



Decentralization and Poverty in Indonesia: The Case of Karo District

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ABSTRACT

This study examines the link between decentralization and poverty. This study takes Karo District, an agricultural region, compared with Indonesia and North Sumatra Province. The result reveals that poverty rate is declining during 2002 to 2012 in Karo, North Sumatra Province and Indonesia. There is an opinion that with or without decentralization poverty tends to decrease because of industrialization accompanied by labor migration. North Sumatra and Indonesia as a whole support the opinion that industrialization may be a tool to overcome poverty, but it not the case for Karo. Industrialization has not been a “vehicle” to poverty reduction in Karo since it has not undergone any industrialization. The equality of inter-regional fiscal capacity, the stepping-up of local people’s participation and the improvement of local administrative apparatus seem to have had a positive impact on poverty reduction in Karo.

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1. Introduction

Decentralization has become an important development agenda across developing countries. Since the mid-1970s decentralization has been introduced across East Europe, Africa, South America and Asian’s countries (Callahan, 2007). The link between decentralization and poverty has been examined in countries, such as in Brazil, West Bengal and Kerala in India (Heller, 2001). In these areas, decentralization led to greater participation of citizens and in some areas improved equality for marginal groups, in the end resulting in pro-poor policies. In Bolivia decentralization has increased responsiveness to the local needs in some poor districts. This has led to a change in the pattern of Bolivian public investment, which was most conspicuously observed in the social services and urban development, such as water, sanitation and education (Faguet, 2004).

However, some studies found less positive impacts of decentralization on poverty. A study conducted by Blair (2000) in six countries (Bolivia, Honduras, India,

Mali, the Philippines, and Ukraine) found that decentralization failed to overcome poverty or address problems of the very poor. This was because local elites get most of the power through decentralization and steer benefits to themselves. Furthermore, in Uganda, decentralization has brought higher administrative costs due to the added costs of maintaining a large number of districts. The number of districts doubled to 78 in no more than 15 years. This proliferation of administrative structures has diverted resources away from other more directly related poverty alleviation efforts (Steiner, 2007). In Indonesia, decentralization also creates regional heterogeneity in poverty across the nation. This means that poverty in some local areas is far greater than others probably due to regional differences in the levels of education, existence of conflict, and degree of urbanization (Sumarto et al, 2014). Thus, some previous research actually finds the opposite of what the theory of decentralization promised, and clearly suggests that decentralization still has problems.

The Karo district of North Sumatra Province has made significant progress in reducing its poverty rate

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during the decentralization era. According to the Central Bureau of Statistics (BPS) the poverty rate in Karo was 23.2 % in 2002 but declined to 9.93 % in 2012, which shows remarkable progress in poverty reduction. From 2002 to 2012, the agriculture sector contributed more than 50 % of gross regional domestic product, while the industrial sector contributed only less than 5 %. This characteristic shows the uniqueness of the Karo district. In many cases one way to reduce poverty is by economic development that increases income. As pioneered by W.A. Lewis, the idea of economic development itself is to expand the modern sector (industrial) followed by labor movement from the traditional sector (Lewis, 1954). Thus, Karo district provides an interesting case where poverty reduction has been realized without the progress of industrialization.

2. Decentralization in Indonesia

2.1 History and Background

Indonesia had been under a centralized government during the New Order era started in 1966. In this era government restored the inflow of western capital and created political stability by through a strong role for the army. These efforts led Indonesia into a period of economic expansion which lasted until 1998. During the New Order era, Indonesia built industries in areas such as steel, aluminum, textiles, and cement. The increasing oil price in 1970 also gave Indonesia a massive income from oil and gas exports. During the New Order era Indonesia went through six five-year development plans (Repelita) beginning on 1 April 1969, each of which had a unique aim. The first Repelita (1969 – 1974) aimed to improve agriculture, irrigation and transportation. This period focused on food production. The second Repelita (1974-1979) focused on the availability of building materials and increasing employment opportunities. The third Repelita (1979-1984) focused on the “trilogy of development” comprising high economic growth, national stability and equitable wealth distribution. The fourth Repelita (1984-1989) focused on self-sufficiency in rice production and industrial machinery. The fifth Repelita (1989-1994) focused on agricultural and industrial sectors, and the sixth Repelita (1994-1999) which also become the first stage of long-term development plan (PJP) focused on the second era of national awakening.

