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*Fiscal Space in Indonesia:  
An Evaluation on Sustainability and Effective Allocation*

**Olivia Husli Basrin**

*The Dynamics of Donor-Think Tank Engagements in Bangladesh*

**Ahmed Khaled Rashid**

*Assessment of the Financial Markets Integration of the ASEAN5*

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*Dynamics of State, Sangha and Society in Myanmar:  
A Closer Look at the Rohingya Issue*

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*Ethnic Violence: A Case Study on Ethnic Riots in Sri Lanka*

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*Bolsa Família: a Way Out of Poverty or a Welfare Trap?*

*A 2030 Backcasting of the Brazilian Conditional Cash Transfer Program*

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*Governance and Development:*

*Indonesia's Tradable and Non-Tradable Industries*

**Jose Ma. Luis P. Montesclaros**

*Microfinance and Community Currency: the Case of Banco Palmas, Brazil*

**Rafael Barreto Souza and Lorryne Porciuncula**

## VISION

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The Asian Journal of Public Affairs (AJPA) is a global public policy journal in Asia committed to encouraging dialogue and debate about critical issues that affect the Asia Pacific region.

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The journal promotes research in public policy by graduate students and practitioners across the world showcasing best practices in policy implementation across Asia.

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Graduate students and practitioners are invited to submit papers, case studies, and book reviews for the upcoming issue of the *Asian Journal of Public Affairs*.

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**15 August 2013**

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*Sanjan Haque*<sup>1</sup>

Thank you for your continued support for the Asian Journal of Public Affairs (AJPA). This student-run journal continues to grow and this publication constitutes the eleventh issue. This is the longest issue of the journal to-date, and includes some exciting and thought-provoking commentaries and articles, and book reviews, as well as case studies from the LKY School case competition. In this issue we have also included conference papers from Global Public Policy Network student conference held in Singapore in December 2012.

The theme for the commentaries in this issue, *Territorial Disputes in Asia*, was chosen by the team to highlight the importance of multi-national claims on maritime territories and borderlands, and other issues of national sovereignty that manifest themselves in spatially-focused conflict (physical or diplomatic) across Asia.

Dean Kishore Mahbubani of the LKY School examines China's recent approach to territorial disputes in a commentary that contains excerpts from his latest book. Alistair Cook examines the development of regional institutional arrangements in the context of international and non-international conflicts. Professor Kanti Bajpai opines on India's territorial disputes with China and Pakistan, examining the possibility of rational solutions in light of government weaknesses in all three countries.

The articles examine a broad range of topics submitted by graduate students across the world focused on public policy in Asia. Olivia Basrin explores the theoretical framework of fiscal space and applies it to Indonesia's high growth economy. Ahmed Rashid examines the implications of donor funding across think tanks in Bangladesh within a divisive and confrontational political milieu. Eduardo Lucio investigates the progress of bonds and equities markets integration in the economies of five ASEAN countries. Mary Long sheds light on the origins and conditions of inter-communal violence between Rakhine Buddhists and Rohingya Muslims in Rakhine State, Myanmar. Madhawa Palihapitiya has written a case study about ethnic riots in Sri Lanka, supporting policy efforts to predict and prevent ethnic violence. Supplementing the articles are submissions from the GPPN conference focusing on social protection and

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<sup>1</sup> Sanjan Haque is an independent consultant with over six years experience in programme design and impact evaluation of livelihoods projects in Asia. He has previously worked with BRAC and as a consultant for UK Department for International Development (DfID), Bangladesh. He holds Master degrees in Public Policy from the Lee Kuan Yew School of Public Policy and International Studies & Diplomacy from the School of Oriental & African Studies. He can be reached via [haquesanjan@gmail.com](mailto:haquesanjan@gmail.com)

microfinance programmes in Latin America and improvement of labour productivity for accelerated national growth.

This issue showcases two award-winning case studies from the Lee Kuan School of Public Policy's 2013 case-writing competition. Beñat Camara and Zhang Yingxin Louisa examine the implications of the introduction of private healthcare insurance on the informal sector in Laos. Allen Lai looks at non-profit collaboration during Wenchuan Earthquake in China.

AJPA successfully completed the second *AJPA Excellence in Public Policy Essay Competition 2012/13*. The competition was designed to highlight excellence in public policy in Asia from students enrolled at GPPN institutions. There was robust competition among the participants and a three-person adjudication panel composed of faculty at the LKY School. First prizewinner Sudheesh Chemmencheri from the LSE examines the Ujjwala policy in India, which promotes participatory budgeting. Runner-up Rike Bran from the Hertie School of Governance examines the hindrances to renewable energy in Japan.

The publication of this journal reflects the collective effort of the editorial and administrative teams, and without their unwavering support it would be impossible to publish this issue. I would also like to thank the LKY School for its continued support and the Editorial Board for its steadfast guidance. Please visit [www.ajpajournal.org](http://www.ajpajournal.org) for past issues of the journal. Happy reading!

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## ASIAN TERRITORIAL DISPUTES: CHINA AND ITS NEIGHBOURS

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*Kishore Mahbubani*<sup>2</sup>

One of the modern miracles of our time is the re-emergence of China as a global great power without upsetting the global system or triggering a major global geopolitical contest. A large part of this is due to the remarkable geopolitical acumen that Deng Xiaoping and his successors showed during China's re-emergence. Deng provided some wise advice to his fellow Chinese leaders: "(1) *lengjing guancha*—observe and analyse [developments] calmly; (2) *chenzhuo yingfu*—deal [with changes] patiently and confidently; (3) *wenzhu zhenjiao*—secure [our own] position; (4) *taoguang yanghui*—conceal [our] capabilities and avoid the limelight; (5) *shanyu shouzhuo*—be good at keeping a low profile; (6) *juebu dangtou*—never become a leader; (7) *yousuo zuowei*—strive to make achievements."

Against this larger backdrop of geopolitical acumen, it is remarkable how many mistakes China has been making in its handling of territorial and other disputes with its neighbours in recent years. Clearly, China has been losing some of its geopolitical acumen. However, we also do not yet fully understand why this is happening.

Here are some examples of mistakes China has been making. It completely mishandled an episode in which a Chinese fishing boat collided with Japanese Coast Guard patrols near the disputed Senkaku Islands on 7 September 2010, an error that could potentially set back Sino-Japanese relations for several decades. It was unwise for China to demand an apology from Japan after having publicly humiliated Japan into releasing the fishing boat.

To make matters worse, China began to make more aggressive statements and take more aggressive postures on the South China Sea in 2010 and 2011. China published a map of the South China Sea with dotted lines that seemed to show that China claimed around 80 percent of the sea. When China submitted to the UN Commission on the Limits of the Continental Shelf a map including the nine-dotted-lines territorial claim in the South China Sea on 7 May 2009, the

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<sup>2</sup> *Kishore Mahbubani is Dean of the Lee Kuan Yew School of Public Policy. This essay contains extracts from The Great Convergence: Asia, the West, and the Logic of One World.*



Philippines lodged a diplomatic protest against China. Vietnam and Malaysia followed. Indonesia also registered a protest, although it had no claims on the South China Sea. In the face of this opposition, Chinese officials refused to back down. In March 2010, they told US officials that they considered the South China Sea to be a “core interest” on par with Taiwan, Tibet, and Xinjiang.<sup>3</sup>

In July 2010, an editorial in the *Global Times* stated, “China will never waive its right to protect its core interest with military means.”<sup>4</sup> The same month, a Chinese Ministry of Defence spokesman said that “China has indisputable sovereignty of the South Sea and China has sufficient historical and legal backing” to underpin its claims.<sup>5</sup> China had declared that it viewed the South China Sea as a “core interest.” China also objected strongly to Vietnam and Malaysia’s joint submission to the UN on extended continental shelf claims in the South China Sea.

