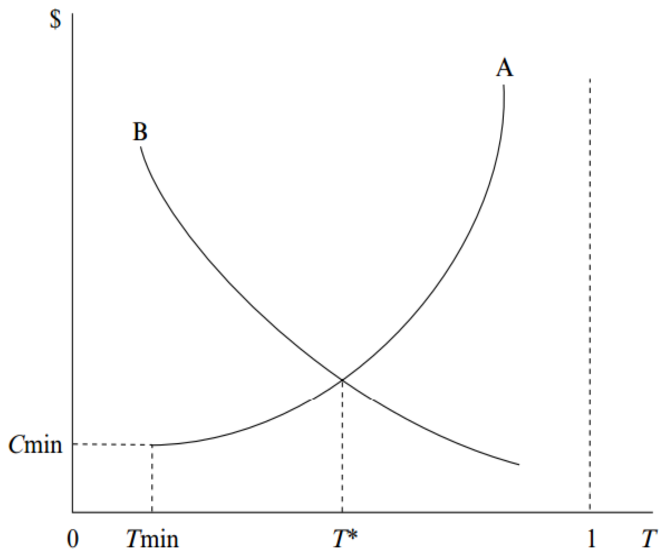



*Figure 1.4 Optimal targeting*

- Finely targeted schemes imply high administrative costs for their operation and in general there will be an expectation that the more finely targeted these are (that is the lower is the degree of leakage) the higher will be the ratio of administrative costs to benefi ts to the poor. This has the important implication that the optimal degree of targeting need not be to aim for the minimum degree of leakage since the costs of such targeting need to be compared with the benefits. We can illustrate this simply in Figure 1.4 where the horizontal axis shows the degree of targeting – that is the share of benefi ts going to the poor – from an intervention. This ranges from a low but positive figure ("*T"* min), since the poor will gain something from any non-targeted activity, to just below 100 per cent, since zero leakage to the non-poor is implausible. The vertical axis gives monetary values of cost and benefi ts per dollar received by the poor. Line "A" shows the relationship between increasingly finely targeted interventions and administrative costs per dollar of benefit to the poor, which is assumed to rise steeply. There will be some minimum cost required to establish any scheme, which is shown as "*C"* min. Unit costs of targeting must be compared with "B", which is the marginal social benefit of an extra dollar going to the poor as compared with someone at the average income level. This value must exist conceptually, provided benefi ts to the non-poor have a positive social value (implying a trade-off between gains to different groups). "B" is drawn as declining with the accuracy of targeting and the intersection between the curves "A" and "B" gives the optimal degree of targeting *T**.
- Finally in political economy terms since only the poor gain, in comparison with a universalistic approach there may be no influential political constituency arguing for targeted schemes. This raises the potential paradox that programs with a high leakage may have stro political support, due to gains by a politically influential middle class, which sustains a higher level of program expenditure than would be otherwise

possible. It is thus conceivable that in absolute terms the poor may gain more from a universal scheme than from a more finely targeted one.

The strong implication of these points is that whilst concerns over leakage and budgetary costs may undermine the case for a universalistic solution, methods of targeting must balance costs, associated particularly with administration and incentives, against gains to the poor. The test for targeting measures therefore becomes one of cost effectiveness where the objective is to create income or income equivalent gains for as many of the poor as possible at the minimum cost.

The country cases shed considerable light on issues of leakage and undercoverage, but other aspects noted here remain unclear. For example, there is little evidence from the country cases surveyed on the quantitative importance of either costs to the poor from participation in targeting schemes or of incentive effects. Also estimates of benefits to the poor, in terms of income, consumption or welfare changes, relative to costs, are rarely available to allow precise comparisons between alternative targeting schemes.

However in a few cases there are data on costs of transferring income to the poor, for example from employment creation schemes or food subsidies. In the absence of this type of data it is difficult to estimate the optimal degree of targeting. Finally, the studies do confi rm the political economy problem of generating support for targeting. The relatively low amount of resources devoted to targeting schemes in all of the countries indicates a problem with generating an infl uential political constituency for these measures.

### 1.3. Classification of Targeting Measures

A wide variety of measures have been applied over the last two decades as a means of reaching the poor and these can be classified in different ways (World Bank, 2000: 85). The following four-fold classification is used commonly;

- *Targeting by activity*, such as primary health care and primary education, where it is established that the distribution of benefits tends to be progressive. It has become commonplace to argue that these types of activity should have priority over, for example, urban hospitals or higher education on the grounds of the lower uptake of the latter services by the poor. This has been termed ‘broad targeting’ as compared with narrower forms of argeting that attempt to identify the poor more precisely.
- *Targeting by indicator*, where alternatives to income, which may be expected to be correlated with poverty, are used to identify the poor. These can include lack of or size of ownership of land, form of dwelling, and type of household, for example number of children or gender of the head of the family.
- *Targeting by location*, where area of residence becomes the criterion for identifying the target group, as a particular form of indicator targeting. Poor area programs, where all residents are assumed to be poor, have become relatively common and for example were a central element in poverty reduction initiatives in PRC.
- *Targeting by self-selection or self targeting*, where programs are designed to be attractive only to the poor. An example is workfare, where payment is either in cash or in food, at equivalent wage rates that are below market-clearing levels and therefore only of interest to those with an opportunity cost below the market wage. Another self-selection procedure is the subsidization of low quality foodstuffs (like high-broken rice).

## 2. MEASURING POVERTY

### 2.1. The Standard Approach of a Poverty Line

The standard approach is to establish a poverty line, normally reflecting a minimum necessary standard of living (or that adequate for a minimum calorie intake), and to identify who falls below this line. Establishing the poverty line can be complex, and especially will be discusses the experience in PRC, where there has been considerable discussion about the level and trend in the poverty line. Once such a line is available there are alternative ways of quantifying the degree of poverty. Of these the simplest and most widely cited is the 'headcount index', which gives the proportion of the population below the poverty line.

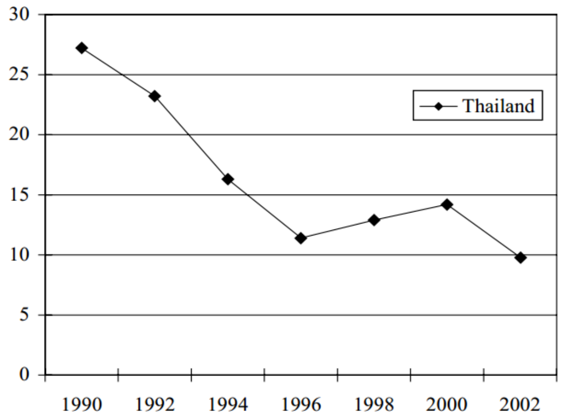



*Figure 1.5 Poverty headcount (%): Thailand*

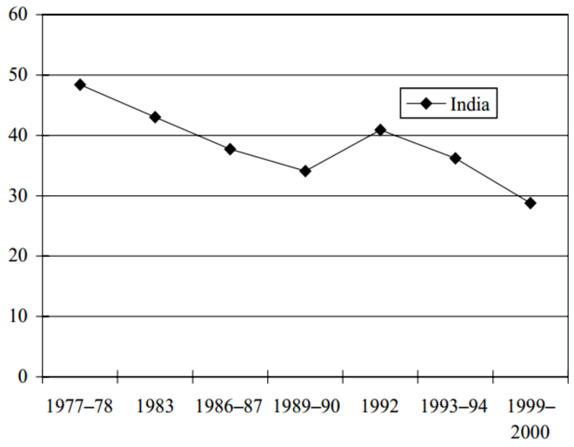



*Figure 1.6 Poverty headcount (%): India*

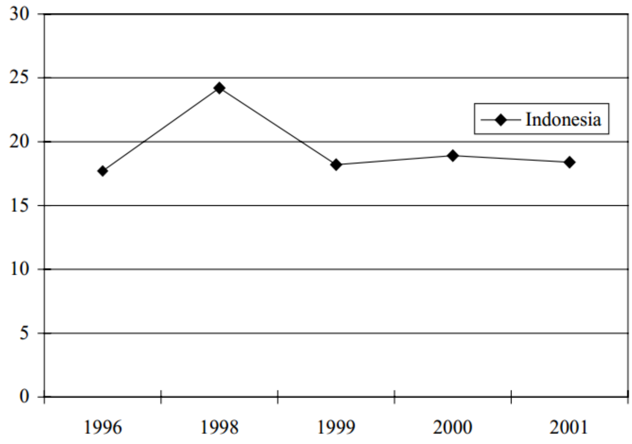



*Figure 1.7 Poverty headcount (%): Indonesia*

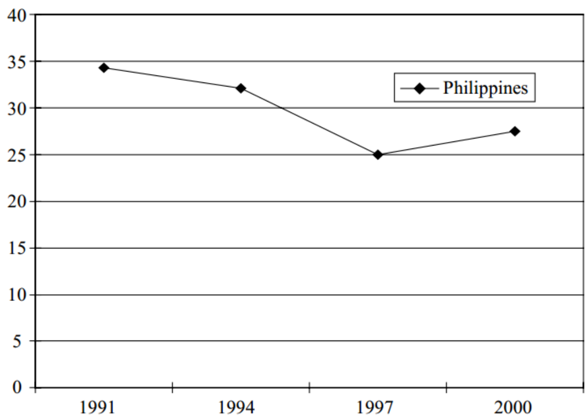



*Figure 1.8 Poverty headcount (%): Philippines*

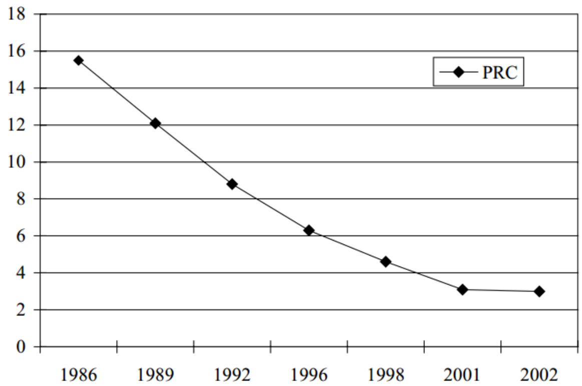



*Figure 1.9 Poverty headcount (%): PRC*

For four countries cases Figures 1.5 to 1.9 show the official estimates of the poverty headcount (proportion of the population below the official national poverty line) for each country. (Balisacan, Pernia & Asra, 2003). As they are based on different poverty lines the estimates are not directly comparable across countries. They show that poverty remains very high in India and the Philippines and by official figures is now very low in PRC (although as we have noted the accuracy of the official poverty line used in PRC is widely disputed) (Riskin et al., 2001). In all countries however there is a downward trend in poverty estimates and it is the role of targeting programs in this process that we examine.