But in the middle of 1997, this success turned into a crisis. This crisis caused huge depreciation of the rupiah against the US dollar, from IDR. 2,300/USD at the beginning of August in 1997 to IDR.15,000/USD by mid-1998. The depreciation of the rupiah caused domestic inflation to become very high, and affected the prices of daily needs to increase massively. A rising

resentment against corruption and oppression, combined with the fact the regime was unable to deal with the Asian economic crisis, culminated in massive protest. Riots and student demonstrations occurred against the New Order government and Soeharto himself in many parts of Indonesia which forced President Soeharto to step down in May 1998 after holding power for 32 years.

2.2 The Objectives and Goals

A new era of government in Indonesia has begun since then. One of the demands in this reform era was changing the system of government that tended to be authoritarian in the New Order into a more democratic system, including a demand for a change in the central and local governments relationship. Thus, the idea of decentralization in Indonesia is based on a desire to create democracy, equity and justice, efficiency, community participation and empowerment, and strong local legislatures. It is assumed that decentralization will create democracy through local community participation. Decentralization in Indonesia is also supposed to provide substantial resources to local governments. Fiscal transfer from central to local governments was accompanied by reassigning more than 2.5 million civil servants to districts. This transfer was supposed to provide local government authority with the expertise to manage its responsibilities. With these changes, local governments are expected to become more independent in managing their resources, promoting their own interests, and initiating their own policies (Sujarwoto, 2012). Development starts from the needs of the people, and people have more functions in the development process under *Musrenbang* (community consultations on development planning).

2.3 The Impacts

Decentralization in Indonesia has had various impacts. In political authority terms, Indonesian districts can carry out their own political processes by conducting general elections for both executive and parliament members (*Pilkada*). Under the decentralization policy local parliaments are in a strong position. They have rights to impeach the governors or heads of district. In addition the heads of districts do not have any obligation to the governors, but they have to be responsible to the district/municipal parliaments.

Another impact of decentralization is that local people and authorities have been inspired to form their own regional areas and create several new provinces and districts (kabupaten) and cities (kota). From 1999 to 2014, 223 autonomous regions have been formed, including 8 new provinces and 215 districts. In 2014

there were 34 provinces in Indonesia from a previous 26 and 508 Districts from a previous 293.

2.4 Decentralization and Poverty Reduction

After more than a decade has passed since the implementation, poverty is still a serious problem for Indonesian development. Out of a population of 237 million, more than 28 million (11.25 %) Indonesians currently live below the poverty line. According to data from the Central Bureau of Statistics (BPS) over the past decade Indonesia has made significant progress in reducing poverty, from 47.97 million people in 1999 to 28.28 million in 2014 which means from 23% of the population in 1999 to less than 12% in 2014 (BPS, 2014). This new policy is expected to help governments to reduce poverty which is one of the main social problems in Indonesia. However, each region in Indonesia has a different characteristics, and it is not easy for local governments to develop their regions. Since decentralization allows more resources to be transferred to local governments, it requires local governments to be creative and innovative. However during the New Order Era local governments under the excessive control of the central government were weak and poorly trained. Thus, it can be understood that local government capacity is still in transition, and it is inevitable that local government still needs guidelines and infrastructure regulations from the Central Government. This means that the central government is still expected to lead the decentralization process in the future.