Christopher Joyner explains the importance of these South China Sea disputes: “The Spratly Islands are considered strategic, economic, and political assets for littoral states in the South China Sea because they can serve as legal base points for states to project claims of exclusive jurisdiction over waters and resources in the South China Sea. They hold strategic importance for all states in the region, because they straddle the sea lanes through which commercial vessels must sail en route to and from Southeast Asian ports.”<sup>6</sup>

All these actions offered Secretary of State Hillary Clinton an opportunity to exploit the potential divisions between China and ASEAN at the ASEAN Regional Forum in July 2010. In a well-orchestrated move that appeared to have the backing of many Southeast Asian nations, Clinton called the dispute “a leading diplomatic priority” for the United States and voiced her country’s willingness to mediate a resolution. “The United States has a national interest in freedom of navigation, open access to Asia’s maritime commons and respect for international law in the South China Sea,” Clinton said. She added that the

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<sup>3</sup> Edward Wong, “Chinese Military Seeks to Extend Its Naval Power,” *New York Times*, April 23, 2010, <http://www.nytimes.com/2010/04/24/world/asia/24navy.html?pagewanted=all>.

<sup>4</sup> “American Shadow over South China Sea,” *Global Times*, July 26, 2010, <http://opinion.globaltimes.cn/editorial/2010-07/555723.html>.

<sup>5</sup> “China Says Its South China Sea Claims Are ‘Indisputable,’” *Bloomberg*, July 30, 2010, <http://www.bloomberg.com/news/2010-07-30/china-has-indisputable-sovereignty-in-south-china-sea-defense-aide-says.html>.

<sup>6</sup> Christopher C. Joyner, “The Spratly Islands Dispute in the South China Sea: Problems, Policies, and Prospects for Diplomatic Accommodation,” *Investigating Confidence-building Measures in the Asia-Pacific Region*, ed. Ranjeet K. Singh (Washington, DC: Henry L. Stimson Center, 1999), 57.

United States supported “a collaborative diplomatic process by all claimants for resolving the various territorial disputes without coercion.”<sup>7</sup>

This statement infuriated Beijing. The Chinese foreign minister, Yang Jiechi, was visibly taken aback and described Clinton’s remarks as orchestrated, “virtually an attack on China,” asserting that, “nobody believes there’s anything that’s threatening the region’s peace and stability.” Greg Torode reported that Yang was shocked and accused his US counterpart of unleashing an anti-China plot. “Yang left the closed-door meeting,” Torode wrote,

“...and later gave a rambling speech in which he threatened economic punishment for Southeast Asian nations that sought to stand up to Beijing. John Pomfret collaborates [sic] this account: “Foreign Minister Yang reacted by leaving the meeting for an hour. When he returned, he gave a rambling 30-minute response in which he accused the U.S. of plotting against China on the issue.” . . . On 1 August Yang stated, “What will be the consequences if this issue is turned into an international or multilateral one? It will only make matters worse and the resolution more difficult. International practices show that the best way to resolve such disputes is for countries concerned to have direct bilateral negotiations.”<sup>8</sup>

It would be wise for China not to underestimate the disquiet that its huge claims over the South China Sea have created. Using dotted lines on a map that was first published in the 1940s, China has claimed more than 80 percent of the South China Sea. That claim has been met with incredulity. Lee Kuan Yew, a former prime minister of Singapore, observed that it is “clear that territorial claims [are] more complex than producing a map with dotted lines and saying: ‘All this is mine.’ I mean who produces this map? What is the authenticity of this map? Who kept it? And even if you can prove its antiquity, what does it show?”<sup>9</sup> A commentary in the *Asia Times* on 5 October 2011, put that matter succinctly: “It would be rather absurd if England were to try to claim sovereignty over most of the English Channel, Iran the Persian Gulf, Thailand

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<sup>7</sup> “Clinton’s Comments on South China Sea Territorial Dispute Press China-U.S. Relations,” *2point6billion.com*, July 27, 2010, [http://www.2point6billion.com/news/2010/07/27/clinton-percentE2\\_percent80\\_percent99s-comments-on-south-china-sea-territorial-dispute-press-china-u-s-relations-6528.html](http://www.2point6billion.com/news/2010/07/27/clinton-percentE2_percent80_percent99s-comments-on-south-china-sea-territorial-dispute-press-china-u-s-relations-6528.html).

<sup>8</sup> Carlyle A. Thayer, “Recent Developments in the South China Sea: Grounds for Cautious Optimism?,” December 14, 2010, <http://www.rsis.edu.sg/publications/WorkingPapers/WP220.pdf>.

<sup>9</sup> Lee Kuan Yew quoted in Jeremy Au Yong, “The Way to Solve Border Disputes: MM,” *Straits Times*, September 29, 2010.

the Gulf of Thailand, Vietnam the Gulf of Tonkin, Japan the Sea of Japan, or Mexico the Gulf of Mexico. But that is exactly what China is trying to do by claiming most of the South China Sea.”<sup>10</sup>

China’s leaders therefore face an acute dilemma in handling the South China Sea territorial disputes. On the one hand, given the rising nationalism in China, especially in the blogosphere, China’s leaders cannot afford to be seen to be weak in their handling of the South China Sea dispute. It has not helped that some officials unwisely decided to print the full extent of China’s claims on Chinese passports. This will make it even more difficult for China’s leaders to make sensible compromises on these territorial disputes.

On the other hand, if China were to continue with its aggressive postures in the South China Sea, it could waste the enormous amount of political goodwill that China has collected from decades of geopolitical acumen in its handling of its neighbors. Equally importantly, it would provide America with a wonderful geopolitical opportunity to exploit the distance between China and its neighbors. It would be perfectly natural for America to exploit such an opportunity.

Handling this painful dilemma will not be easy. China’s new leaders will need to display an extraordinary degree of political wisdom to manage it. The future of East and Southeast Asia will depend on the ability of China’s leaders to deliver these high levels of political wisdom.

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<sup>10</sup> Huy Duong, “The South China Sea Is Not China’s Sea,” *Asia Times*, October 5, 2011, [http://www.atimes.com/atimes/Southeast Asia/MJ05Ae03.html](http://www.atimes.com/atimes/Southeast%20Asia/MJ05Ae03.html).

## ASIA–PACIFIC REGIONALISM AND THE CONFLICT CONSTRAINT

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*Alistair D. B. Cook*<sup>11</sup>

As the ‘Asian Century’ continues apace into its second decade, with the continued rise of China, development of regional institutional arrangements and sustained economic development across the Asia - Pacific, there remains a significant challenge to on-going regional success. The second decade has included many disputes both along traditional territorial lines as well as challenges to the nation-state itself across the region, which raises questions around the sustainability of these regional advances. What are the emerging and prominent conflict dynamics across the region? Are regional institutional arrangements well placed to tackle these intra-regional conflicts?

In the Geneva Conventions, war is constructed as either international or non-international, which accurately illustrates the centrality of the state, the main actor in the international system. However, while the Asia – Pacific faces international territorial disputes in the South and East China Seas for example, there remain other significant conflicts that challenge state centrality such as non-state armed groups. These conflicts are not adequately framed as non-international, because as conflict analysis shows, even ‘internal conflicts’ are host to competing interests both from within a given nation-state and interests from outside it; essentially being both international and non-international at the same time. As a result conflict dynamics include multiple actors and relationships pursuing an agenda for legitimacy in competition with an established state.

This contestation of the state challenges its very authority and is most likely found in non-consolidated and heterogeneous states. The Asia – Pacific region is home to many such states with competing interests, which adds to the complexity and dynamics surrounding the development of regional institutions and multilateral mechanisms such as the Association of Southeast Asian Nations (ASEAN). Yet it is increasingly commonplace for the focus of conflict management and resolution measures to be directed at the regional level of global governance. While the United Nations system still provides the main

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forum for raising issues of global importance, increasingly, regional organisations are seen as the main driver for managing and resolving conflict in the first instance.

It is without doubt that attention within the Asia – Pacific in this regard is aimed at ASEAN. The Association was founded in 1967 through the signing of the ASEAN Declaration in Bangkok by the Founding Father Nations of ASEAN namely Indonesia, Malaysia, Philippines, Singapore and Thailand. This was followed by the establishment in 1971 of the zone of Peace, Freedom and Neutrality and then the binding commitment of the 1976 Treaty of Amity and Cooperation, which established the fundamental principles of interaction between ASEAN member states outlined in the ASEAN Declaration, which had expanded to become the comprehensive Southeast Asian organisation with the inclusion Brunei Darussalam in 1984, Viet Nam in 1995, LAO PDR and Myanmar in 1997 and Cambodia in 1999. It is this treaty that largely forms the basis for interactions not only in Southeast Asia but the wider East Asian region as well – the so-called ‘ASEAN Way’ (Tan 2011).