However, more sophisticated indicators are also available and are drawn on in the country studies. These aim to assess the depth of poverty (that is how far on average the poor are from the poverty line) and the severity of poverty (that is the distribution of income or consumption within the group of the poor). The depth of poverty is captured by the ‘poverty gap’ measure, which is the difference between the income (or consumption) of a poor individual, and the income (or consumption) poverty line as a proportion of the poverty line, aggregated for all of those in poverty and then divided by the total population. Hence a poverty gap of 0.2 should be interpreted to mean that averaged over the whole population the living standard of the poor is 20 per cent below the poverty line. Hence, assuming away targeting problems, the cost of removing poverty totally will be 20 per cent of the poverty line multiplied by the total population. (Balisacan, Edillon, Brillantes & Canlas, 2000),. Besley, T. and R. Kanbur (1991) A variant of the poverty gap that refl ects distribution within the poor is the squared poverty gap, which is calculated in the same way, except for the important difference that the gap between the income of a poor individual and the poverty line as a proportion of the line is squared, so that the larger gaps are given a greater relative weight in the indicator. (Besley & Kanbur, 1991). Hence for a given average income of the poor, a worse distribution within the poor will result in a higher value of this indicator, capturing a greater severity of poverty. This indicator also has the convenient property that it is decomposable, so that it can be calculated for different subgroups in the population, and total poverty can be derived by weighting this poverty indicator for each subgroup by their population share.

As they offer different types of information, often all three indicators are calculated for individual countries and their trends over time tracked. However, the basic headcount indicator and the squared poverty gap can give quite different perspectives because of the latter's incorporation of a distributional dimension. Errors of targeting can in principle arise for several reasons; inaccurate specifi cation of who are in fact poor; poorly designed programs that do not reach the target group even if it is known accurately; and poor governance in the implementation of schemes so that benefi ts leak to the non-poor. Since targeting in its broad and narrow sense has been widely used over the past two decades there is now a relatively long record of experience that can be surveyed to attempt to establish generalizations about the effectiveness or otherwise of particular measures. Experiences in five countries suggest that errors have been signifi cant and that in some cases these programs have had only a minor impact on poverty reduction.

The rest of the structured as follows. The second section looks at the scale of resources devoted to poverty-targeting measures in the different countries and how this has changed over time. The third section examines the criteria used in the different cases to identify who are 'the poor'. The fourth section looks at the "Type 1 and 2" errors associated with different forms of targeting, looking in particular at the effectiveness of the most common measures – location targeting, self-targeting, and broad targeting. These errors raise questions about governance and the capacity of states to mount effective targeting policies. The final section looks at poverty reduction in the countries covered and the role of targeted measures in the process.

## 2.2. How Important have Poverty-Targeting Measures been in Monetary Terms?

This question is important not just in assessing the overall impact of such expenditures on the poor, but also in terms of the potential trade-off between poverty alleviation and economic growth. In most countries, however, the scale of public poverty-focused expenditures has not been large enough to raise the issue of a potential or actual trade-off. India is the country with the longest record of poverty-focused interventions and of our cases the one where such expenditures appear to have taken the highest share of the budget of central and state or local governments. Estimation of total expenditure on poverty-targeted programs in India is difficult because of the variety of schemes and the range of financing whether at the central, state or district level. Excluding fertilizer subsidies, which are not explicitly targeted at poor farmers, **Srivastava** estimates expenditure on the largest targeted programs to be about Rs411 billion in 2001–02 (which is about 11 per cent of the central government expenditure and 2 per cent of GDP). (Cornia & Stewart, 1993)**.** If fertilizer subsidies are treated as povertytargeted interventions the proportions rise to 15 per cent and 3 per cent, respectively. Another estimate of the time trend of this expenditure suggests a rise of about 50 per cent in real terms over the 1990s with the main increase between 1992–93 and 1993–94 (Shariff et al., 2002).

In PRC since the mid 1980s, when the responsibility for poverty reduction initiatives was centralized in the Leading Group for Poverty Reduction of the State Council, three types of funds are categorized in official statistics as central government poverty reduction funds – subsidized loans, workfare programs and budgetary funds for poor counties. In 2002 these were RMB 29.1 billion showing a real average annual growth since 1986 of around 6 per cent. Most of this real increase came after 1996 and the real value of these funds almost trebled between 1996 and 2002 (Wang, Table 4.2).

There are also poverty expenditures by local governments and government departments that might be as much as 25 per cent of the central government poverty expenditure (or around another RMB 7.5 billion). In combination, this estimate of RMB 37 billion is 5 per cent of the central government budget in 2002. Over the period 1986–2002 central government poverty expenditure has averaged 5 per cent of the budget and no more than 0.2 per cent of GDP (Wang, Table 4.2).

In Indonesia there have been a variety of targeted measures broadly covering employment creation, food subsidies, and education and health provision for the poor. The main program to pre-date the Financial Crisis of the late 1990s was a poor village credit scheme introduced in 1994 (the Inpres Desa Tertinggal or IDT), which had a budget of around $200 million annually over 1994–96 (Perdana & Maxwell, 2003). The IDT reached around 20.000 villages and was designed around a smallscale revolving fund as credits were to be repaid and relent in the targeted poor villages. Although it is diffi cult to obtain data on the costs of all schemes in 1998–99 at their peak, approximate estimates suggest that they might have taken around 9 per cent of the central government budget (Perdana & Maxwell, 2003).

In Thailand government poverty reduction programs have focused on cash and in-kind (principally health facility) transfers to poor families, and interest-free loans for either productive activities or education. Over the 1990s these programs in total rose from 1.1 per cent (in 1993) to 4.6 per cent (in 2000) of central government expenditure (Warr and Sarntisart, 2004). However, the education loans program  is controversial and there is some dispute as to whether it is poverty-focused.

If it is excluded, the increase in poverty-related expenditure is from 1.1 per cent to 3.3 per cent of total central government expenditure. Since 2000 the government defi nition of poverty-focused expenditure has been widened considerably with the result that now offi cially a signifi cantly higher proportion of expenditures are seen as poverty programs. Under this wider definition these activities took 10 per cent of central government expenditure in 2000 rising to around 13 per cent in 2003 (Warr and Sarntisart, 2004).

In the Philippines a range of anti-poverty programs have been applied with different approaches and nomenclature used by different administrations. Location targeting has been important in identifying where schemes would function. Funds are provided for a range of services identified by communities themselves. There is also a rice subsidy program for farmers and consumers implemented by the National Food Authority (NFA) and a scheme to provide a limited range of free drugs to the poor. Even including the food subsidy activities of the NFA total direct poverty-focused expenditure was not more than 1.5 per cent of total central government expenditure in the immediate pre-Crisis period in 1997–98 and no more than 0.3 per cent of GDP. In the years since then, government social sector expenditure on all categories has fallen as a proportion of GDP and real government health and education expenditure has fallen in per capita terms, although data on actual poverty targeted expenditure are not available (Balisacan & Edillon, 2004).

## 2.3. Identification of the Poor

Apart from self-targeting and the use of broad targeting, which focuses on particular categories of activities rather than their users, other forms of targeting, by defi nition, require inclusion and exclusion criteria, so that the poor can be separated from the non-poor. However, collecting accurate data on income or consumption is diffi cult. The use of modern 'poverty mapping' techniques, which combine data from household surveys (which allow a link between consumption levels and various household characteristics) with data from population censuses which collect detailed location-based data on households, is very recent for our country cases. (Datt and Ravallion, 1998).

Hence in practice up to very recently all of the countries used approximate indicators for identifying the poor; for example various basic need measures or rough estimates of average income in a particular village or larger unit. In India there was a serious effort in the 1990s at administrative identifi cation of the poor as a means of targeting principally the food and other subsidies from the public distribution system. As income estimates were uncertain, other additional criteria included housing conditions, number of family earners, land access and ownership of livestock and consumer durables. State governments had the responsibility for identifying the poor, although the process was slow and incomplete and even where surveys were undertaken identifi cation cards were not provided to a signifi cant number of poor families. (Deaton, 2001). In Indonesia receipt of food subsidies was determined by the classification scheme of the National Family Planning Coordinating Board (BKKBN: Badan Koordinasi Keluarga Berencana Nasional), which covers households nationally. This classified households into a number of categories on the basis of criteria including food consumption patterns, access to health care and possession of alternative sets of clothing.

In response to the impact of the Crisis of 1998–99 additional economic criteria were added; the poorest category covered households that failed any one of the following:

- all family members are normally able to eat at least twice a day;
- all family members have different types of clothing for home, work or school;
- the largest section of the fl oor of the family home is not made of earth;
- sick children are able to receive modern medical attention and women have access to family planning services.

However, administration of the food subsidy program showed both a disappointingly high leakage rate to the non-poor and high undercoverage. (Deshingkar and Johnson, 2003). Village-based programs were also an important part of targeted poverty measures in Indonesia. Here poor villages were designated using a scoring system covering social and economic characteristics, including infrastructure, housing and population. Classification of a village as poor ('neglected') was based on a combination of its position relative to the provincial average and a subjective assessment from a field inspection by local officials. By this twin approach, 31 per cent of villages in the country were classed as neglected in 1993. Within these villages village leaders appear to have had a major influence on how program funds were allocated (Perdana and Maxwell, 2003).

In PRC geographic targeting has been the key approach with (up to 2001) poor counties being the basic units for central government poverty reduction funds. Although originally when the poor county designation system was initiated in 1986 the aim was to base this on average per capita income of rural residents, this came to be superseded by other criteria, with counties in areas of Revolutionary bases and minority communities, as well as pastoral areas, receiving the 'poor' designation despite the fact that their income per capita was well above the initial norm. (Dev and Evenson, 2003)

The re-designation of counties in 1993 was again intended to apply an income criterion, based on an estimated national poverty line, and although many poor counties were added to the list, since few counties were dropped, many (266 out of 592) counties still did not conform to the income criterion (Wang, 2003). Within poor counties officials could have discretion in allocating poverty reduction funds.

In 2001 the focus shifted from 'poor county' to 'poor village' designation, so that in principle poor villages could receive poverty funding even if they were not located within a poor county. Poor village designation was carried out using a weighted poverty index generated by the scores under various indicators; grain production per person year; cash income per person year; percentage of poor quality houses; percentage of households with access to potable water, electricity and all-weather roads; percentage of women with long-term health problems; and percentage of children attending school.

Weights for these indicators in different counties should be determined by groups of villagers in a participatory manner. Within a village, in the absence of fi rm income data, again a participatory approach is recommended to identify who are poor and therefore eligible for poverty reduction funds. County governments have responsibility for the implementation of the system.

In Thailand poverty estimates have traditionally been based on income and expenditure data from the Socio-Economic Survey of the National Economic and Social Development Board. Poverty is concentrated heavily in the rural areas particularly in the North East (with 60 per cent of the officially estimated poor in 2000). In principle regional targeting of poverty funds should have been important but as we discuss further below there is only a very weak correlation between provincial incomes and the allocation of central government expenditure. In addition, the education loans program in particular does not appear to have been carefully targeted, since education institutions themselves were left to decide who was a poor student (Warr and Sarntisart, 2004).

In the Philippines again location targeting was significant with priority provinces identified for most schemes; within these provinces the most depressed districts (*barangays*) were to be the main benefi ciaries. For the Care for the Poor program, the flagship of the Estrada administration, there was a finer screening of the benefi ciaries within priority provinces with attempts made to identify the poorest families in particular areas. Where feasible, poverty was defi ned in terms of unmet basic needs (in terms of shelter, health and education, for example). Where data were unavailable, local social workers were consulted in the identifi cation of the poor. More recent initiatives of the President Arroyo administration, which provide support to local communities, combine a location targeting approach with poverty mapping within provinces. Provinces were ranked by poverty incidence and approximately the poorest half were deemed eligible. Within provinces the poorest 25 per cent of municipalities are selected using a poverty map. All districts within the chosen municipalities can receive funds. (Dollar and Kraay, 2004)

**2.4. Errors of Targeting – Misappropriation**

Apart from technical difficulties in identifying who the poor actually are, governance issues are raised in all the country cases to explain relatively high levels of leakage as funds intended for the poor are diverted to others. This is brought out in a number of evaluation reports on the various targeting schemes. Food and credit subsidy programs and employment creation schemes, in particular, offer considerable scope for malpractice. India may not be the worst of the country cases studied here, but various evaluation reports, both official and unofficial, have documented the problem clearly.