3. Description of The Research Site

3.1 Overview of North Sumatra Province

Karo At the beginning of Indonesian independence in 1945 Sumatra Island was one province called Sumatra Province. Due to difficulties in transportation and defense Sumatra Province was divided into three provinces, namely North Sumatra, Central Sumatra and South Sumatra. Later Central Sumatra province was superseded by several new provinces namely, Aceh, West Sumatra, Riau, Jambi, Bengkulu and Lampung, were established. In the decentralization era, two new provinces established in this region were Kepulauan Bangka Belitung and Kepulauan Riau, so at this moment there are 10 provinces on the island of Sumatra. As for North Sumatra, before decentralization there were 17 districts/cities. Similar to other region in Indonesia, during the decentralization era several new districts /cities were established. Nowadays North Sumatra province has 33 districts /cities.

3.2. The District of Karo as a Research Site

Karo is an in-land district of the North Sumatra, Indonesia. It is approximately 76 km northwest of Medan, the capital city of North Sumatra province. Karo is bordered on the north side by Langkat and Deli Serdang Districts, on the south by Dairi and Toba Samosir Districts, on the east by Deli Serdang and Simalungun Districts, and on the west by Aceh Tenggara District of Nanggroe Aceh Darusalam Province. According to the Central Bureau of Statistics the population of Karo was 382,622 in 2014, with labor distributed among the agricultural sector (159.199 - 77.02 %), industrial sector (22.273 - 10.78 %) and service sector (25.237 - 12.21 %). This district is well known as an agricultural producer, the main produce being vegetables, fruits and flowers. Karo also has several plantations spread among sub-districts, producing mainly palm oil, coffee, tobacco and cocoa. These commodities are marketed to other districts such as Medan, Tanjung Balai, and other provinces namely Aceh, Riau and Jambi (domestic market). The industrial potency in Karo is likely low, mostly only for small industries that support agriculture. As a result, agriculture has an important role to boost incomes.

3.3 Social Development in Karo

Every year Karo district promotes the participatory development program called *Musyawaharah Rencana Pembangunan – Musrenbang*, this program involves community consultations on development planning held annually from village level to district level. representatives from local government, local parliament, village, religious group and other stake holders gather to discuss the program. The community is involved in order to provide suggestions to local government regarding social development programs that have been or will be implemented. Through *Musrenbang* local people are able to participate and contribute to their local programs.

Moreover local participation is also highlighted in local elections. Through direct local election people choose the head of the region and local parliament members every five years. In 2005 Karo held its first local election. Through the direct local elections, governments are expected to perform with high degrees of accountability and responsibility. Indeed in 2014, there was an important test of that principle when for the first time the head of Karo was dismissed from office for not being able to carry out his responsibilities. After many protests, the elected head, Kena Ukur Surbakti, was finally dismissed by the President of Indonesia. This showed that the participation of local people can be an effective check on the power of their leaders,

encouraging prospective leaders to take responsibility and perform their duties well so as not to be removed.

4. Empirical Analysis Decentralization and Poverty Reduction

4.1 Analytical Framework

Specifically, this study will examine the effectiveness of decentralization in poverty reduction, determine the factors related to decentralization and poverty reduction, and finally make a policy recommendations to improve the relationship of decentralization and poverty reduction in Karo district.

The term poverty in this study is used as defined by the Central Bureau of Statistics (BPS). BPS uses the concept of ability to meet basic needs. With this approach, poverty is seen as an economic inability to meet the basic needs of food and non-food measured from the expenditure side. So the poor are those with an average monthly per capita expenditure below the poverty line . In order to examine the link between decentralization and poverty reduction this study analyzes statistical data from Karo district, North Sumatra Province and Indonesia.

4.2 Economic Growth and Industrial Change

As a measure of economic success, increasing gross regional domestic product also indicates an increase in welfare, and reductions in poverty and unemployment in the region.