There were numerous influences that spurred the creation of ASEAN and its founding principles to bolster efforts to ensure independence from external aggression such as Cold War rivalries, and foster a stronger voice in international forums. A notable driving force at the time was the post-colonial and newly independent status of the member states (other than Thailand) and the experience of weak domestic political structures, social instability and human insecurity. As a region that was largely colonised by western powers, the development of ASEAN was to reinforce rather than pool their individual national sovereignty in contrast to but reflective of the European experience (Pettman 2010, 297). The ASEAN experiment was essentially founded on a collective regional elite effort to consolidate post-colonial state boundaries and fend off competing interests for legitimacy.

It is here that the conundrum lies for the development of an effective conflict management and resolution mechanism at the regional level. The very actors at the state level which spurred the creation of the regional structure are themselves an interested party in a particular conflict, combined with them being the gatekeeper at the regional level over whether a particular conflict is regionalised thus constraining the ability for regional mechanisms to work effectively and consistently. However, this does not adequately explain why regional mechanisms are successful in some cases. The limited success of conflict management mechanisms at the regional level is attributable to the competing interests at the regional level.

In other words, more powerful or strategic interests (i.e. other states) can also calculate a manoeuvre or instigate a trade-off in which the state in question

forgoes their absolute right to reject the regional mechanism in favour of it being initiated. Furthermore, given the presence of personality – driven regional relations, the implementation of a regional response can also be attributed to individuals within governments (regional response champion) in addition to the relative power of the state pursuing a regional response. Indeed, this was seen in 2011 when Indonesia held the position of ASEAN Chair and the determination of Indonesian foreign minister Marty Natalegawa to lead an ASEAN effort to mediate the Thailand – Cambodia border dispute (Haywood 2011).

In addition, a collective effort to initiate a regional conflict management response can also provide the conditions for successful implementation. An example of this is the development of the ASEAN Code of Conduct in the South China Sea involving ASEAN member states and China. This example illustrates the resolve of the member states collective effort and the multiple strategies at play in influencing the outcome of the negotiation process.

However, the implementation of these two cited examples of regional level conflict management mechanisms do fall within the rather more traditional notion of territorial disputes, essentially international disputes with both being over a border between two states. This kind of dispute management allows for the two interested parties to negotiate a settlement or prevent escalation towards conflict.

Nevertheless, this essentially only cover international disputes and does not address non-international conflicts. Across the Asia – Pacific region, there are a host of conflicts that threaten the consolidation of post-colonial states. More recently, however, there have been a series of peace negotiations across the region, which has resulted in greater autonomy in Aceh, Indonesia and parts of Mindanao, Philippines. The region has observed the initiation of peace negotiations with ethnic nationalities in Myanmar with a quasi-civilian government, as well as the launch of a peace process in Southern Thailand. Yet, while progress has been made in several areas, other areas have seen the continuation of conflict since 2011 between the Kachin and Myanmar government, the escalation of communal violence in Rakhine state in western Myanmar which broke out in 2012 and continues into 2013, and the outbreak of violence with the Sulu situation in Sabah, Malaysia in 2013.

In these conflicts, there is a considerably smaller role for ASEAN because it treads on the domestic affairs of a member state and remains out-of-bounds to an active regional conflict management and resolution mechanism. That said, since the 2008 ASEAN Charter, there have been notable advancements in pursuing human security strategies at the regional level, which have direct

effects on conflicts such as these. These include the establishment of the regional human rights body, the ASEAN Intergovernmental Commission on Human Rights as part of the ASEAN Political-Security Community, and the ASEAN Commission on the promotion and protection of the rights of women and children as part of the ASEAN Socio-Cultural Community. The establishment of these regional bodies are seen as the beginning of a conversation on human security issues, which affect the region as a whole. In order to look at regional responses for a particular conflict, then the observer needs to look at other relationships at the bilateral and multilateral levels.

In this context, the role of international organisations and United Nations bodies such as the UN Refugee Agency or bilateral assistance from other states illustrate a wide range of parties involved in some of the conflict situations in the region. While these are examples of humanitarian assistance activities carried out for the human consequences to a conflict, the role of external actors can also directly contribute to the conflict. A notable historical example in this regard was the Chinese funding of communist insurgencies in Southeast Asia, for instance the funding of the Communist Party of Burma until the 1980s, which fuelled insurgency in some, border areas of the country.

As a result of the conflict dynamics illustrated in international and non-international disputes as categorised by the Geneva Conventions, the constraints on the further development of regional conflict management and resolution mechanisms are driven by both state and non-state-based interests. At present regional responses to conflicts within the Asia – Pacific will remain at best limited to inter-state disputes within the ASEAN framework, and the non-international disputes will remain the purview of the broader international community and the host of interests that drive interactions at that level. However, recent advances in pursuing an ASEAN community have opened up the prospects for greater involvement at the regional level but have yet to be realised.

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## INDIA'S TERRITORIAL DISPUTES: GETTING TO YES?

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*Kanti Bajpai*<sup>12</sup>

India is involved in two of the most enduring territorial disputes in Asia if not the world – with Pakistan over Kashmir; and with China in three sectors along its lengthy borderland. Both disputes have been militarised: India and Pakistan fought over Kashmir in 1948, 1965, and 1999; and India and China fought in 1962. With Pakistan, tensions at the Line of Control (LOC) are chronic. In addition, since 1989, insurgents and terrorists have made their way across the Line to carry out acts of violence within India. In the case of the Line of Actual Control (LAC) with China, both armies have regularly transgressed the Line. Can India ever hope to resolve these costly disputes with its two powerful neighbours? I argue that there is a more or less rational solution to both quarrels but also that the prospects of a settlement are fairly distant, given the nature of domestic politics and the growing weakness of governments in all three countries.

The India-Pakistan and India-China dispute are legacies of colonialism. The partition agreement between India and Pakistan specified that the princely states within the Indian subcontinent were free to merge with either successor state. Most princes made up their minds quickly and sensibly. The ruler of Kashmir, a Hindu, presiding over a Muslim majority area, was unable to decide. Eventually, confronted by a tribal rebellion within his state, he signed with India. War ensued between India and Pakistan as Indian troops rushed to the ruler's help. Since the war of 1948, India and Pakistan have been unable to resolve their differences over Kashmir – two-thirds of the state is under Indian rule; one third is under Pakistan; and a small slice was ceded by Pakistan to China.

India and China are quarrelling over three sectors of territory in their borderlands: the western, the middle, and the eastern. In the western sector, the two countries differ over a desert-like tract called Aksai Chin, under Chinese control since 1962. The middle sector dispute is over a relatively small piece of land, largely in the Indian state of Uttar Pradesh. In the eastern sector, a large

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part of the Indian state of Arunachal Pradesh is at issue, a part that the Chinese refer to as South Tibet. Here too British colonial rule played a role. British administrators in India and in London at various times took rather different views of India's boundaries and frontiers, depending on imperial geopolitical interests vis-à-vis Russia and China as well as political interests in the borderland areas and in Tibet. China under Mao, essentially, rejected all colonial boundaries with India. As a result, when the British left India, there was still no firm and unambiguous view of the line between India and China. From 1949-50 onwards, it was clear that New Delhi and Beijing held to quite different views of Aksai China and substantial chunks of Arunachal Pradesh.

From 1948-49, India tried to resolve differences with both Pakistan and China. In the case of Pakistan, New Delhi initially turned to the United Nations. For a decade, the UN worked closely with India and Pakistan to implement the plebiscite that the Indian government was committed to holding in Kashmir. However, the emerging Cold War alignment of Pakistan with the US, Indian domestic politics, disagreement over the conditions for the holding of a plebiscite (India wanted Pakistani troops to leave Kashmir altogether before it was held; Pakistan wanted the plebiscite to be held under the protection of a UN force), and the increasing discomfort of both countries with the idea of an independent Kashmir caused UN efforts to fail. Bilateral negotiations nearly bore fruit in the late 1950s and early 1960s, but by 1963 these too had failed. After the 1971 war, in which Bangladesh was created (in part through Indian military intervention), the two countries signed the post-war Simla Pact, which committed them to bilateral negotiations.