Apart from the early days of the Maharashtra Employment Guarantee Scheme, employment creation and food-for-work programs are judged to have fared poorly. (Fan, Hazell and Thorat, 1999). An assessment of the Employment Assurance Scheme (EAS) found that the rules were being broken (for example self-selection was undermined by the use of contractors who hired local labor, and the norm that 60 per cent of costs should be on labor was often ignored). Nationally it was estimated that only 15 per cent of expenditure on the scheme was going as benefits to workers, against a target of 60 per cent. Another wellstudied scheme has been the Comprehensive Rural Employment Scheme formed by a merger of the EAS with another scheme. Here poor workers are to receive foodgrains as payment in kind for wages, as well as some money income. There is an estimate that due to malpractice amongst local government administrators and contractors no more than 25 per cent of the wage fund that the poor are entitled to actually reaches them (Nayak et al., 2002).

Another study drawing on a village-level survey in Andhra Pradesh finds local elites controlling the implementation of the scheme at the village level, with benefi ciaries (that is those who would obtain work and food) selected at local meetings. Contrary to the guidelines of the scheme the use of contractors was widespread. The contractors were often found to obtain profits illegally through a number of means including claiming the full rice quota for incomplete work, double-claiming to different government departments, submitting infl ated costs and paying workers wholly in cash and reselling the rice on the open market (Deshingkar and Johnson, 2003). A self-employment scheme – the Golden Jubilee Rural Self Employment Program – was launched in 1999 as a means of consolidating other programs that encouraged self-employment.

An important component of this program is a credit subsidy for benefi ciaries. Official evaluations have revealed banks imposing illicit charges on borrowers of up to 20 per cent of the loan. An offi cial audit of the scheme found that over 50 per cent of the funds were either diverted to other purposes (state governments putting the funds in special deposits), mis-utilized or misreported. Here, as with the employment programs discussed above, there was strong evidence of beneficiaries paying bribes to receive funds. It is informative that in the survey of Indian experience, the scheme that is found to be most closely targeted is the very modest National Old Age Pension Scheme, which targets destitute pensioners with a very small monthly pension. Evaluations have concluded that it reaches the needy with benefi ts, either in cash transferred directly at village meetings or through deposits in post office savings accounts. The small amounts and direct transfer are seen as helping avoid leakage (Srivastava, 2002). The point is that even in an environment of weak governance, modest but well thought-out schemes can work effectively.

The Indian cases of malpractice in poverty-focused expenditure may be far from the worst but they are the best documented. In Indonesia there have been many allegations of corruption and malpractice, but these are less fi rmly based on evidence. For example, the employment creation programs through labor-intensive infrastructure schemes, which were one of the key planks of the response to the impact of the Financial Crisis, were alleged to have been associated with considerable malpractice by local officials as expenditures designed to cover wages were diverted to materials and equipment, which could be sold locally (Perdana & Maxwell, 2003). As we have noted, food subsidy schemes everywhere provide an opportunity for diversion of goods for sale at commercial prices. This no doubt occurred in Indonesia, although the main complaint of evaluation reports on the rice subsidy scheme, for example, has been that village officials and community leaders chose not to target within their own village communities but rather distributed more or less equally between families regardless of apparent poverty status. This is put down principally to social pressure rather than corrupt practices. The consequence was, however, that on the basis of selective survey data roughly twice as many families were receiving subsidized rice as planned by the central government and hence average allocations per family were well below the target of 20 kg (Hastuti & Maxwell, 2003).

The Philippines is another case where malpractice is often alleged and a number of targeting schemes left considerable discretion for politically determined allocations. For example, in the 1990s under the Care for the Poor program to meet basic needs of the poor, two-thirds of funds were allocated on the decision of Congressmen, not on the decision of government implementing agencies (Balisacan et al., 2000).

Apart from motives of corruption, the institutional objectives of public officials can also create targeting errors. This appears to have been particularly important in the poor county employment creation and subsidized loan programs in PRC, where because of the financial constraints they faced, local officials had incentives to divert funds to projects capable of generating revenue rather than funding projects with the greatest direct poverty impact (Wang, 2002). Similarly with micro-credit schemes, the officials of the implementing banks were under pressure to lend to the more credit-worthy customers, who would not be the poorest households (Park & Ren, 2001).

### 2.5. Errors of Undercoverage and Leakage

Aside from malpractice, which has been relatively common, if not always well documented, in our country cases there are instances of what we can term technical errors of targeting. This can be demonstrated most readily for location targeting measures, since average income and consumption estimates are normally available at the level of provincial or local government units and these can be compared with national or provincial poverty lines and with the allocation of public expenditure. Most studies indicate that regional targeting has in practice been a relatively 'blunt instrument' for reaching the poor.

For Thailand, we have detailed evidence from Warr and Sarntisart (2003), who examine the distribution of government expenditure between rich and poor provinces, although they have no information to allow an assessment of intra-province distribution. They correlate provincial public expenditure per capita under different broad categories with provincial per capita incomes, and fi nd positive elasticities, so that in general expenditure per person and, by implication, benefit rises with income. Hence there is no evidence of progressive targeting across provinces by broad expenditure category. When the same exercise is repeated for the specifically poverty-focused expenditure no signifi cant relationship with provincial income per capita is found for most categories. However, provincial size does appear to matter so that, in general on a per capita basis, smaller provinces are favored in poverty-targeted expenditure. Only in the case of one minor category (the 'Poor and Low-Income People' expenditure) is there a signifi cant negative relationship between allocations per capita and provincial income. This category was only 6 per cent of total poverty expenditures over 2000–2002, and within it the clearest evidence of a progressive allocation was for grants for health care. Hence on a regional basis within Thailand, there is no evidence of a successful targeting at poorer provinces.

For PRC, Park et al. (2002) and Wang (2003) assess what they term 'targeting gap errors' by examining the classification of counties as 'poor' in the light of their estimated income per capita relative to the poverty line.13 What they term the 'Targeting Count Gap' (TCG) can be interpreted as the percentage of counties that are mis-targeted and this can be disaggregated into the two types of error. Table 1.1 below shows the situation taking the official poverty line to estimate mis-targeting.

*Table 1.1 PRC provinces: targeting count gap 1986 to 1995*

| Year | Type 1 error (undercoverage) | Type 2 error (leakage) | Total |
|---|---|---|---|
| 1986 | 0.094 | 0.050 | 0.144 |
| 1987 | 0.082 | 0.065 | 0.146 |
| 1988 | 0.044 | 0.101 | 0.144 |
| 1989 | 0.056 | 0.096 | 0.152 |
| 1990 | 0.078 | 0.093 | 0.171 |
| 1991 | 0.058 | 0.101 | 0.158 |
| 1992 | 0.038 | 0.107 | 0.145 |
| 1993 | 0.002 | 0.225 | 0.227 |
| 1994 | 0.005 | 0.232 | 0.237 |
| 1995 | 0.004 | 0.218 | 0.222 |

Source: Park et al., (2002)

The data have an intuitively clear interpretation showing that the effectiveness of targeting has decreased over time. Initially undercoverage was the major problem, but over time leakage became considerably more important, particularly after the re-designation of poor county status in 1993, when about 20 per cent of counties with incomes above the poverty line became mis-targeted. However even with perfect designation at the county level there would still be targeting errors due to the presence of the non-poor in poor counties and of the poor in non-poor counties. Estimates suggest that the share of the poor (at the official poverty line) living in non- poor counties rose from 29 per cent in 1992 to 38 per cent in 2001 (Wang, 2002).

Further evidence of errors in regional targeting comes from the Philippines. Balisacan et al. (2000) identify the 25 most depressed provinces in the late 1990s ranked both by the incidence of poverty or by the poverty gap measure (the rankings are not identical). These are then compared with the priority provinces under the Social Reform Agenda of the Ramos administration. Out of the 26 priority provinces only 11 are in the ranking of most depressed by the poverty indicators. It is clear that formal poverty data were only one of a number of factors used by the government to determine priority status.

Similar recent assessments of regional targeting for Indonesia are unavailable, however survey work illustrates the error of omission in the national Neglected Village program 1994–96 (IDT: Inpres Desa Tertinggal). As noted above, this was a location-targeting program designed to channel small-scale credit to the poorest households targeted at over 20 000 ‘neglected’ (that is poor) villages across the country. Using a pilot study of the IDT in 384 villages in 6 provinces Sumarto et al. (1997) demonstrate the weakness of targeting.

They illustrate undercoverage by focusing on the provinces of Central Java and West Nusa Tenggara (WNT). In the former, 30 per cent of all villages are classed as neglected and covered by the program, but 46 per cent of the poor (insofar as these can be identifi ed accurately) are in villages that are not covered. In WNT a much higher proportion of all villages are classed as neglected, but still over 40 per cent of the poor live in non-IDT villages and are not covered by the program.15 In addition for Indonesia, the National Economic Survey (SUSENAS: Survei Ekonomi Nasional) provides detailed information, which has been used to assess who has benefi ted from the set of povertytargeting measures introduced in the wake of the Financial Crisis (Perdana & Maxwell, 2003). Table 1.2 summarizes the results of the most detailed study based on this data.

The data are extremely detailed and reveal clearly that of the anti-poverty programs over the period only the subsidized ration scheme reached a signifi cant proportion of those eligible (40 per cent). Subsidized rice reached over 50 per cent of households in the bottom quintile, but for all other schemes the proportion of the target group reached was below 20 per cent and often well below it. Hence undercoverage was clearly a problem. In terms of leakage this was most serious for the rice and nutrition programs, where gains to the richest 20 per cent were high and the ratio of non-poor benefi ciaries to their share in total population was highest (nearly 1.0 for the nutrition program implying nearly zero targeting effectiveness), although these figures do not reveal the magnitude of gains per family, only whether they were in receipt of some benefits.

*Table 1.2 Indonesia: Impact of anti-poverty programs August 1998–February 1999*

| Program | Potential recipients (million) | Coverage Poorest 20% (%) | Coverage Richest 20% (%) | Coverage all potential recipients (%) | Proportion of beneficiaries from non-poor | Targeting ratio[a] (%) |
|---|---|---|---|---|---|---|
| Subsidized rice[b] | 50.4 | 52.6 | 24.3 | 40.1 | 0.74 | 0.92 |
| Employment creation[b] | 50.4 | 8.3 | 2.5 | 5.6 | 0.70 | 0.88 |
| Primary scholarships[c] | 29.7 | 5.8 | 2.0 | 4.0 | 0.71 | 0.89 |
| Lower secondary scholarships[c] | 10.4 | 12.2 | 4.9 | 8.4 | 0.71 | 0.89 |
| Upper secondary scholarships[c] | 6.4 | 5.4 | 2.0 | 3.7 | 0.71 | 0.90 |
| Health cards[d] | 27.6 | 10.6 | 3.1 | 6.3 | 0.67 | 0.83 |
| Nutrition[e] | 20.0 | 16.5 | 14.2 | 15.9 | 0.79 | 0.99 |

*Notes*:
[a] Targeting ratio is share of non-poor (defined as those above bottom quintile) in total beneficiaries to their share in total population, which is 0.80 by definition.
[b] Subsidized rice and employment creation programs potentially available to all households.
[c] Scholarships are potentially available to all individual pupils enrolled at the relevant levels.
[d] Health cards potentially available to all those individuals who were estimated to have visited a health care provider in the three months prior to the survey.
[e] Nutrition support potentially available to all individuals in the 'pregnant women and children under three years' category.