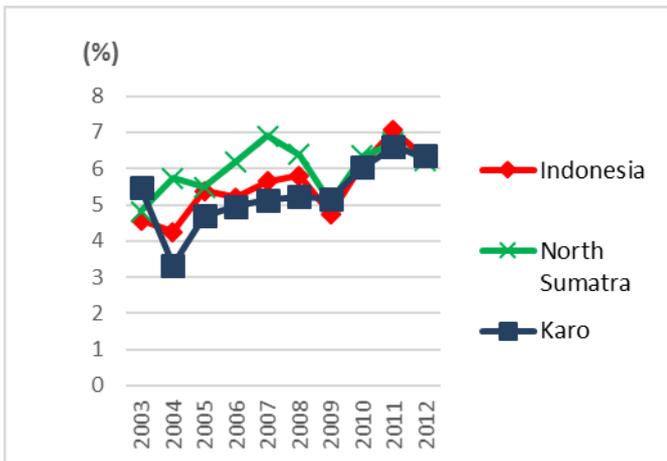


Figure 1 Trends of Economic Growth Rates

The figure shows that, in general, the economic growth rates of Indonesia, North Sumatra Province and Karo decreased in 2009 and 2012.

Based on the data in 2002 the agricultural sector accounted for only 16.45 % and decreased to 13.86 % in 2012 for Indonesian GRDP. While the industrial sector

accounted by 43.1 % in 2002 and decreased to 37.8 % in 2012. Service is the predominant sector which accounted for 40.5 % in 2002 and increased to 48.4 % 2012. The percentage of agriculture is the lowest compared with industrial and service sectors. Thus, the agricultural sector is the lowest contributor to GDP growth at 21 %, while the leading sector is service at 59.51 % followed by the industrial sector at 30.28 %. This indicates the change of Indonesia economic structure in 2002-2012.

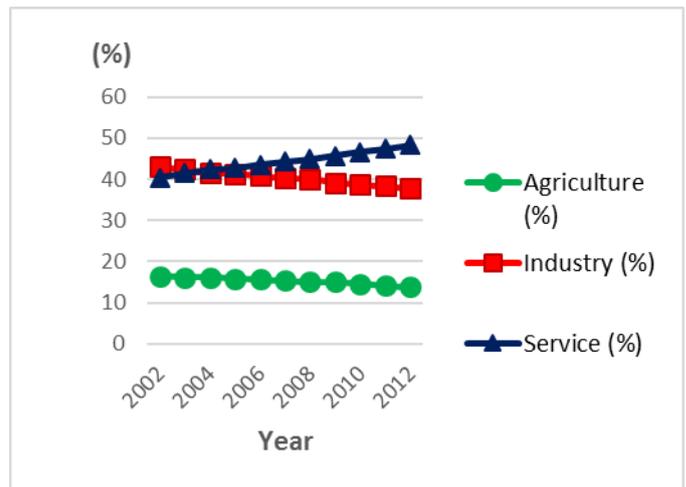


Figure 2 Shares of Sectors of Industrial Origin in Indonesia

As for North Sumatra Province, in 2002 the agricultural sector accounted for 26.84 % and decreased to 22.89 % in 2012 in the total GRDP. As for the industrial sector, in 2002 this sector accounted for 32.7 % and decreased also to 29.3% in 2012. The dominant sector in North Sumatra Province GRDP is the service sector which reached 40.5 % in 2002 and increased to 47.8% in 2012. This makes service as the leading sector in contributing GDP growth of North Sumatra Province at 57.14 %, followed by the industrial sector which is 24.98 % while the agricultural sector contributes only 17.88 %. Even though there are different percentages in agricultural and industrial sectors, the difference is not large, so North Sumatra Province may be considered a more agricultural region. From the data, Indonesia and North Sumatra Province are similar in their economic structure, with agriculture being the lowest sector.