In the event, this never happened. When a rebellion broke out on the Indian side of the LOC in 1989, the issue of Kashmir resurfaced. As things stand, the two countries are committed to discussing Kashmir, along with seven other issues, in a comprehensive dialogue begun in the early 1990s. Back-channel negotiations in 2006-07 were apparently tantalisingly close to bringing off a deal, the nature of which is not entirely known but which included a softening of the LOC to allow people and goods to move more freely, demilitarisation of both sides of Kashmir, Kashmiri self-governance in some form of association with India and Pakistan, and the institutions of similar governance practices on both sides of the LOC. Indian state elections in 2006 and President Pervez Musharraf's resignation in 2007 derailed the putative agreement.

In the case of China, New Delhi initially held to very hard position, refusing after the 1962 war to negotiate until Beijing restored all territories taken in the war. However, by the early 1970s, both countries had softened their stand, leading to the restoration of full diplomatic relations in 1976. In 1988, Prime Minister Rajiv Gandhi made an official visit to China. Out of this came India's

decision to resume trade, people-to-people and other links with China, and to open negotiations on the border. The two countries have held border talks almost continuously since then.

The climax of India-China negotiations has been the 2005 agreement on “Political Parameters and Guiding Principles for the Settlement of the India-China Boundary Question”, which sets out the broad protocols and norms of a settlement. The agreement makes six crucial points: the two sides would seek a “political settlement”; they should make “adjustments...so as to arrive at a package settlement to the boundary question. The boundary settlement must be final, covering all sectors of the India-China boundary”; they would give “due consideration to each other’s strategic and reasonable interests”; in reaching a settlement, they would take into account “historical evidence, national sentiments, practical difficulties and reasonable concerns and sensitivities of both sides, and the actual state of the border”; the final boundary should be “along well-defined and easily identifiable natural geographical features”; and they would “safeguard due interests of their settled populations in the border areas”. India, Pakistan, and China are trying to resolve two complex disputes arising from the detritus of colonialism.

The alternative is suspicion, high levels of defence spending, the militarisation of the borderlands, and possibly even war under the shadow of nuclear weapons. The broad outlines of a solution have now been fairly clearly articulated and seemingly accepted by the leaderships of all three countries, yet there is no end in sight. India and Pakistan have come much closer to an actual solution: a neutral, demilitarised, partially autonomous Kashmir. The problem is that the reaction of key constituencies is unknown, including the Pakistani military, Kashmiri separatists on both sides of the Line, Islamic militants, right-wing Hindu extremists in India, and perhaps even the Indian military. In addition, public opinion more broadly has not been seriously gauged. The linkage to other India-Pakistan problems, specifically differences over the Indus river waters and over Siachen and Sir Creek, is also unclear.

India and China, on the other hand, are much further away from an actual solution: all they have managed to do is agree on the key protocols and norms governing a settlement, not a settlement itself. China has at various times proposed a swap, whereby it keeps what it controls in the western sector, namely, Aksai Chin, and India retains its area of control in Arunachal Pradesh. Zhou Enlai in 1960 and Deng Xiaoping in 1980 most famously made the offer, which India turned down. Since then, China has cooled to the idea of a swap, partly because there is no leader powerful enough to make the offer and partly because having had its offer of a swap turned down, Beijing is understandably wary of making the offer again. India would probably now accept a swap,

although even this is not certain given that there remain absolutists who want to reclaim every inch of territory lost to China in 1962.

Any settlement between India and China faces a number of hurdles. Both countries must deal with a more assertive media, growing nationalism, and possible objections from the armed forces. For China, a settlement would almost certainly also have to take into consideration the situation in Tibet and India's attitude towards the Tibetan question. Related to Tibet is the question of Tawang in Arunachal Pradesh. China insists on control of Tawang because of the important Buddhist monastery there; India sees Tawang as a vital part of its defence. In India, any decision to cede territory will require a constitutional amendment, which in an era of coalition politics will be no easy process. Since both countries have territorial quarrels with other neighbours, they must think of the linkages to those negotiations: coming to a settlement on this dispute might encourage third parties to conclude that India and China are ready to deal with them – which may not be the case for a variety of reasons.

India's territorial disputes with Pakistan and China are unlikely to be resolved quickly. There are complex reasons for this, as already suggested here. Having said that, over time New Delhi has worked out diplomatic agreements, tacit and formal, that have helped stabilise relations with both Pakistan and China. With Pakistan, it signed the Simla Pact (1972) and the Lahore Declaration (1999); with China, the 2005 agreement. India has also worked out a series of confidence-building measures as a way of stabilising the military relationship and instituted high-level political meetings as a way of strengthening diplomatic ties with both countries. The presence of nuclear weapons is another factor for restraint: the danger of getting into a shooting war and having it escalate to the nuclear level is a shadow that must hang over decision makers in all three capitals. In addition, the three countries face massive internal problems and other geopolitical challenges. Going to war would be costly and, for the weaker party, could be calamitous. War is not an attractive option even for Beijing, although clearly China is economically and militarily far more powerful than India.

In the end, a neutralised, autonomous Kashmir linked to both Pakistan and India and territorial adjustments between China and India in which Aksai Chin remains largely with the Chinese and Arunachal Pradesh largely with the Indians are the most likely solutions. But this is a long way into the future, perhaps at least a decade. Much will depend on domestic politics. If India is beset by coalition politics, if Pakistan continues its slide into political confusion and extremist violence, and if China's rise to power is accompanied by growing nationalism, Indian diplomacy will be unable to settle its quarrels with its two most important neighbours.

India could have settled with Pakistan and China in the period between 1947 and the early 1960s. It failed to do so, partly due to its own mistakes. Settling those quarrels now, fifty years later, is even more fraught and complex. At the same time, India as well as Pakistan and China are entering an uncertain era, with the possibility that they will all be under relatively weak governments for the foreseeable future. Weak governments cannot easily cooperate. International agreements require “double-edged diplomacy”, to use Harvard political scientist Robert Putnam’s phrase: they need internal as well as external bargains to be struck. A weak central leadership will find it hard to strike these double-edged bargains with historic adversaries. Since 1995, India has only signed two big agreements – accession to the World Trade Organization and the India-US nuclear accord. This is a measure of how difficult it is for weak governments to enter into international agreements. India, Pakistan and China must carefully weigh up the costs and benefits of a settlement as also the likelihood that they can carry domestic opposition and public opinion now or in the future.

## FISCAL SPACE IN INDONESIA: AN EVALUATION OF SUSTAINABILITY AND EFFECTIVE ALLOCATION

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*Olivia Husli Basrin*<sup>13</sup>

*The issue of fiscal space has currently gained prominence due to the prevalence of debt crisis in developed countries. Indonesia, taking lessons from the 1997 Asian financial crisis, has been able to keep its debt-to-GDP ratio low. However, if it hopes to promote greater economic growth and infrastructure development, Indonesia must take advantage of its fiscal space and expand it even further particularly considering the high economic trajectory it is currently on. The objective of this paper is to explore the theoretical framework of fiscal space and apply it to the case of Indonesia. The paper is further divided into three sections: 1) measuring fiscal space availability in Indonesia; 2) formulating policies to expand it; and 3) discussing its effective allocation to ensure future sustainability.*

### **Introduction**

In the latest Articles IV Consultation on Indonesia by the IMF, one of the recommendations presented highlights the importance of fiscal flexibility to respond to external crisis (IMF 2012). Taking into account its traumatic history with near fiscal insolvency, Indonesia has taken on a conservative approach in maintaining fiscal balance, allowing a maximum 3 percent budget deficit and a maximum debt of 60 percent of GDP, as stated in Article 12 par.3 of Law no.17 of 2003 on State Finance (Kuncoro 2011). With such constitutional constraints and rigid expenditure allocation, many have argued that Indonesia's access to fiscal space is fairly limited (Winarno 2012). However, in consideration of the recent government's emphasis upon infrastructure, health, and development spending as well as the pressing needs to respond to the lingering Eurozone crisis, this should not be the case.