*Source*: Sumarto et al. (2001)

Self-targeting schemes were intended to overcome many of the problems faced by directed or narrow targeting. Nonetheless they have also proved disappointing in many cases. In India there has been considerable experience with food-for-work and employment creation programs designed to attract the poor by offering below market-clearing wage rates. Evaluations have revealed serious undercoverage. In the 1990s the Employment Assurance Scheme offered on average only 17 days of employment per person per year against a target of 100 days. Further, its village coverage was low with another evaluation fi nding no more than one third of eligible villages actually covered. This meant that in some states less than 10 per cent of the target group was reached. This, combined with the low number of days' work on offer under the scheme, rendered its overall impact on the welfare of the poor largely minimal. In this case part of the problem had to do with the slow release of central government funds to the states and part to lack of matching funding by the states themselves (Srivastava, 2002). In other schemes, however, the level of wages set for employment has been identifi ed as a critical factor with relatively high and therefore attractive wages leading to a 'crowding out' of the poor. In India under the food-for-work scheme in a survey in Andhra Pradesh, Deshingkar and Johnson (2003) conclude that wages either in cash or in kind were set too low in prosperous villages thus attracting non-poor migrants, but too high in poorer villages leading to crowding out of the poor. A similar conclusion is reached for an Indonesian employment creation scheme (the Padat Karya). An evaluation of this, drawing again on the SUSENAS data, found that for the 1998–99 period, as many as 70 per cent of beneficiaries were from non-poor households (Perdana and Maxwell, 2003).

Self-targeting has also been implied by health and nutrition and many micro-credit schemes. For example, in Indonesia the poor are entitled to health cards giving them access to free medical treatment. The definition of the poor was based on the BKKBN classifi cation scheme noted above. Insofar as the better off will prefer to pay for improved access to health care there is an element of self-targeting in such a measure. Initial assessments of the Health Card program in its fi rst six months of operation, again using SUSENAS data, showed substantial undercoverage with only around 10 per cent of the poorest 20 per cent of households covered. A subsequent more detailed analysis suggested that even though coverage may have been low, the scheme did help to prevent a decline in use of health facilities by the poor in the wake of the Financial Crisis (Pradhan et al., 2002). More explicit self-targeting is involved in the Affordable Medicine for All (GMA) program in the Philippines which provides free drugs for a limited number of conditions at public hospitals and a limited number of distribution outlets, to which it is expected only the poor will choose to go for the drugs. There on how expenditure is allocated within the sector, but in general there is evidence that broad targeting within these sectors can reach the poor. In terms of other evidence on the impact of broad categories of investment, a simulation exercise for the Philippines, using coefficients derived from a regression model of poverty, shows general road expenditures to have high economic returns, but to have a negative direct effect on the poor, although this is compensated by a positive impact from growth. Electrification emerges as the best option in terms of high economic returns and a relatively strong positive effect in reducing poverty (Balisacan & Edillon, 2002).

## 3. LITERATURE REVIEW

### 3.1. How Effective has Targeting Been?

Some errors of targeting and some misappropriation are inevitable in any economic environment and more can be expected in low-income countries. Further, the very modest level of resources directed at the schemes would also limit their impact, even given far lower targeting errors. However, the consistent picture that emerges from the available evidence is that while some schemes may have had a modest positive effect on the poor, in our casestudy countries in general, trends in poverty reduction have been driven by macroeconomic developments – the rate and pattern of economic growth – rather than by targeted interventions.

There is a vast literature on the relationship between growth and poverty, which concludes there is virtually everywhere a clear negative relationship, although its strength varies between countries with different social, economic and political structures. This can be illustrated for our country cases. Warr (2000), for example, examines changes in poverty incidence (the headcount ratio based on offi cial poverty estimates) across a set of countries including India, Indonesia and Thailand. He fi nds elasticities of poverty incidence (the proportionate change in the headcount ratio relative to the proportionate change in GDP per capita) of –0.9 for India, –2.0 for Thailand, and –0.7 for the Philippines.17 For PRC a similar exercise finds an elasticity for poverty incidence of –0.8 (World Bank, 2001). Estimates are also available for the income poverty elasticity, that is the relation between growth (change in mean income) and the change in the income of the poor (normally taken as the bottom quintile). For the Philippines the income poverty elasticity (defi ned as the ratio of the latter to the former) is found to be relatively low at 0.54, whilst for Indonesia the comparable elasticity is 0.71 (Balisacan and Pernia, 2003; Balisacan et al., 2003). In both countries there is a clear tendency for the elasticity for different quintiles to rise as one moves up the income scale, although this is particularly marked in the Philippines. In other words, although the poor benefit from growth they do not benefit as much (both proportionately as well as absolutely) as the better-off.18 Similar results with growth accompanied by a strongly worsening income distribution are found for PRC, with an implicit poverty elasticity of around 0.5 (Stern, 2001).19

These results imply that growth reduces the headcount index of poverty and raises the income of the poor, although often not by as much as it raises the income of better-off groups.20 However, the issue remains of the impact of poverty-targeted programs discussed here, either in reinforcing the positive effects of growth or in protecting the poor at times of recession. As noted above, it would be unrealistic to expect a dramatic impact even in the presence of more accurate targeting, given the modest budgets allocated to these funds.21

Given the high leakage rates reported above and the administrative costs involved in reaching the poor, one would expect that these schemes involved relatively high costs of transfer per unit of benefit received by the poor. Estimates of the optimal degree of targeting, as discussed above, are rarely available. However, in a simulation exercise for the Philippines, Balisacan and Edillon (2002) report that simple geographic targeting provides the maximum benefit to the poor for a given program cost, as compared with other schemes, once the administrative costs per applicant reach a modest figure (roughly 50 per cent of the daily minimum wage in Metro Manila). The implication is that, once administrative costs are allowed for, relatively simple forms of targeting dominate the alternatives.

Few rigorous cost effectiveness studies of alternative targeting schemes are available. For India a comparison of employment guarantee schemes and food subsidies suggests that at best the cost of transfer is nearly double the benefi ts received by the poor. Approximate estimates suggest that the cost of transferring a rupee to the poor through the Maharashtra Employment Guarantee Scheme in its early years (Rs 1.85 per rupee transferred) compared very favorably with both the later national employment scheme, the Jawahar Rozgar Yojana (Rs 2.28 per rupee transferred) and the food subsidy program under the Public Distribution System (Rs 6.68 per rupee transferred) (Dev and Evenson, 2003). Separate estimates for the impact of the Employment Assurance scheme in three states (West Bengal, Gujarat and Haryana) found the cost per job per day to be Rs 200–300, which is well in excess of wage rates, which were roughly in the range of Rs 35–50 (Srivastava, 2002).

The operations of the National Food Authority in the Philippines, particularly through its rice subsidy, have been the subject of several cost effectiveness assessments. For the early 1990s costs are again roughly twice the sum transferred to consumers (Subbarao et al., 1996). However, NFA rice is sold in special retail outlets in a form of self-targeting, and m will leak to the non-poor. Assuming a 50 per cent leakage rate, more recent cost effectiveness estimates for the NFA rice subsidy suggest that in 1997 it costs Pesos 4.2 per peso of benefi t received by poor consumers and Pesos 2.5 per peso of benefi t in 1998. Much of this mis-targeting will have been due to a regional misallocation with some of the poorer provinces being under-represented, relative to their share in poverty, in the receipt of NFA rice (Manasan, 2001).

In addition, however, it is important to remember that despite high leakage and high cost, some of these schemes may nonetheless have been influential in protecting the poor at times of adverse shocks. This is the judgement on some of the many schemes introduced in Indonesia at the time of the Crisis of the late 1990s, particularly in relation to health and education initiatives. For example, there is some evidence that the education scholarship program helped in keeping up school enrolment rates and reducing drop-out rates from poor families. Similarly the Health Card scheme to allow free access to public health facilities is credited with stabilizing the utilization rate of such facilities by the poor (Perdana and Maxwell, 2003). Cost and leakage may have been high, but some real benefi ts appear to have been created.

Apart from these analyses of the cost of transfers to the poor, a few detailed quantitative assessments of the longer-term income effects of this type of program are available. Of our case-study countries, the most work has been done for PRC. From a regression model Rozelle et al. (1998) find some positive income effects from direct lending to households in poor counties in Shaanxi 1986–91; however, funds allocated directly to enterprises in these counties do not appear to have any positive effect on growth. Zhang et al. (2002) look at Sichuan province and compare growth across program poor, non-program poor and non-poor counties. Allowing for a range of other factors they find that program status does appear to have a positive effect on growth. Hence, whilst non-poor counties grew more rapidly, the gap between poor and non-poor counties is lower when counties have a designated poor status and receive poverty funding commensurate with this designation. An even stronger result is provided by Park et al. (2002) using a regression model, which makes growth across counties a function of initial income, other initial characteristics (principally grain production), time invariant characteristics, including poor county status, and a number of time-varying factors. They find that designation as a poor county increases household per capita income, over that otherwise expected, by 2.2 per cent annually in the 1986–92 period and 0.9 per cent annually in 1992–95. When this rate of increase is compared with the amount of funding to poor counties this gives a rate of return of between 12 per cent and 16 per cent depending on the time period.22 This evidence needs to beuch qualifi ed, however. First, even accepting the regression specifi cation as a means of establishing the counterfactual in the absence of designation as a poor county, the study makes no claims to know how the extra income within the counties concerned was distributed. There need be no inevitable assumption that the incomes of the poor grew by the same rate as average incomes in the poor counties. Second, the authors make clear that their results may be an over-estimate as they have not been able to include all costs of the targeting programs. Third, their returns must be compared with the opportunity cost of capital in China at this time, which was probably relatively high, given the rapid growth rate, and may have been at least 12 per cent or more (which implies that equivalent or higher returns could have been obtained on investment elsewhere in the economy).

A detailed examination of the impact of public spending on poverty in PRC, which gives a less positive assessment of the poverty loans program, is provided by Fan et al. (2002). Using a simultaneous equation model, that has now been applied to a number of countries, they assess the effect on poverty in terms of numbers pulled above the poverty line due to a given amount of different public expenditures. By far the highest poverty effect is due to education, followed by agricultural Research and Development (R&D). Poverty loans have a relatively very small (and statistically insignificant) impact per unit of expenditure. They have the smallest poverty effect of any category of expenditure included (only 13 per cent of that of education, 15 per cent of that of R&D, and roughly one-third of that of roads).23 Similar studies have been done for India and Thailand using the same model, but only the India study includes poverty loans (covering rural and community development and employment programs) as a separate expenditure category (Fan et al., 1999). For the Indian case in terms of poverty impact the relative ranking of the poverty expenditure category is higher than for PRC (it is fourth behind roads, R&D and education).24 However, per unit its impact is still well below that of these other categories of expenditures, being 17 per cent of that of roads, 30 per cent of R&D and 88 per cent of education. No doubt the targeting errors reported in this part are a major part of the explanation.