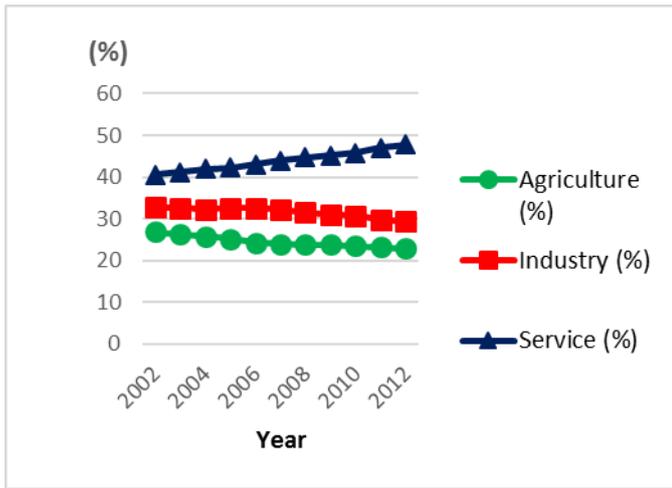


Figure 3 Shares of Sectors of Industrial Origin in North Sumatra

Meanwhile data from the Karo district, shows that the agricultural sector is the largest contributor to Karo’s GRDP. In 2002 the agricultural sector accounted for 63.33 % of Karo’s GRDP which decreased to 57.47 % in 2012. From the data it can be seen that during the period 2002 – 2012, the agricultural sector accounted for more than half of GRDP, while the industry sector seemed not to change significantly, accounting for only 4.68% in 2002 and slightly increasing to 4.88 % in 2012. The service sector increased tremendously from 31.98 in 2002 to 37.65% in 2012. The agricultural sector, the dominant sector, contributed 48.79% to GDP growth, while the industrial sector contributed only 5.16 %. This data shows that the Karo district is a region which has agriculture characteristics. Unlike North Sumatra Province and Indonesia, Karo relies on agriculture (the traditional sector) instead of the industrial sector in its economic development.

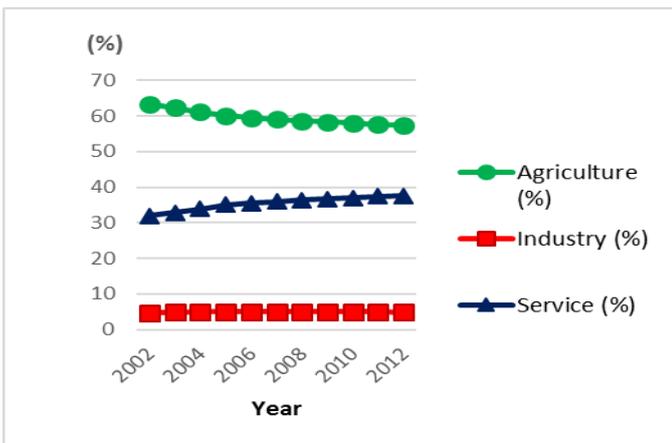


Figure 4 Shares of Sectors of Industrial Origin in Karo

4.3 Trends in Poverty Reduction

Since economic structure differs among Indonesia, North Sumatra Province and Karo, it is interesting to investigate out how poverty reduction differs in these regions. In many cases industry is an important key to increase income in a region because this sector can absorbed more labor.