According to Peter S. Heller, fiscal space is defined as government's capacity to provide financial resources for a desired purpose, providing that the fiscal position is sustainable in both the medium and long term (Heller). Despite past

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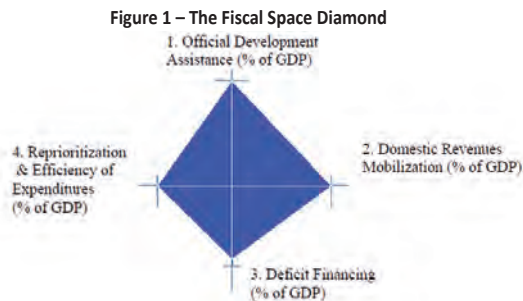
insolvency issues, Indonesia has managed to reduce its public debt-to-GDP ratio and expanded the state budget annually along with its rapid economic growth. Its medium and long-term economic performance forecast shows positive growth, indicating the sustainability of its fiscal position. (IMF 2012) Hence, the previous argument on limited fiscal space is questionable. This paper aims to evaluate Indonesia's fiscal space and its related policy implications.

### Literature Review: "Fiscal Space"

The concept of fiscal space has been brought up frequently in financial policy discussions. It is still in definitional evolution, but in many literatures it has been loosely defined as accessible budgetary room to provide financial resources for a specific purpose without threatening fiscal sustainability in the medium and long run (Heller, Understanding Fiscal Space 2011). A more technical definition states that fiscal space is the difference between a country's sovereign debt-to-GDP ratio and its debt limit, which is the point before default where policymakers would begin to take unconventional fiscal policy measures (Zandi 2011). Both definitions conceptualize fiscal space in pure financial terms without taking into account its public policy implications. An alternative definition provided by Roy et al., a proponent of developmental fiscal space, stated that fiscal space is the *financing that is available to government as a result of concrete policy actions to enhance resource mobilization, and the reforms necessary to secure the enabling governance, institutional, and economic environment for these policy actions to be effective, for a specified set of development objectives* (Roy n.d.). Based on the definitions above, the fiscal space framework consists of: (i) creation of fiscal space; (ii) its effective utilization; and (iii) measuring its sustainability, which will be further discussed below.

### Creation of fiscal space

According to Heller, there are three ways to create fiscal space: raising revenue, reprioritization of expenditure, and borrowing (Heller, Understanding Fiscal Space 2011). This is expressed through the fiscal space diamond as shown in Figure 1.



Source: UNDP. Roy et al.

In a conventional budget balance sheet, there are two sources of revenues, tax and non-tax. To increase tax revenues, government could introduce a higher tax rate or expand the tax base, for example by eliminating prior tax concessions or minimizing tax incentives given to certain business groups. Expanding the tax base has a lower political implication as compared to increasing tax rate, which arguably would reduce people's welfare, especially if it is not allocated effectively (Heller). Non-tax revenues can be raised by exploiting national assets such as natural resources or profits from state enterprises, but their sustainability are very low.

Reprioritisation of expenditure could create fiscal space with a very minimal risk of running insolvency. This method has been recommended by the IMF and the World Bank, especially for countries that run budget deficits due to high subsidies (IMF 2012). This is conducted by re-evaluating current expenditures, minimizing spending on non-revenue generating projects such as defense and subsidies, and increasing capital expenditure that creates future revenues to expand medium and long-term fiscal space, hence securing macroeconomic stability. Heller also suggested that fiscal space could be created by conducting government projects efficiently, with an absence of corrupt practices prevalent among developing countries (IMF 2012). This is supported by Roy et al. who argue that expenditure efficiency would enhance fiscal space for human development by weighing it against distributive concerns, of which the poor would receive the most benefit of government's projects (Roy n.d.).

The most popular approach taken in creating fiscal space is by borrowing resources domestically and externally. The issue of debt sustainability is relevant here because servicing debt can extend to the medium and long-term range where fiscal space may be further constrained. Its availability depends upon historical records of debt-to-GDP ratio and economic growth prospects (Heller, *Understanding Fiscal Space* 2011). It is crucial that such fiscal space be allocated effectively to projects that would produce enough revenue to service debt, without threatening the country running insolvency. A riskier approach to fiscal space creation is by printing money, hence expanding the monetary base. It is possible only to finance immediate budget deficits and must be followed with sterilization efforts in order to avoid the risk of hyperinflation that will lead to insolvency (Kuncoro 2011).

### **Effective utilisation of fiscal space**

A study by Rodriguez and Moreno indicated that the sustainability of fiscal expansion depends on the type of expenditure (Rodriguez 2006). Fiscal space had been traditionally used to finance debt due to budget deficits and buffer against external financial crisis as part of contingency planning. Expansion of



annual expenditure in non-revenue making areas, with the absence of a growing economy, takes up fiscal space – a phenomenon currently observed in Greece and Iceland (Zandi 2011). Such usage of fiscal space is not sustainable in the long run because country would eventually reach the point when it could no longer service the debt interest that increased as a result of default risk.

Recently, economists such as Roy et al. have argued that fiscal space should be used for developmental purposes that include infrastructure, health, education, and attainment of Millennium Development Goals. Their main argument is based on the presumption that investment in infrastructure and human development has a positive effect on productivity and output in the long run, hence the sustainability of fiscal space is ensured (Roy n.d.). In other words, investment in these areas would produce return that could service the debt and create even greater future fiscal space. The lack of developmental fiscal space is especially common in developing countries. Opposing arguments emphasize the importance of short-term fiscal stability and solvency and hence may undermine the long-term impact of human development, which is often difficult to calculate.

Another area in which to utilize fiscal space is research and development (R&D), particularly due to the pressing challenge imposed by global issues such as climate change, and energy, food, and water security (Heller). Aside from a number of developed countries, R&D is often overlooked and under-developed because it is difficult to measure its rate of return on investment, unlike infrastructure development. Moreover, countries do not see the urgency of such expenditure, which has reduced its popularity during annual budget reviews. Similarly, the argument of allocating fiscal space to pension funds and medical care was never fully reflected in policymakers' decisions, even in developed countries with critical aging population. Moody's agency classified this issue as a part of contingency planning these countries, must undertake through the expansion of fiscal space availability (Zandi 2011).

### **Measuring fiscal space and its sustainability**

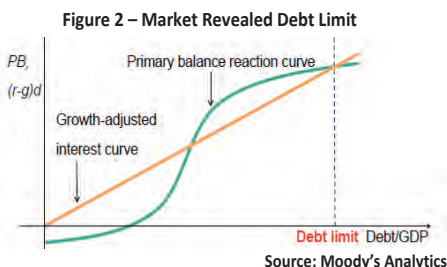
There are a number of approaches to measure fiscal space. It can be evaluated as the difference between current level of expenditure and the maximum level of expenditure a government can take without threatening its fiscal solvency (Ostry 2010). The main challenge with this approach is the difficulty in measuring maximum level of expenditure, which is dependent upon many variables including economic forecast, debt ratio, etc. Hence, the most common approach used to measure fiscal space is the difference between current public debt-to-GDP ratio, with a country's debt limit implied by the country's historical record of fiscal adjustment (Ostry 2010). This is known as the *debt sustainability approach*. Debt limit is defined as the point before default where a country would then claim insolvency. The criticism of this approach is it assumes that fiscal space is only created by debt, domestic or external.

However, considering that debt is the most common means of expanding fiscal space, this approach offers a fairly accurate calculation.