### 3.2. Poverty in Indonesia

Between the mid-1960s and 1996, when Indonesia was under the rule of Soeharto's New Order (Orde Baru) government, the country witnessed a significant decline in poverty - both urban and rural - due to robust economic growth and efficient pro-poor programs. During the Soeharto's period the number of Indonesians that lived below the poverty line eased from over half of the total population to 11 percent. However, when the Asian Financial Crisis rocked the financial foundations of Indonesia in the late 1990s it had a devastating impact on poverty alleviation, causing the poverty rate to slip back from 11 percent to 19.9 percent in late 1998, meaning that much of the New Order's good work had been undone.

The Asian Financial Crisis started on 2 July 1997 when the Thai government, burdened with a huge foreign debt, decided to float its baht after currency speculators had been attacking the country's foreign exchange reserves. This monetary shift was aimed at stimulating export revenues but proved to be in vain. It soon led to a contagion effect in other Asian countries as foreign investors - who had been pouring money into the 'Asian Economic Miracle countries' since a decade prior to 1997 - lost confidence in Asian markets and dumped Asian currencies and assets as quickly as possible. (https://www.indonesia-investments.com/culture/economy/asian-financial-crisis/item246)

### 3.3. The Indonesian Crisis Begins

Although the Asian region showed worrying signs, foreign investors initially kept confidence in the Indonesian technocrats' ability to weather the financial storm (as they had done before in the 1970s and 1980s). But this time, however, Indonesia would not get off scot-free. It became the hardest-hit country because the crisis not only had economic but also significant and far-reaching political and social implications. When pressures on the Indonesian rupiah became too strong, the currency was set to float freely starting from August 1997. Soon it began depreciating significantly. By 1 January 1998, the rupiah's nominal value was only 30 percent of what it had been in June 1997. In the years prior to 1997 many private Indonesian companies had obtained unhedged, short-term offshore loans in US dollars, and this enormous private-sector debt turned out to be a time bomb waiting to explode.

Continued rupiah depreciation only worsened the situation drastically. Indonesian companies rushed to buy dollars, thus putting more downward pressure on the rupiah and exacerbating the companies' debt situation. It was certain that Indonesian companies (including banks; some of which were known to be very weak) would suffer huge losses. New foreign exchange supplies were scarce as new loans for Indonesian companies were not granted by foreign creditors. As the government of Indonesia was unable to cope with this crisis it decided to seek financial assistance from the International Monetary Fund (IMF) in October 1997.

### 3.4. The IMF Arrives and Chaos Continues

The IMF arrived in Indonesia with a bailout package totaling USD $43 billion to restore market confidence in the Indonesian rupiah. In return it demanded some fundamental financial reform measures: the closure of 16 privately-owned banks, the winding down of food and energy subsidies, and it advised the Indonesian Central Bank (Bank Indonesia) to raise interest rates. But this reform package turned out to be a failure. The closure of the 16 banks (some controlled by Soeharto's cronies) triggered a run on other banks. Billions of rupiah were withdrawn from saving accounts, restricting the banks' ability to lend and forcing the Central Bank to provide large credits to the remaining banks to avert a complete banking crisis.

Moreover, the IMF did not try to curb Soeharto's system of patronage that was damaging the country's economy and undermining the IMF accord. This patronage system was Soeharto's tool to maintain power; in exchange for political and financial support, Soeharto gave powerful positions to his family, friends and enemies (thus becoming cronies). Other developments that were negatively impacting on Indonesia towards the end of 1997 were a serious El-Nino drought (bringing severe droughts that caused forest fires and poor harvests) and rising speculation about Soeharto's deteriorating health (which caused political uncertainties). Gradually, Indonesia was heading towards a political crisis.

A second agreement with the IMF was needed as the economy was continuing its downward spiral. In January 1998 the rupiah lost half of its value within the time-span of five days only, causing Indonesians to hoard food. This second IMF agreement contained a detailed 50-point reform program, including provisions for a social safety net, a gradual phasing out of certain public subsidies and the tackling of Soeharto's patronage system by ending monopolies of a number of his cronies.

However, reluctance of Soeharto to implement this structural reform program faithfully, meant that the situation did not improve. Critics of the IMF, however, point out that the institution pushed for too much reform within too little time, thereby worsening the Indonesian economy. The IMF indeed made errors in its initial approach to the Indonesian crisis but it did come to realize that the key in overcoming this crisis was to restart private capital flows to Indonesia. In order for this to happen the patronage system had to be broken down.

**Indonesian GDP and Inflation 1996-1998:**

| | **1996** | **1997** | **1998** |
|---|---|---|---|
| **GDP growth** (annual percent change) | 8.0 | 4.7 | -13.6 |
| **Inflation growth** (annual percent change) | 6.5 | 11.6 | 65.0 |

**Source: Hill, H. (2000). The Indonesian Economy, p. 264**

**Table: 1.3**

A third agreement with the IMF was signed in April 1998. The Indonesian economy and social indicators were still showing worrying signs. But this time, however, the IMF was more flexible in its demands than on previous occasions. For instance, large food subsidies for low-income households were granted and the budget deficit was allowed to widen. But the IMF also called for the privatization of state-owned companies, faster action on bank restructuring, a new bankruptcy law as well as a new court to handle bankruptcy cases. It also insisted on the closer monitoring of its implementation as recent experiences had shown that the Indonesian government was not fully committed to the reform agenda.

## 4. METHODS

### 4.1. Sampling The Crisis Hits its Climax

In the meantime, major social forces were at work as well. Demonstrations and criticism directed towards the government of Soeharto intensified severely after he was re-elected and had formed a new cabinet in March 1998. This provocative new cabinet contained a number of members from his crony-group and therefore did little to restore confidence in the Indonesian market. After the government decided to reduce the subsidies on fuel in early May, large-scale riots broke out in Medan, Jakarta and Solo. Although the IMF had given Soeharto time until October to reduce these subsidies gradually, he decided to do it all at once, probably underestimating its impact or overestimating his own position.

The tense atmosphere came to a climax when four Indonesian students were killed during a protest at a local university in Jakarta. It is suspected that an army unit of the special forces was behind these shootings ('Trisakti shootings'). The next couple of days Jakarta was plagued by the worst riots ever. As had happened before, the ethnic Chinese - disliked for their assumed wealth - were often target during these violent riots. Chinese stores and houses were burned to the ground and Chinese women brutally raped. When the riots calmed down, more than one thousand people had lost their lives and thousands of buildings were destroyed. On 14 May 1998 President Soeharto stepped down from the presidency when all politicians refused to join a new reorganized cabinet. The financial crisis had fully grown into a social and political one.

### 4.2. A New Political System and the Start of Recovery

Bacharuddin Jusuf Habibie, vice-president in Soeharto's last cabinet and thus - by law - replacing Soeharto as Indonesia's next president, turned to the economic technocrats to deal with the ongoing financial crisis. This resulted in a fourth agreement with the IMF. It was signed in June 1998 and allowed the budget deficit to widen further while new funds were pumped into the economy.

Within the time-span of a couple of months there were some signs of recovery. The rupiah began to strengthen from mid-June 1998 (when it had fallen to 16,000 rupiah per dollar) to 8,000 rupiah per dollar in October 1998, inflation eased drastically, the Jakarta stock exchange started to rise and non-oil exports started to revive towards the end of the year. The banking sector (center of the crisis) remained fragile as the number of non-performing loans were high and banks were very hesitant to loan money. Moreover, the banking sector had caused a sharp increase in government debt as this debt was primarily due to the issuance of bank restructuring bonds. But, albeit fragile, Indonesia's economy improved gradually through 1999, partly due to an improving international environment which caused a rise in export revenues.

### 4.3. Lessons Learned from the Asian Financial Crisis

It is interesting to question what chances are of such a crisis occurring again in Indonesia in the foreseeable future. Most likely chances are small. First of all it needs to be stressed that the Asian Financial Crisis hit Indonesia hardest of all involved countries because it was not just an economic crisis. It started out as an economic crisis but became severely aggravated because it was accompanied by a deep political and social crisis in which the government was not willing to implement much needed economic reforms but instead was trying to cling on to their hold of power. As an orderly and conducive political climate is of vital importance for investor confidence, the uncertainties and tensions in Indonesian politics made many investors turn their back to the country. Also after Soeharto's fall, political uncertainties put off many investors (foreign and domestic) to (re)enter the Indonesian market.

Today, however, Indonesia is well on its way to become a full democracy, albeit its a process that is accompanied by growing pains. Decades of authoritarian rule have depoliticized the people and political institutions to a considerable extent. It will take time before the country can leave behind the rank of 'flawed democracy' as measured by Economist Intelligence Unit for its Democracy Index. But fair and free elections imply that there has been more popular support for the governments during the Reformation period than ever before. The decision to have the president directly elected by the people is an important one, psychologically. Nonetheless, it should be underlined that the Indonesian political climate is more volatile than long-established democracies due to many dissenting forces looking to establish their position in the young democracy. For a detailed account on this topic visit our Reformation section.

Another important factor that seriously aggravated the financial crisis in Indonesia was the terrible state of the Indonesian financial sector. This was caused by a culture of patronage and corruption which lacked a decent supervision model. Even the Central Bank had no idea about the flows of money (and resulting huge short-term private debt) which entered Indonesia and caused a 'bubble economy'. The culture of patronage and corruption (and lack of legal certainty) seriously hampered the functioning of an efficient economy and was a time bomb waiting to explode.

Since the end of the crisis, however, Indonesian governments have made prudent financial measures to make sure a similar crisis cannot happen. Supervision on liquidity of the banking sector is strict and transparent, 'hot money' is more carefully handled (for example by halting short-term debts), and the government's debt-to-GDP is lower (around 25 percent and showing a decreasing trend) than most economic advanced countries. When the 2008 crisis hit, Indonesia saw a large outflow of money again but was able to guarantee a stable economy due to sound economic fundamentals. Even during this 2008-2009 crisis Indonesia showed robust growth with 4.6 percent GDP growth, mainly due to domestic consumption.

Graft scandals, however, still fill the pages of Indonesian newspapers on a frequent basis. Corruption and the clustering of capital within the small elite are still serious problems in the country and hamper the economy from being more efficient and righteous. In particular political corruption remains problematic and quite often politicians have major business interests (such interests influence their political vision).

The following table provides poverty and inequality figures - both relative and absolute - for the population of Indonesia (for an analysis of Indonesia's Gini ratio please scroll to the bottom of this page).