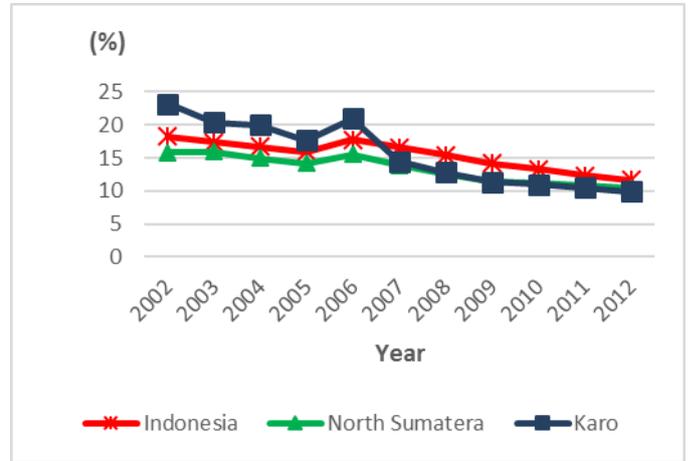


Figure 5 Poverty Rate in Indonesia, North Sumatra Province and Karo

The figure shows changes in poverty rates in Indonesia, North Sumatra Province and Karo from 2002 to 2012. It can be seen that the poverty rate decreased in these regions. Poverty increased in 2006 due to the fuel price rises which affected rice and several commodity prices. Indonesia succeed to decrease the poverty rate from 18.20 % in 2002 to 11.66 % in 2012. As for North Sumatra Province the poverty rate was decreased from 15.84 % to 10.41 %. Compared to North Sumatra Province, the poverty rate of Indonesia as a whole is higher. This indicates that North Sumatra Province has a lower poverty rate compared to other provinces of Indonesia. Compared to Indonesia and North Sumatra Province, Karo had the highest poverty rate in 2002 which was 23.2 %, but then decreased significantly to only 9.93 % in 2012, the lowest compared with the others. This data is interesting, since in theory, economic development is usually underpinned by the industrial sector (modern sector), followed by labor movement. The modern sector is considered to provide higher profit and income than the agricultural sector (traditional sector). Based on these characteristics, the modern sector becomes an important factor to boost economic growth and reduce poverty in the region. Indonesia as a whole supports that theory. Based on data above, there are significant differences between the contributions of agriculture and the industrial sector to GRDP, which were 12.5% versus 40.3% in 2012. Since

the percentages of agriculture and industry sectors are not very different in North Sumatra Province, it can be assumed that similar changes began to occur in this province. However, this phenomenon does not seem to occur in Karo, because there was no significant decline in the agriculture sector. Indeed, agriculture remained the dominant contributor to GRDP while the industry sector is the lowest contributor.

4.4 The Impact of Decentralization on Agricultural Productivity

Since agriculture is the dominant sector in Karo, it is necessary to investigate productivity in this region compared with Indonesia and North Sumatra Province. Productivity is considered to have a positive correlation simply with the increase of agricultural products which leads to the increasing of average income.

agricultural sector decreased by only 1 % during the period 2002-2012.

5. The Challenges of Decentralization in Karo District

5.1. How to Expand Regional Own Source Revenue

Decentralization may help government to reduce poverty by improving the efficiency of public service delivery and better target efficiency in policy program. One effort to improve the quality of public services is by increasing the allocation of government public service expenditures. In this case the ability of local governments to explore their potentials in order to increase their local own source revenue (PAD) is important. It is expected that by increasing its PAD the local government would also increase public sector expenditure, and thereby bring better quality public services, improve infrastructure development and increase household incomes to overcome poverty.

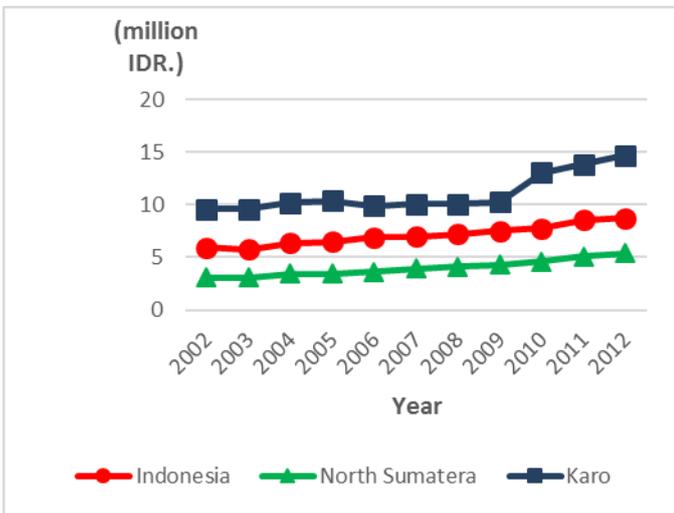


Figure 6 Productivity of Working Population Aged 15 Years and Over in Agriculture