The debt approach begins with a basic rationale that a country must issue debt equal to the difference between interest payments on its existing debt and its primary balance, expressed as:  $D_t = D_t R_t - PB_t$  (where  $R_t$  is the nominal interest rate for government bond, and  $PB_t$  is the primary balance). This can be re-written in terms of shares of GDP as:  $d_t = (r_t - g_t)d_t - pb_t$ , where  $(r_t - g_t)$  is equal to a country's growth adjusted interest payments. This relationship is expressed in Figure 2, where the debt limit is defined as the intersection between the growth-adjusted interest curve and the primary balance reaction curve. Any point between the debt limit and public debt-to-GDP ratio, which is marked by the first point of intersection between the two curves, is the fiscal space. Countries need to ensure that fiscal space is not exhausted and hence must attempt to stay as far away from the debt limit (Ostry 2010). If the limit is surpassed, a country would then undergo a liquidity crisis resulting in insolvency. Investors' assessment of potential fiscal shock is a factor in determining how close a country could reach its debt limit, considering that investors are the market for government debt (Zandi 2011). Hence, the credibility of fiscal management is crucial to maintain.

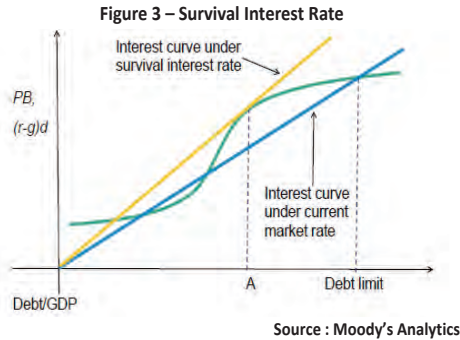
It must be noted that the primary balance reaction curve as shown in Figure 2 could shift downward due to deterioration of economic fundamentals. If this occurs, fiscal space would diminish and country would enter fiscal insolvency. Similarly, the growth-adjusted interest curve could also shift, especially as a country is approaching its debt limit. This is because investors would demand higher yields to compensate for increased risk of default, which shifts the interest rate curve. It would also take up the available fiscal space. This shift will continue until it reaches what is termed as the survival interest rate, which is the highest nominal long-term sovereign interest rate a country can survive before rising interest payment outstrips ability to service debt. This is shown in Figure 3.

Another approach to measure fiscal space is based on the developmental needs of a country. Roy et al. state that a country should engage in scaling up its public investment, which looks at the medium to long-term fiscal framework (Roy n.d.). It focuses on economic growth projections and financing details to achieve the development goals. There are no specific mathematical



formulas to calculate the developmental fiscal space but it could be extracted based on government's social and human development plan in the medium to long-term scenario.

As countries attempt to tap into their fiscal space, sustainability should always



be considered because as illustrated above, insolvency is always lurking. If fiscal space is created by debt, it must be allocated into projects that will provide return, which could service the future interest rate of the debt, hence ensuring the availability of future space (Heller, 2011). Moreover, country should always anticipate external financial

crisis that would affect its trade balance, capital flow, and currency management. These threats would shrink the primary balance curve and require fiscal space to buffer them before threatening the overall fiscal condition of the country. Debt, domestic or external, usually implies long-term servicing, which raises the possibility of currency and interest rate fluctuation.

### Case study: fiscal space in Indonesia

Positive economic prospects and prudent fiscal policies have enabled Indonesia to begin looking at the possibility of accessing fiscal space to further expand its expenditures, especially to areas critical for national development. In his state address, President Yudhoyono presented the 2013 draft budget with total expenditure increasing about 7.1 percent to US\$176 billion (Winarno 2012). Total revenue is expected to be US\$158.6 billion, hence a deficit of around US\$17.9 billion, which is about 1.65 percent of GDP. This expansion of expenditure is afforded mainly by the increase in tax and non-tax expenditures as well as debt, considering the fiscal constitutional constraints mentioned in the introduction. Recommendations by the IMF encouraged Indonesia to abandon its 3 percent limit on budget deficit in order to facilitate infrastructure development planning (IMF 2012). This comes about as a part of the new confidence that the international market has upon the resilience of Indonesia's economy. Policymakers need to be cautious and not complacent with this achievement, reminding themselves of the experience of insolvency following the Asian crisis. In the sections that follow, this paper evaluates fiscal space in Indonesia based on the literature framework explained above.

## Measuring Indonesia's fiscal space

As outlined in the framework above, fiscal space could be measured in two ways: debt sustainability, and developmental needs. Based on the debt sustainability framework, Indonesia's current debt level is calculated below:

$$D_t = D_t R_t - PB_t$$

$$D_t = [112,868.6 \text{ (million USD)} * 0.88 \text{ (LIBOR rate)}] + [7,602.41 \text{ (million USD)} * 10.1 \text{ (10-year government bond)}] - (-13,065 \text{ (million USD)})$$

$$D_t = \text{US\$189,173.70 million}$$

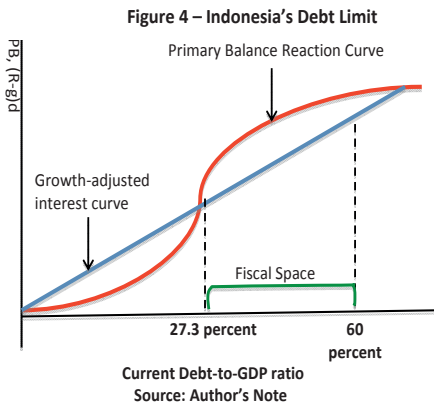
Note: Data are collected based on June 2012 record of government debt from Bank of Indonesia. US\$112,868.60 is total public external debt including ODA, non-ODA loans, and market loans. The LIBOR rate is taken as the basis of foreign debt interest rate. US\$7,602.41 is total domestic debt in the form of government securities.

As of September 2012, Indonesia's public debt-to-GDP ratio has increased to 27.3 percent, from 25 percent in 2011 (Sutianto 2012). The increase is mainly spent on expanding expenditures in various areas including subsidies and capital spending, as well as servicing previous debt. According to studies about Indonesia's debt sustainability, the current state budget is still in safe condition to meet all government debt obligations in the long-run (Kuncoro 2011). The debt position calculated above consists mainly of long-term maturity structure that could be sustained conditional to continuous economic growth. In fact, a stress test by the ADB showed that Indonesia's debt-to-GDP ratio should continue to fall in the upcoming decade despite of potential macroeconomic shocks (ADB 2012). It must be noted that based on the 2012 budget draft, Indonesia's primary balance has a deficit of US\$265 million (Ministry of Finance 2012). The theory on debt sustainability states that increasing debt-to-GDP ratio must be accompanied with a positive primary balance. Indonesia's performance in this area is quite concerning despite the fact that it is only 0.3 percent of GDP. Hence, even though the fiscal space available for Indonesia is still quite large by empirical measures, government must reform their expenditure to boost primary balance.

The debt limit scenario as shown in Figure 4 also supports the finding. Precise calculation of Indonesia's debt limit is not available in this paper due to constraints in running time series regression. The law on State Finance states that public debt should not exceed 60 percent of GDP shares, which could be taken as the constitutional debt limit. The fiscal space available is quite large, shown as the difference between current debt-to-GDP ratio and the debt limit. As stated by Heller, an optimal fiscal space is not measured by how close it comes to the debt limit (Heller, *Fiscal Policy for Growth and Development: The Fiscal Space Debate* n.d.). Even though Indonesia's current debt-to-GDP ratio is

far from the limit, it should not attempt to continue expanding without careful allocation of expenditure.

Indonesia's fiscal space should also be calculated based on developmental understanding. According to the National Medium-Term Development Plan for



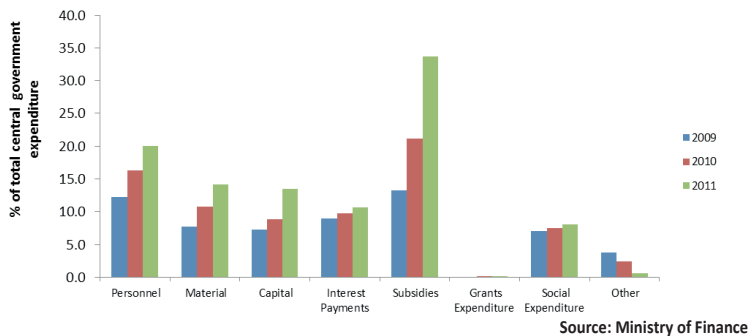
2010-2014 (*Rencana Pembangunan Jangka Menengah*), government will focus its efforts in improving people's welfare through better education, health, food security, energy, and infrastructure (RPJM 2010). These sectors are also highlighted in the Long Term National Development Plan for

2005-2025. A detailed budgetary allocation for the attainment of these goals was not produced by the government. However, an approximate cost of development could be derived from UNDP's country program for Indonesia regarding achievement of MDGs. The financial resources needed amount to US\$163.2, spanning to 2015 (UNDP 2011). This is low compared to the country's annual expenditure (see Appendix 1). Moreover, Indonesia's economic forecast indicates continual growth of GDP, which ensures the availability of fiscal space to be channelled to development sectors. However, the government's commitment to such causes is very questionable.