**Indonesian Poverty & Inequality Statistics:**

| | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** |
|---|---|---|---|---|---|---|---|---|---|---|
| **Relative Poverty** (% of population) | 16.6 | 15.4 | 14.2 | 13.3 | 12.5 | 11.7 | 11.5 | 11.0 | 11.1 | 10.9[1] |
| **Absolute Poverty** (in millions) | 37 | 35 | 33 | 31 | 30 | 29 | 29 | 28 | 29 | 28[1] |
| **Gini Coefficient/ Gini Ratio** | 0.35 | 0.35 | 0.37 | 0.38 | 0.41 | 0.41 | 0.41 | 0.41 | 0.41 | 0.40 |

[1] March 2016

**Sources: Statistics Indonesia (Badan Pusat Statistik) and World Bank**

**Table: 1.4**

The table above shows a gradual, yet steady, decline in national poverty in Indonesia. However, the Indonesian government applies rather easy terms and conditions regarding the definition of the poverty line. Hence, it results in a more upbeat picture than it is in reality. In 2016 the Indonesian government defined the poverty line at a monthly per capita income of IDR 354,386 (approx. USD $26.6). This is a very low standard of living, even for Indonesian standards.

If we apply the poverty threshold as is used by the World Bank, which classifies the percentage of the Indonesian population living on less than USD $1.25 a day as poor, then the percentages in the table above will rise by a couple of percentage points. Moreover, according to the World Bank, when taking into account the percentage of the Indonesian population that lives on less than USD $2 a day, the figure would jump even more sharply. This shows that a large proportion of the Indonesian population is in fact near poor. Recent reports in Indonesian media suggest that around a quarter of Indonesians (which translates to around 65 million people) are currently near poor (as they live just above the poverty line).

Although over the past decade Indonesian poverty numbers have shown a steady downward trend, it is assumed that in the future this downward trend will continue at a slower pace. Most of Indonesians that rose out of poverty in recent years were those who had been living just below the poverty line. This means it took less effort to push them out of poverty. It is now the bottom base of Indonesia's poor people who need to be alleviated. This is more complicated and thus should result in slowing rates of poverty reduction.

Food price stability (rice in particular) is a vital matter for Indonesia as the country contains a population that spends a large proportion of their disposable incomes on rice. Therefore, inflationary presseures on the price of rice (for example due to bad harvests) and other food products can have serious consequences for those that are poor or near poor. In fact, it can push a significant number of near poor people into full poverty.

Besides food prices, inflation also tends to peak when the government adjusts administered prices (this is primarily related to energy subsidies for fuel and electricity). For example, when the Susilo Bambang Yudhoyono administration drastically cut fuel subsidies in late-2005 a significant increase in poverty occurred between 2005 and 2006. Rising international oil prices had made the government decide to reduce fuel subsidies in order to relieve the government's budget deficit. This consequently led to a double-digit inflation rate of between 14 and 19 percent year-on-year (y/y) until October 2006. President Joko Widodo also drastically cut fuel subsidies, both in late-2014 and early-

2015. However, due to the low crude oil prices at the time this decision had less far-reaching impact on the nation's inflation rate. Still, inflation surged to between 8 - 9 percent (y/y) in 2014 and therefore there also occurred a small increase in Indonesia's poverty rate from 2014 to 2015, both in terms of urban and rural poverty.

### 4.4. Indonesian Poverty and Geographical Distribution

One remarkable characteristic of Indonesian poverty is that there is a major difference in terms of relative and absolute poverty in relation to geographical location. While in absolute terms over half of the total Indonesian poor population lives on the island of Java (located in the more populous western half of Indonesia), in relative terms the provinces of eastern Indonesia show far higher numbers of poverty. The table below shows the top five of Indonesian provinces regarding highest incidences of relative poverty. All these provinces are located outside the more developed western-located islands of Java, Sumatra and Bali.

**Indonesian Provinces with Highest Relative Poverty:**

| Province | Poor People[1] |
|---|---|
| Papua | 28.5% |
| West Papua | 25.4% |
| East Nusa Tenggara | 22.2% |
| Moluccas/Maluku | 19.2% |
| Gorontalo | 17.7% |

[1] as percentage of total population per province in March 2016

**Source: Statistics Indonesia (BPS)**

**Table: 1.5**

These eastern provinces of Indonesia, where farmers lead a largely subsistence existence, contain very high rates of rural poverty. In these regions, indigenous communities have been living on the margins of development processes and government (or international) programs. Migration to urban areas is often the only way to find employment and - thus - escape poverty. However, contrary to relative poverty in eastern Indonesia, the table below shows that absolute poverty in Indonesia is mainly clustered on the islands of Java and Sumatra. These two islands are the most populous islands in Indonesia.

**Indonesian Provinces with Highest Absolute Poverty:**

| **Province** | **Poor People*)** (in millions) |
|---|---|
| East Java | 4.78 |
| Central Java | 4.51 |
| West Java | 4.49 |
| North Sumatra | 1.51 |
| East Nusa Tenggara | 1.16 |

*) per March 2016

**Source: Statistics Indonesia (Badan Pusat Statistik)**

**Table: 1.6**


### 4.5. Rural and Urban Poverty in Indonesia

Indonesia has experienced a process of rapid and continued increased urbanization (similar to the trend around the globe). Since the mid-1990s the absolute number of Indonesia's rural population began to decline and today more than half of Indonesia's total population lives in urban environments (in the mid-1990s approximately one-third of Indonesia's population lived in urban societies).

With the exception of a few provinces, the rural populations of Indonesia are relatively poorer than the urban ones. Indonesia's rural poverty rate (percentage of the rural population living below the national rural poverty line) dropped to around 20 percent in the mid-1990s but suffered at the hands of the Asian Financial Crisis that ravaged the country between 1997 and 1998, causing the number of poor people in the rural areas to rise again to 26 percent. After 2006, a significant decline in rural poverty in Indonesia emerged (see table below) although in the period 2012-2016 the decline was limited amid Indonesia's 2011-2015 economic slowdown.

**Rural Poverty in Indonesia Statistics:**

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Rural Poverty[1]** | 21.8 | 20.4 | 18.9 | 17.4 | 16.6 | 15.7 | 14.3 | 14.4 | 13.8 | 14.2 | 14.1 |

[1] % living below rural poverty line

**Source: Statistics Indonesia (BPS)**

**Table: 1.7**

The urban poverty rate is the percentage of the urban population living below the national urban poverty line. The table below, that indicates urban poverty in Indonesia, shows a similar pattern as Indonesia's rural poverty rate: a solid decrease since 2006 but a less smooth performance in the period 2012-2015 due to the nation's economic slowdown. This macroeconomic slowdown occurred primarily due to sluggish global economic growth, falling commodity prices, and Bank Indonesia's high interest rate environment in the 2013-2015 period (to combat high inflation, support the rupiah exchange rate and limit the nation's current account deficit).

**Urban Poverty in Indonesia Statistics:**

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Urban Poverty[1]** | 13.5 | 12.5 | 11.6 | 10.7 | 9.9 | 9.2 | 8.4 | 8.5 | 8.2 | 8.3 | 7.8 |

**1) %-age living below urban poverty line**

**Source: Statistics Indonesia (Badan Pusat Statistik)**

**Table: 1.8**

## 4.6. Widening Inequality in Indonesia?

The Gini ratio (or coefficient), which measures income distribution inequality, is an important indicator to assess the degree of 'righteousness' in a country (although this indicator does have some flaws). A Gini coefficient of 0 indicates perfect equality, while a coefficient of 1 indicates perfect inequality. It is interesting to note that a sharp rise in income distribution inequality occurred in Indonesia in the post-Soeharto era. Thus, the period of democracy and decentralization in the post-Soeharto era created an environment that allowed for rising inequality in Indonesian society: while in the 1990s Indonesia's Gini ratio stood at an average of 0.30, it rose to an average of 0.39 in the 2000s, and remained stable at 0.41 in the years 2011-2015 before easing slightly to 0.40 in 2016. It actually is a painful fact that Indonesia's rising inequality emerged while - at the same time - the overall economy expanded from a USD $163.8 billion economy in 1999 to a USD $861.9 billion economy in 2015 (and while Indonesia became a member of the G20 group of major economies in 2008).

A World Bank report that was released in December 2015 claims that only the richest 20 percent of Indonesia's population have enjoyed the fruits of a decade-long economic growth, implying that 80 percent of the population (or 200 million people in absolute terms) are left behind. These are alarming figures. In fact, after China, Indonesia saw the highest rise in income distribution inequality between the 1990s and the 2000s among Asian countries:

**Asian Countries with the Highest Average Gini Ratio:**

| **Country** | **Gini Ratio in the 1990s** | **Gini Ratio in the 2000s** | **Difference** |
|---|---|---|---|
| China | 0.34 | 0.45 | +0.11 |
| Indonesia | 0.30 | 0.39 | +0.09 |
| Laos | 0.32 | 0.38 | +0.06 |
| India | 0.34 | 0.39 | +0.05 |
| Vietnam | 0.37 | 0.37 | 0.00 |
| Cambodia | 0.39 | 0.38 | -0.01 |
| Philippines | 0.45 | 0.44 | -0.01 |
| Malaysia | 0.49 | 0.47 | -0.02 |
| Thailand | 0.46 | 0.41 | -0.05 |

**Source: World Bank**

**Table: 1.9**

In Indonesia the Gini ratio is also closely related to the movement of commodity prices. The rising trend of the nation's Gini ratio in the 2000s came amid the commodities boom, while the Gini ratio stabilized after commodity prices collapsed in 2011. Therefore, rising or falling commodity prices apparently particularly affect the top 20 percent of the Indonesian population. Lower commodity prices weakens this group's incomes and purchasing power. A high degree of inequality in society is a threat because it not only jeopardizes social cohesion but it also jeopardizes political and economic stability. Moreover, research conducted by the World Bank shows that countries with more equal wealth distribution tend to grow faster and more stably compared to those countries that exhibit a high degree of inequality. Besides overall nationwide inequality in Indonesia, there also exists a high degree of inequality among the various regions within the country. For example the island of Java, particularly the Greater Jakarta region, contributes about 60 percent to the total Indonesian economy. Direct investment is also highly concentrated on this island causing rising inequality between Java and the outer islands.

What can the government do to combat income distribution inequality in Indonesia? Key strategies would be to increase employment opportunities for Indonesians by encouraging the development of labor-intensive sectors (particularly the agriculture sector and manufacturing industry). To achieve this, it is important to attract direct investment in these labor-intensive industries (implying the government needs to continue its focus on improving Indonesia's investment climate).

Meanwhile, the government needs to focus on the development of new economic growth centers outside the island of Java in order to reduce inequality (structurally) among the various regions. Infrastructure development in the remote regions is one strategy to achieve this (which will cause the so-called multiplier effect). Lastly, education and health should also be improved nationwide as higher education and healthy lifestyles tend to lead to higher incomes.

However, the methodology of the Gini coefficient can be questioned as it divides the population in five baskets, each containing 20 percent of the population: from the 20 percent richest to the 20 percent poorest. Subsequently, it measures the (in)equality between those five baskets. The problem when using this coefficient for Indonesia, however, is that the country is characterized by extreme inequality within each basket, making the outcome of the Gini coefficient less in tune with reality.