In Indonesia, agricultural productivity of the population working age population 15 years and over in agriculture, shows increased by a factor of 1.45 from 5.70 in 2002 to 8.29 in 2012. Productivity increased over the 10 years. Meanwhile, the number of workers engaged in agriculture fell by 3 %. This appears to be an indication of workforce moving from the agricultural sector to other sectors in Indonesia. As for North Sumatra province in, productivity increased from 3.11 in 2002 to 5.37 in 2012, while workers in agriculture decreased by 13 % in the period 2002 – 2012. This figure shows that the productivity workers in agriculture in the Karo district increased from 9.60 in 2002 to 14.71 in 2012. The productivity in the Karo district is the highest among Indonesia and North Sumatra Province. Furthermore, the number of workers engaged in the

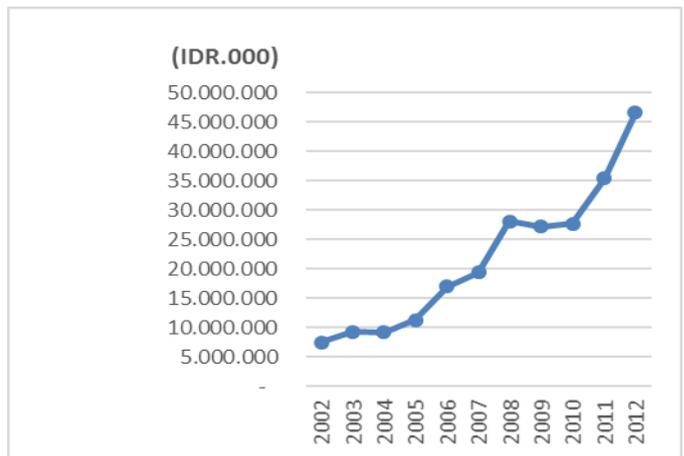


Figure 7 Realization of Karo's PAD

In addition to PAD, other sources of revenue included the Balance Fund from the Central Government in the form of the general allocated fund (DAU) and the specific allocated fund (DAK). DAU and DAK are sourced from the State Revenue and Expenditure Budget (APBN). DAU aims to bring equality of inter-regional finances in order to fund the needs of the region for the implementation of decentralization because some regions do not have adequate fiscal infrastructure to improve the public service development.

Meanwhile, DAK is allocated to certain regions which aims to fund special programs in the region in accordance with national priorities, such as health, education and agriculture. From the definition in the Law 33 of 2004 it can be concluded that DAU and DAK

are means to address fiscal imbalances between regions and/ or to also provide a source of local financing. This indicates that a region with a low fiscal capacity will be prioritized to receive more DAU and DAK. Figure below shows the trend of funds transfer from central government to Karo district. This fund transfer helps Karo district to optimize its financial capacity.

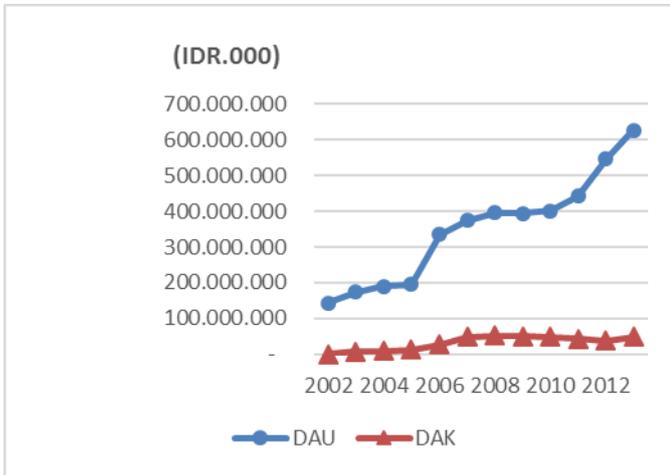


Figure 8 Realization of General Allocated Fund (DAU) and Specific Allocated Fund (DAK) of Karo.