### Creating fiscal space

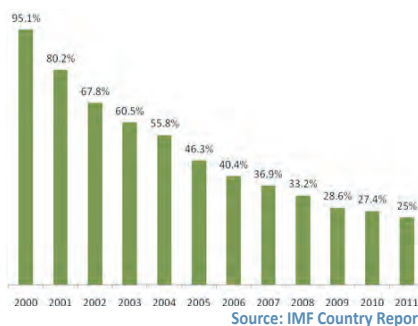
Among the various options to create fiscal space as presented by Heller, the most applicable ones in the case of Indonesia include reprioritization of expenditure, domestic debt, and expanding tax base. As evident in the budgetary trend from 2009-2011, shown in Annex 1, fuel subsidies constitute a large portion of government expenditure, especially in 2011 following the increase in oil prices (Ministry of Finance 2011). In fact, the 2013 draft budget ratified by the legislature would allocate US\$28.5 billion for energy subsidies, a significant increase from US\$20.8 billion in 2012. Energy subsidy in Indonesia is one of the highest in the world and its sustainability has been criticized by many. The argument in defense of the continuity of such expenditure is that it would protect the poor from increases in global oil prices that would then affect

Figure 5 – Composition of Central Government Expenditure (2009-2011)



commodity prices<sup>14</sup>. However, according to Bulman et al. subsidy burdened Indonesia's fiscal condition with very limited benefit felt by the poor (Bulman 2010). Another area of expenditure that should be minimized to create greater fiscal space is personnel spending that stipulate government salaries, honorarium and vacation, as well as social assistance. From 2009-2011, personnel expenditure and subsidies have taken up an average of 50 percent of total government expenditure (Ministry of Finance 2011). In contrast, capital expenditure that is meant to improve the much-needed infrastructure development in Indonesia was only about US\$3 billion in the 2013 draft budget, despite the government's claim of significant increase in spending (Winarno 2012). A similar is found with the health and education sectors, as shown in Figure 5 as social expenditure.

Figure 6 – Indonesia's Debt-to-GDP Ratio



It is crucial for the government to engage in reprioritization of expenditure because the deficit that is incurred by the current spending is not sustainable in the long run. Many government programs, especially infrastructure development and attainment of MDGs, have been sacrificed in order to extend subsidies. There is a strong political opposition against any government attempt to reduce fuel subsidies, as evident in early 2012, because of the fear that commodity prices would rise sharply (World Bank 2012). Hence,

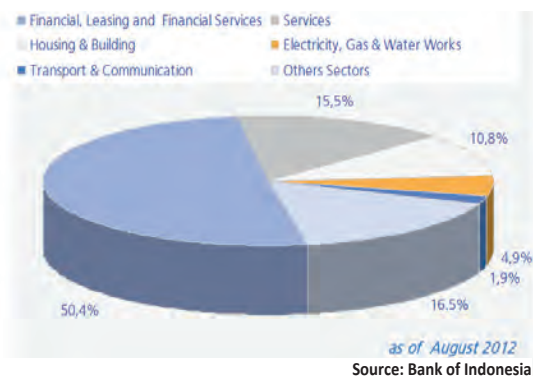
<sup>14</sup> As an archipelagic nation, the distribution of commodities greatly depends on land and water transportation with high fuel consumption. Hence increase in fuel price would reflect in higher commodity price.

the commitment of the government to reprioritization of expenditure is very low since it is not a popular policy. However, once this approach is taken, the availability of Indonesia's fiscal space would increase greatly as it would minimize non-returning expenditure and at the same time reduce debt level.

Another approach that could be taken is to increase debt. Indonesia's current public debt to GDP ratio has been falling, as indicated by Figure 6, with the current level of 25 percent in 2011. Public debt in the form of government bonds has continued to increase, replacing the reduction in foreign debt. This change of trend can be attributed to the growing attractiveness of the government bond market (Kuncoro 2011). Strong macroeconomic performance increases investors' confidence in government debt. The long-term characteristic of these debts makes them less volatile to fluctuations in domestic interest rate. As discussed above, Indonesia's debt sustainability is quite high, providing that its macroeconomic condition does not revert drastically.

Figure 7 shows government expenditure based on external debt. More than 50 percent is allocated for financial services as a part of monetary policy conduct. Infrastructure as reflected by transport and communication as well as housing and building make up only around 12 percent of total debt. This raises a serious concern because aside from financial services, more than 35 percent of external debt is allocated to non-returning sectors that cannot service the principal and interest of the debt. Despite the large amount of fiscal space, if this trend continues, Indonesia's debt sustainability could be threatened. Therefore, creating fiscal space through debt is a valid option for Indonesia, but its allocation must be effective.

**Figure 7 – Government's External Debt Position according to Top 5 Economic Sectors**



Political opposition against acquiring more debt is not as vocal as it is against reducing fuel subsidies. However, a past traumatic history of near insolvency

due to external borrowing might lead to public disapproval for creating more fiscal space through debt.

Indonesia's fiscal space could also be created by increasing tax and non-tax revenues. Broadening the Indonesian tax base system seems to be the more likely option as compared to increasing tax rate, because political opposition against the latter is greater and from an economic perspective the Laffer curve would apply.<sup>15</sup> Indonesia's current finance minister also argued that broadening the tax base is essential to increase revenue and expand the formal sector of economy (Broadening Tax Base, Jakarta Globe). The current rate of tax compliance within the workforce is as low as 7.7 percent, and the same bleak picture applies to the business sector with only 3.8 percent. As the economy of the country continues to grow along with its workforce, the tax base will be broadened. Ensuring tax compliance is a significant challenge because of the high rate of tax evasion in Indonesia. The most effective approach is by improving transparency in the allocation of taxpayers' money. In doing this, reprioritization of expenditure mentioned earlier must be adopted to focus more on sectors that would directly improve people's welfare. Non-tax revenues could be enhanced through further exploitation of Indonesia's natural resources, which have very low sustainability in economic as well as environmental terms. The fiscal space created through such revenue would only be available in the short run meanwhile government projects could span to the long-term. The same analysis is applicable to the creation of fiscal space through selling of government assets and state enterprises.

Another option of creating fiscal space as suggested by the IMF is to abandon the three percent limit on the government deficit (IMF 2012). This would ensure fiscal flexibility that is especially crucial today considering the uncertainty of global financial condition with the lingering Eurozone crisis. Indonesia's current level of deficit is very low as compared to other developing countries. Fiscal discipline is crucial but considering the pressing need for the country to develop its physical and capital infrastructure, the budget deficit should be allowed to go higher. There are political consequences that should be considered, such as lowering budget accountability to the public.

### **Effective allocation of fiscal space in Indonesia**

Once fiscal space is created, the next question to address is how to allocate the resulting resources effectively. This requires government to engage in project

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<sup>15</sup> Laffer curve: a representation of the relationship between government tax rate and tax revenue. It postulates that no tax revenues will be collected at extreme tax rate. Stiglitz, Joseph. "Optimal Taxation". *Economics of the Public Sector, Third Edition*. New York: W.W. Norton & Company 2000., p.555



that would produce enough revenue to finance itself, service debt, and ensure the same availability or even greater future fiscal space. A great example would be infrastructure development projects that are particularly needed by Indonesia to boost its long-term economic performance. A growing body of economic theory and empirical evidence has indicated that there is a positive correlation between infrastructure and economic activity, especially in the form of telecommunication, road, and electricity networks (Ter-Minassian 2009). Greater economic activity implies broader tax base, which would increase government revenue and hence enlarge the fiscal space.