**4.7. Cases in North Sumatra Poverty Level Increasing**

A rickety hut located in a slum area of Medan, North Sumatra, is the home of Yunus Ramadhan, his mother and elder brother. It is on the verge of collapsing. Living without a father, 8-year-old Yunus earns money as a scavenger. Along with his 13-year-old brother Chaidir Ali, he also works shining shoes. Their mother, Darnius, collects and sells recycled goods. “Our father has passed away, so we have to work and help our mother earn a living to put food on the table,” Yunus told The Jakarta Post after polishing shoes on Jl. Agus Salim, Medan. Yunus and his family are among thousands of poor families in Medan.

According to Central Statistics Agency (BPS) data, the number of poor people in North Sumatra increased by 0.47 percent this year. BPS North Sumatra head Wien Kusdiatmono said the number of poor people in the province was 1,360,600, or 9.85 percent of the province's population.

Wien added that the poverty number had risen since March 2014, when it stood at 1,286,700.

“The number of poor people in North Sumatra has risen by 73,900 people, or 0.47 percent,” said Wien at his office. Wien added that the poverty rate corresponded with the National Social Economic Survey (Susenas) conducted in September 2014.

According to the survey, the number of urban poor in North Sumatra stood at 667,500 people and 693,100 people in rural areas. The increase in the number of poor people during March and September 2014 was believed to be attributed to the inflation rate, which rose from 1.48 to 2.83 percent during September 2013 to March 2014. Other factors included the Farmers Exchange Rate (Nilai Tukar Petani), which experienced a drop from 101.31 points in March 2014 to 99.79 points in September 2014. The open unemployment rate also increased from 5.95 percent in February 2014 to 6.23 percent in August 2014.

Economic growth also slowed from 5.64 percent in the first quarter in 2014 to 5.20 percent in the third quarter of 2014. Wien explained that poor people were categorized as those with expenditure levels below the poverty line. According to him, the poverty line in North Sumatra in September 2014 was Rp 330,663 (about US$27) monthly per capita. For urban areas, added Wien, the poverty line was Rp 349,372 monthly per capita, while in rural areas Rp312,493 monthly per capita.

North Sumatra Governor Gatot Pujo Nugroho (at that time) acknowledged the increase in poverty in the province, but played it down. 'The rise in the poverty rate is insignificant, less than 1 percent,' he said. He added he had urged agencies and working units in the North Sumatra administration to address the poverty issue by offering project tenders to facilitate the improvement of people's welfare. Brilian Moktar, a member of the North Sumatra Provincial Legislative Council (Dewan Perwakilan Rakyat Daerah) Commission “E” on *people's welfare*, said the rise in the number of underprivileged people in the province indicated that the provincial administration had failed to improve people's well-being. Brilian said the programs run by the administration had only touched middle to upper-income groups.

“Many underprivileged people in North Sumatra still do not benefit from government programs. This is cause for concern as it will impact on increasing the poverty rate,” said Brilian, who vowed to bring the matter to the DPRD for thorough discussion. Indonesia's poverty level fell slightly in September last year, despite low commodity prices and rising minimum wages, according to the BPS. (http://www.the jakartapost.com/news/2015/01/09/north-sumatra-poverty-level-increasing-says-bps.html)

**4.8. Behind the Rise of Poverty in Indonesia**

One of the impacts of the slowing economic growth in Indonesia is the rise of poverty. About 1.1 million more people from 26 provinces became newly poor (defined as those whose incomes fell below the poverty line) between September 2014 and September 2015. At the same time, 268,000 people from 13 provinces were lifted from poverty. According to Central Statistics Agency (BPS) figures, the total number of people in absolute poverty is now 28.2 million, an increase of 2.8 percent over the same period, but these figures hide the wide differentials of poverty increases among provinces in the country.

Major provinces in Sumatra, except Lampung, had worsening poverty. North Sumatra, Riau and Jambi registered a double-digit increase in the number of their poor people. These provinces are major commodity producers and so they were not only hit by the falling commodity prices, but also by forest fires and the smoky haze they spewed that rampaged through those provinces for several months in 2015. The highest increase in poverty was in East Nusa Tenggara (NTT), where it jumped by 17 percent, six times the rate of increase of the national average. But the most baffling is Bali, where despite its flourishing tourist industries, its number of poor people went up by 11 percent, the third largest increase in the country after NTT and Riau.

In Sulawesi, except in West Sulawesi where poverty declined by 1 percent, all provinces suffered substantial increases in poverty, the biggest being in Southeast Sulawesi where the number of poor increased by almost 10 percent. In Kalimantan, out of four provinces, only West Kalimantan suffered a poverty increase. Surprisingly, despite the fall in coal prices and declining exports, the number of poor people in East Kalimantan fell by 17 percent. Papua, which has the highest poverty rate in the country, surprisingly experienced a modest increase in poverty, while in West Papua the number of the poor did not change.

In Java, the number of poor people increased in Banten and West Java and slightly increased in East Java. In Central Java, the number of poor people declined by 1.8 percent, while in Yogyakarta it dropped by nearly 9 (nine) percent. In Jakarta, the capital, the number of poor people fell by 10.7 percent. This is not surprising given the aggressive actions by its governors in implementing various social programs to alleviate poverty, specially by issuing various smart cards to the poor.

It is not clear at this point why few provinces managed to reduce poverty. The presence of a high number of manufacturing industries is no guarantee for containing poverty, as shown in Banten and/or West Java. But political will by the head of the local government could play an important role in reducing poverty, in the form of their determination to build infrastructure a high priority in their budget, to spend more on health and education and to improve the access for the poor to water and better sanitation. Unfortunately as most provinces lack the resources and determination to alleviate poverty, the general trend has been an increase in poverty. Besides, there are also several reasons that could be attributed to the increase of poor people during this period.

First, because economic growth slowed many companies have shredded their workforces, economic activities shrank and many lost their jobs. Second, when President Joko 'Jokowi' Widodo decided to cut fuel subsidies at the end of 2014, the government initiated the Prosperous Family Savings Program (PSKS), a temporary cash handout to the poor, with the objective of shielding them from the effects of fuel price increases, but because of the budget fiasco in 2015, the cash disbursement to the poor was delayed and it was distributed only in April 2015.

Therefore, the poor were practically unprotected during the first three months of 2015, at a time when the impacts of the fuel price increases had already started. Another reason is that during this time, as reported by the BPS, while real wages of construction workers stagnated, real wages of farm workers shrank by 2 percent. As the majority of farm workers are poor, the decline in their real wages has significant impact on the poverty increase. But the most damaging reason for the increase in poverty is the steep rise in rice prices. Given the large need for rice on the poverty line a small increase in rice prices could lead to a substantial increase in the incidence of poverty. This is because income of the poor is mostly used for buying rice, but last year the increase in rice prices was not small.

According to the BPS, the price of rice of inferior quality “the kind that is mostly consumed by the poor “€ rose by 9.5 percent between December 2014 and December 2015. The poor, especially farm workers, must have been badly hurt by the rice price increase because it happened when their real wages went down 2 percent. So in protecting the poor and keeping poverty low, there is nothing more critical than stabilizing the prices of rice, but the government record in this matter was poor last year. Estimates of rice production by the Agriculture Ministry showed a surplus, but in fact rice stocks dwindled and prices kept surging. Reluctantly, the government has finally conceded that it had to import rice. It ultimately imported 848,000 tons of rice from fourth quarter to January 2015 and an additional of 600,000 tons are on their way.

Maintaining an adequate supply of rice for the government is getting more complicated in the face of the impact of El Nina and a delay of rice planting for several months. The problems are confounded by the unreliable government statistics on rice production on which policy for building rice stocks are based. The uncertainty has forced the government to resort to importing rice, but for the sake of preventing rice prices and poverty from increasing, importing rice should not be done on *ad hoc* basis. (Winarno, 2016).

### 4.9. Inclusive Social Protection for Poverty Alleviation

Indonesia has emerged as a middle-income country and an important player in the global economy (G20) but faces three major problems: a slowing reduction of poverty rates, rising inequality and a high level of vulnerability for much of the population living in poverty. As of September 2015, 28.51 million Indonesians (11.13 percent) lived below the poverty line, with the poor experiencing worsening socio-economic conditions. Around 70 million people lived just above the poverty line and were vulnerable to economic shocks or other crises 'such as ill-health or unemployment ' which could push them into poverty.

In fact, over 80 percent of the population lives on less than Rp32.000,00 (US$2.20 for US$ = Rp14.545,00) per day, which isn't even enough to buy a cup of coffee at Starbucks. Indonesia's Gini coefficient, which indicates inequality in income distribution, is 0.41, its highest in 50 years and the highest among Asian countries. If it continues to rise, Indonesia could be at risk of social instability. According to the 2015-2019 Medium-Term Development Plan (RPJMN - Rencana Pembangunan Jangka Menengah Nasional), the government aims to address the three above-mentioned major problems using four inter-linked strategies, which are: building a strong foundation for economic growth resulting in quality employment opportunities; establishing a comprehensive social protection system; promoting sustainable livelihoods; and increasing and expanding basic social services. By 2019, as projected in the RPJMN, the poverty rate and Gini coefficient are expected to fall to 7-8 percent and 0.36, respectively.

Social protection has been rebranded and expanded by the government through the Prosperous Family Savings Program (PSKS - Potensi Sumber Kesejahteraan Sosial) that gives direct assistance to the poorest 25 percent of the population. This program is implemented through the Smart Indonesia Program (PIP - Program Indonesia Pintar) and the Healthy Indonesia Program (PIS - Program Indonesia Sehat). The government also continues to implement other social assistance programs such as subsidized rice for the poor (formerly known as Raskin) and the conditional cash transfer program (PKH - Program Keluarga Harapan).

As has been the norm, social protection programs are targeted at different segments of the population. Poverty targeting continues to be employed despite the fact that it generates high inclusion and exclusion errors, and, due to its complexity, is administratively expensive to deliver. **Stephen Kidd** of Development Pathways (2016) has noted that 'in developing countries, there is no poverty targeting mechanism that comes remotely near being accurate in identifying people living in poverty. Even well-known schemes such as Brazil's Bolsa Familia and Mexico's Oportunidades programs excluded 49 percent and 70 percent respectively of their target populations.'€ •

Indonesia uses the Unified Data Base (UDB) as the basis for social protection targeting. But, as recent research has shown, it faces the challenge that, among the poorest 40 percent of the population covered by the UDB, a high percentage was not on the UDB. On the other hand, a significant proportion of the richest quintile of the population are on it. Consequently, one cannot expect Indonesia's targeted social protection programs to be effective in reaching the majority of those living in poverty and vulnerability. Furthermore, as pointed out by **Amartya Sen** ( 1995 ), the beneficiaries of poverty targeting tend to be politically weak, with minimal influence over electoral results. And, there is good evidence that poverty targeting can create social tensions in communities, since those excluded from social protection programs become jealous of those who are included as beneficiaries. So the question is why continue targeting? For its advocates, the argument for targeting rests on moral and resource arguments.

The moral argument is to prioritize the poor over the rich, yet, in reality, it is only universal programs that can ensure the inclusion of the poor. The resource argument is to ensure that limited budgetary resources are used effectively, yet, if half of the poor are excluded, can it be considered effective? Given that poverty targeting's disadvantages outweigh its advantages, it is time to look into the alternative approach of inclusive lifecycle social protection as a means of reaching the poor and vulnerable and addressing inequality. In contrast to poverty targeted schemes, inclusive provision offers better and larger contributions (transfer of value) to beneficiaries.