From the figure above it can be seen that fund transfer from central government to Karo district is much larger than the regional own source revenue. It can be also understood that the Karo district is a district that still has a low fiscal capacity and has not been able to increase its PAD optimally. Despite the improvement in increasing its regional own source revenue, the Karo district still has to keep trying to explore potential sectors that could contribute to its regional own source revenue. This is in accordance with the experts who argue that local government best understands how to optimize its sources of income, which sector needs to expand, what kind of potential sources of revenue can be still used, and in which areas the allocated funds should be spent.

5.1.1 The Promotion of Tourism

Tourism is one potential industry that Karo can optimize. This region has long been known as one of the most popular tourist destinations in North Sumatra Province. Karo has several tourist attractions, for instance natural mountains and volcanoes, Brastagi city famous for its moderate weather, Lau Kawar Lake, Sipiso-piso waterfall, Lingga Cultural Village and others. All these existing potentials are certainly supporting factors that can be optimized to expand the tourism sector in this region. Basically, the development

of a regional tourist sector is closely related to the economic development of a region. The positive impact that can be achieved by local community is the expansion of employment in the region. This is one result from a well-developed tourist industry. For instance by construction of infrastructure in the area, the workforce will have more chance to be employed in projects such as power plants, bridges, and hotels, and tourism is also a potential sector to increase Karo's regional own source revenue. Even though the number of guest decreased drastically in 2010 where Sinabung erupted for the first time, the number of tourists has increased again since then.

Other alternative which can be done by Karo district to increase the number of tourist arrivals is to develop and utilize an inter-regional cooperation program. For example, some districts in the region around Lake Toba such as Simalungun, Dairi, and Toba Samosir can work together to improve their ability to manage tourism. Moreover, since the aim of decentralization is to improve public welfare through improvement of public services, community development, and to increase regional competitiveness, Karo district should to enhance the synergistic cooperation with the private sectors and the community in developing the tourism sector. By adopting this strategy, Karo will achieve better tourism management in all supporting areas having a significant impact on the tourism sector, which in turn will increase revenue, income of the community, and also contribute to poverty reduction. Thus, the role and contribution of the private sectors and community participation must be encouraged and facilitated in the development of the tourism sector in this region.

5.2 How to Manage District Expenditure

A research on Uganda, found that a negative impact of decentralization was associated with higher administrative costs. This was related with the added costs of maintaining a large number of districts. The number of districts increased to 78, which was a doubling in no more than 15 years. The resulting proliferation of administrative structures diverted resources away from other more directly related poverty alleviation efforts. Thus, it can be understood that the effectiveness and efficiency of fiscal decentralization in the area of expenditure allocation and all the problems that may exist with respect to the area of fiscal decentralization is a great challenge faced by local governments. How will a local government be able to properly allocate funds in order to enhance local development that will bring prosperity to the people? In

this case the capacity of local governments plays an important role to promote a region's development.

According to the World Bank Data, during the period 2002-2012 Karo spent more than 18 billion IDR for irrigation and more than 43 billion IDR for roads. This may indicate that Karo district has a willingness to promote development in the agriculture sector. However, there is still a challenge in Karo total expenditures. From the BPS data during 2002-2012 the proportion of public service and local operational expenditures in Karo district is still not ideal. More than 50 % of expenditure is for local operational costs included civil servants and administration costs. However in 2013, data shows that there was a change in expenditure proportion. Public service expenditure increased from 20 % to 43%. This can be assumed to be a reflection of aspirations for development in Karo. In other words, the Karo government tended to achieve an ideal expenditure balance between local operational and public service. Whether this ratio of expenditure balance endure longer, it is a challenge for Karo to maintain.

6. Conclusion

This study found that Karo has stable and significantly higher agricultural productivity over North Sumatra and National average. Agricultural productivity has significant correlation with average income which means higher productivity will lead to higher income. Related to decentralization it can be assumed that there are three supporting factors of agricultural productivity in Karo, namely the efforts of community-based development (*Musrenbang*) under decentralization, the effectiveness of agricultural extension works and rural infrastructure development to support agriculture. However, while, this study has only presented a limited analysis of data, it might provide a basis for further research into poverty reduction in the Karo district and in Indonesia as a whole.

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