Large scale and inclusive provision can have multiple benefits beyond the immediate purpose of helping the most vulnerable groups like the elderly, children and people with disabilities. For example, grandmothers in receipt of old-age pensions can care for their grandchildren, to enable their mothers to find work (and further reduce poverty).

And inclusive social protection can generate higher levels of spending in the economy, which can help stimulate economic growth. Inclusive social protection could reach the 80 percent of the aforementioned Indonesian population that continues to live in insecurity on less than Rp32,000 per day. As a result, it can build social cohesion and reduce the risk of political instability.

Providing inclusive lifecycle social protection schemes for the majority of Indonesia's population ” and guaranteeing access for the most disadvantaged and vulnerable ' is affordable. For just over 1 (one) percent of GDP (Gross Domestic Products), Indonesia could provide comprehensive benefits for the vast majority of older people, children and people with disabilities, significantly improving the impact of the national social protection system.

Not only is inclusive social protection socially and economically desirable, but importantly ”as evidenced in many developed and developing countries ” it would be politically popular and would subsequently translate into support for expanding the fiscal space available for financing social protection, while reaping electoral rewards for ambitious and far-sighted policy makers and politicians.

Given the advantages of inclusive social protection, it is sensible for the government to explore the feasibility of piloting, if not implementing it across all areas of social policy, including inclusive old-age grants, child benefits and disability benefits. Our Constitution guarantees the right of all citizens to social security, and it is time that that right is fulfilled.

## 5. CONCLUSIONS

### 5.1. Poverty has Decreased by 2.11 Percent in Indonesia: BPS

The percentage of the Indonesian population living below the poverty line decreased by 2.11 percent to 28.01 million people as of March, 2016, compared to March 2015, according to data provided by the Central Statistics Agency (BPS). The number of people living below the poverty line currently rests at 10.86 percent of the total population, BPS reported. "In Asian countries, including Indonesia, poverty reduction percentages have not been significant in size since 2012, because only core poverty remains," said Suryamin, head of the BPS, on Monday

With 14.97 million people or 53.45 percent of the total poor in Indonesia, Java records the largest number of people living below the poverty line. Poverty has declined in Java, from 15.45 million in March 2015. Java, the most populated island in Indonesia, is listed as the second wealthiest region in Indonesia in 2016. Kalimantan is the wealthiest region. The number of people living below the poverty line rests at 970,000 people, 6.26 percent of Kalimantan's total population. At 22.09 percent, Maluku and Papua report the largest percentage of poor compared to the total population. However, with a population of only 1.54 million people, the number is considered low. The population in the region has increased by 3.35 percent, from 1.49 million people in March 2015. (http://www.thejakartapost.com/news/2016/07/18/poverty-has-decreased-by-2-11-percent-in-indonesia-bps.html).

**5.2. Indonesia to Strive for Poverty Rate Below 10 Percent**

National Development Planning (Bappenas - Badan Perencanaan Pembangunan Nasional) Minister Bambang Brodjonegoro has said that the government plans to lower the poverty rate to below 10 percent this year, from the 10.2 percent recorded late last year. "[A poverty rate of] 10.12 percent is the lowest [recorded] in Indonesian history. We hope it will fall below 10 percent this year," said Bambang on Wednesday, after attending a plenary Cabinet meeting at the State Palace in Jakarta. On Tuesday, the Central Statistics Agency (BPS) announced that the number of people living below the poverty line was 26.58 million in September 2017, or 10.12 percent of the total population.

The Indonesian poverty rate was 11.13 percent in September 2015 and 10.70 percent in September 2016. Bambang, who is also head of the National Development Planning Board (Bappenas), said he had spoken to members of the House of Representatives about the government's poverty eradication target. He added that although the poverty rate could be lowered, the government was still addressing the problems faced by people living in extreme poverty. "We must improve their living standards by ensuring that social assistance reaches them this year," he stressed.

(http://www.thejakartapost.com/news/2018/01/04/govt-to-strive-for-poverty-rate-below-10-percent.html)

### 5.3 Poverty Rate Falls to Lowest Ever: BPS

The poverty rate in Indonesia has fallen to the lowest level ever recorded, according to the latest data from the Central Statistics Agency (BPS). “March 2018 is the first time ever for the poverty rate to be in the single digits. Previously, we were always in double digits,” said BPS head Suhariyanto in a press conference in Jakarta on Monday, adding that the number of poor people was recorded at 25.95 million. BPS records show that the poverty rate in September 2017 stood at 10.12 percent with about 26.58 million people living below the poverty line. The agency revealed that most of the poor people live in villages. The poverty rate in villages was recorded at 13.20 percent in March 2018, down only slightly from 13.47 percent in September 2017.

Suhariyanto said the jump in the government’s social assistance, which had grown by 87.6 percent in the first quarter of 2018, compared to a 3.39 percent increase in the first quarter of 2017, was a significant factor in pushing down the poverty rate. Increased non-cash assistance (BLT - Bantuan Langsung Tunai) and rice for the poor (Raskin - Beras Miskin) had also helped improve people’s welfare, he said, adding that low inflation in 2018 had also contributed to the increase in people’s purchasing power. The BPS also recorded a significant increase in consumer spending at the lowest income level. Back in 1999, the national poverty rate stood at 23.43 percent, with 47.97 million people living in poverty. (http://www.thejakartapost.com/news/2018/07/16/poverty-rate-falls-to-lowest-level-ever.html)

## 5.4 Combating Poverty

Indonesia's poverty rate fell below 10 percent for the first time in March this year, despite sluggish growth in the economy. According to the Central Statistics Agency (BPS), 25.95 million people were living under the poverty line as of March, about 9.82 percent of the total population, the lowest it has ever been. This is a drop of less than one percentage point from 10.12 percent seen in September last year, or in absolute terms, about 630,000 people from 26.58 million.

Although the decrease in the number of poor people is not substantial, the government's efforts to push down the poverty rate to a single-digit figure should be appreciated. The decline in poverty was partly due to the government's increased cash and non-cash assistance for the poor, rather than an increase in people's income. Moreover, the poverty rate in rural areas remains high at 13.2 percent, as compared to 7.02 percent in urban areas. In rural areas in some regions, such as in Maluku, the poverty rate even reached 29.15 percent.

The low poverty threshold of Rp 401,220 (about US$28) per capita per month as the basis for calculating the number of people living in extreme poverty could also be one of the factors that contributed to shrinking poverty figures. With such a poverty threshold, people living on just Rp 13,374 a day are no longer considered poor. As a comparison, globally, extreme poverty is defined as people living with less than $1.90 per day. The government should not be complacent with its success in bringing down the poverty rate to a single-digit figure. About 40 percent of the entire population remains vulnerable as they can easily fall back into poverty if there is disruption in the economy.

Of course, the government's program to reduce poverty through its cash and non-cash assistance is still needed. However, efforts to improve the rural economy should be further promoted so that people will not rely only on farming activities to support their lives. People need to have sustainable sources of income to further improve their welfare. Empowering the rural economy is therefore vital to further slashing poverty, especially in rural areas. Villagers need additional income as they can no longer rely on farming activities to support their families.

The government has introduced a series of economic package policies in order to promote business activities in the regions. The government also plans to develop a number of economic growth centers in the regions through the establishment of special economic zones as part of efforts to empower the local economy. Unfortunately, only a few of the planned economic zones have been realized. The government's programs to accelerate infrastructure development have begun to have a positive impact on the economy. The next step should be speeding up development of the special economic zones. Only with an increase in economic activity can the poverty problem be more thoroughly resolved. (http://www.thejakartapost.com/academia/2018/07/20/combating-poverty.html)

## 5.5. Pattern of Growth

What can one conclude from all of this for targeting policy? One clear implication is that altering the pattern of growth towards sectors with strong employment effects is likely to have the greatest direct impact on poverty reduction. Nonetheless, the need to reach the poor directly and to minimize leakage from and undercoverage of poverty programs remains critical. Self-targeting initiatives have proved only a modest improvement in leakage terms and raise issues of undercoverage. Technical improvements, principally new poverty mapping techniques, offer a means of more sharply identifying who the poor are, but in the absence of strong governance over poverty schemes the risk of misuse of funds remains. Whilst the case for special promotion and protection policies for the poor remains strong, past errors associated with their implementation and design must not be forgotten. In the debates of the 1980s more universal schemes were strongly criticized for their high leakage and their budgetary implications. The more targeted measures of the 1990s, as we have seen, have cost more modest amounts relative to the size of government budgets, but their leakage rates have also been disappointingly high, as have their costs per unit of benefit to the poor, where these can be estimated. Poverty-targeting measures should remain an important component of poverty-reduction strategies, but improvements in both governance and the technical design of schemes are needed. This is likely to require a combination of greater focus on broad targeting (primary education and health care, for example) and selective, narrowly focused, support for the very poor. Broad targeting measures, such as expenditure on primary health care, have been shown to reach the poor disproportionately in a number of countries, and clearly have an important role. Such measures are not solutions to the short-term problem of providing protection to the poor, which is why measures like employment creation schemes and food subsidies have been employed, with the disappointing results that we have observed. However what works, and what does not, is likely to vary substantially between countries. In this spirit the following part we can find discuss in depth the experiences in our case-study countries.

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**RANCANGAN BIAYA PENELITIAN**

Judul **: The Decreasing Target in Poverty Rate in Indonesia: 2018**

Nama Pengusul: Rene Johannes

**Rekapitulasi Biaya**

| No. | URAIAN/RINCIAN | BIAYA |
|---|---|---|
| 1 | Biaya Operasional (Survei/Pengolahan Data) | 12,076,000.00 |
| 2 | Biaya Bahan Habis Pakai | 2,350,000.00 |
| 3 | Biaya Seminar di UB | 4,400,000.00 |
| 4 | Biaya ATK dan Laporan | 1,000,000.00 |
| 5 | Honor Peneliti | - |
| | Jumlah Biaya | 19,826,000.00 |

**Biaya Operasional**

| No. | Pelaksanaan Kegiatan | Jml Personel | Jml Jam/mg | Upah (Rp) | Jml Bulan | Total Biaya |
|---|---|---|---|---|---|---|
| 1 | Pengumpulan Data (Wawancara, dsb.) | 3 | 6 | 175,000 | 3 | 9,450,000 |
| 2 | Pengolahan Data | 2 | 6 | 200,000 | 1 | 2,400,000 |
| 3 | Penunjang Operasional | | | | | 226,000 |
| | | | | | Jumlah | 12,076,000 |

**Biaya Bahan Habis Pakai**

| No. | URAIAN/RINCIAN | Volume | Biaya/unit (Rp) | Biaya (Rp) |
|---|---|---|---|---|
| 1 | Fotokopi dokumen | 500 | 200.00 | 100,000.00 |
| 2 | Cenderamata | 15 | 150,000.00 | 2,250,000.00 |
| | | | Jumlah | 2,350,000.00 |

**Biaya Alat Tulis Kantor**

| No. | URAIAN/RINCIAN | Volume | Biaya/unit (Rp) | Biaya (Rp) |
|---|---|---|---|---|
| 1 | ATK | 1 | 400,000.00 | 400,000.00 |
| 2 | Pembuatan Laporan | 3 | 200,000.00 | 600,000.00 |
| | | | Jumlah | 1,000,000.00 |