The National Medium Term Development Plan has specified a number of major infrastructure projects that the government aims to complete by 2014, which includes highway roads, ports, fiber optic connection, and city transportation (RPJM 2010). These projects are conducted under the Public Private Partnership (PPP) scheme, which is very popular among developing countries for infrastructure development. PPP is often mistaken to create fiscal space because it alleviates the budgetary burden to be allocated to the specific sector (Heller, Understanding Fiscal Space 2011). However, in the long run initial savings from such infrastructure expenditures will be offset because private sector would include the cost of capital into the leasing costs to the government. Hence, fiscal space available today would be taken once the project is completed. Considering Indonesia's large fiscal space, the government should reduce its dependence upon PPP for infrastructure funding, and if they do continue, it should be for the reason of efficiency and quality.

Another area to utilize fiscal space is on human capital development. In addition to attaining the MDGs, the government needs to allocate greater fund for education and health. The current budget for these two sectors is 1.1 percent of GDP and 0.1 percent of GDP, respectively. The government has actually conducted a policy to ensure social health insurance, *Jamkesmas*, and hence it must allocate enough funds for its accomplishment to maintain political credibility and accountability. Considering that the government should not further expand its expenditure and the political constraints in reprioritizing the budget, fiscal space could be taken up for human capital development. According to Roy et al., similar to infrastructure, improved human capital would generate great revenue that could service debt as well as expand future fiscal space (Roy n.d.). This supports the fiscal sustainability of Indonesia in general. Human capital and infrastructure development would enable the country to elevate itself to a higher economic platform as outlined in the National Long-Term Development Plan.

In addition, fiscal space should also be designated to serve as a fiscal buffer against volatility caused by the lingering financial crisis. The 2013 expansionary

national budget does not include contingency planning, which is crucial for Indonesia's open economy. In order to sustain economic growth, government expenditure must not be constrained in the short-term. Therefore, fiscal space should be available to fund expenditure while adjusting to the circumstances of the crisis.

### **Policy implications and conclusion**

There are a number of policy implications that must be considered by the government of Indonesia regarding the creation and allocation of fiscal space:

#### *Reprioritisation of expenditure*

Energy subsidies and personnel expenditure have always dominated Indonesia's annual budget report in terms of size of expenditure. Both sectors are considered as non-revenue making expenditure, which the government should not continue to sustain. The amount of fuel subsidy must be significantly reduced and reallocated to capital expenditure for infrastructure, or the education sector for human capital development. Reprioritization of expenditure would allow the government to operate more efficiently without necessarily adding debt burden to create fiscal space.

#### *Increase tax base and decrease debt accumulation*

The government should engage in tax administration reform to expand the tax base by increasing the rate of tax compliance and minimizing tax evasion, particularly by large corporations. Increasing tax base is more effective and sustainable in increasing government revenues as compared to increasing tax rate. This is especially true considering the country's economic trajectory. The expansion of fiscal space by tax revenues should allow the government to minimize its reliance on debt financing. Despite the manageable debt-to-GDP ratio, future debt servicing will exert significant fiscal constraints that may take up some fiscal space.

#### *Infrastructure and human capital development*

The government should allocate fiscal space effectively to revenue-making expenditures such as infrastructure projects and human capital investment in education and health sectors. These areas would generate great revenues directly or indirectly in the medium to long term that will ensure the availability of fiscal space in the future.

#### *Contingency planning*

In the government's annual budget formulation, contingency planning has often been overlooked by policy makers. Fiscal space should be readily available for unexpected events ranging from natural disasters to financial crisis. This is particularly important considering the lingering crisis in the

Eurozone area that has a significant impact on Indonesia's fiscal position. To continue economic progress, fiscal space should be readily available to buffer the effect of unexpected occasions.

In conclusion, the availability of fiscal space for Indonesia is quite sustainable in the medium and long term. This, however, should not make policymakers complacent in managing expenditure. Effective allocation of fiscal space is crucial to ensure its availability in the future amidst unpredictable global financial conditions.

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## Appendix 1

National Budget - APBN (US\$ Billion)	2009		2010		2011	
	Audited	% of GDP	Audited	% of GDP	Audited	% of GDP
<b>A. State Revenues and Grants</b>	<b>81.5</b>	<b>15.11</b>	<b>109.5</b>	<b>15.47</b>	<b>137.9</b>	<b>16.28</b>
<b>I. Domestic Revenues</b>	<b>81.4</b>	<b>15.08</b>	<b>109.2</b>	<b>15.42</b>	<b>137.3</b>	<b>16.21</b>
<b>1. Tax Revenues</b>	<b>59.6</b>	<b>11.04</b>	<b>79.6</b>	<b>11.24</b>	<b>99.5</b>	<b>11.75</b>
a. Domestic Tax	88.3	16.36	76.4	10.79	93.4	11.03
i. Income Tax	30.5	5.66	39.3	5.55	49.1	5.80
- Oil & Gas	4.8	0.89	6.5	0.92	8.3	0.98
- Non Oil & Gas	25.7	4.76	32.8	4.63	40.8	4.82
ii. Sales tax (VAT)	18.5	3.44	25.4	3.58	31.6	3.74
iii. Property taxes	2.3	0.43	3.1	0.44	3.4	0.40
iv. Duties on Land and Building Transfer	0.6	0.12	0.9	0.12	(0.0)	(0.00)
v. Excises	5.4	1.01	7.3	1.03	8.8	1.04
vi. Other taxes	0.3	0.06	0.4	0.06	0.4	0.05
b. International Trade Tax	1.8	0.33	3.2	0.45	6.2	0.73
i. Import duties	1.7	0.32	2.2	0.31	2.9	0.34
ii. Export tax	0.1	0.01	1.0	0.14	3.3	0.39
<b>2. Non Tax Revenues</b>	<b>21.8</b>	<b>4.05</b>	<b>29.6</b>	<b>4.18</b>	<b>37.8</b>	<b>4.46</b>
a. Natural Resources Revenues	13.4	2.47	18.6	2.62	24.4	2.88
i. Oil and Gas	12.1	2.24	16.8	2.37	22.0	2.60
- Oil	8.7	1.60	12.3	1.74	16.1	1.90
- Natural Gas	3.4	0.64	4.5	0.64	5.9	0.70
ii. Non Oil & Gas	1.3	0.24	1.8	0.25	2.3	0.27
- Mining	1.0	0.18	1.4	0.20	1.9	0.22
- Forestry	0.2	0.04	0.3	0.05	0.4	0.04
- Fishery	0.0	0.00	0.0	0.00	0.0	0.00
- Geothermal	0.0	0.01	0.0	0.01	0.1	0.01
b. Profits of State Owned Enterprises (BUMN)	2.5	0.46	3.3	0.47	3.2	0.38
c. Other Non-tax revenues (PNBP)	5.2	0.96	6.5	0.92	7.9	0.93
d. Revenue from Public Service Centers (BLU/Badan Layana)	0.8	0.15	1.2	0.16	2.3	0.27
<b>II. Grants</b>	<b>0.2</b>	<b>0.03</b>	<b>0.3</b>	<b>0.05</b>	<b>0.6</b>	<b>0.07</b>
<b>B. Expenditures</b>	<b>90.1</b>	<b>16.69</b>	<b>114.7</b>	<b>16.20</b>	<b>147.5</b>	<b>17.42</b>
<b>I. Central Government Expenditure</b>	<b>60.4</b>	<b>11.20</b>	<b>76.7</b>	<b>10.84</b>	<b>100.7</b>	<b>11.89</b>
1. Personnel	12.3	2.27	16.3	2.30	20.0	2.36
2. Material Expenditure	7.8	1.44	10.7	1.52	14.2	1.68
3. Capital Expenditure	7.3	1.35	8.8	1.25	13.4	1.59
4. Interest Payments	9.0	1.67	9.7	1.37	10.6	1.25
a. Domestic	6.1	1.14	6.8	0.96	7.6	0.90
b. Foreign	2.9	0.53	3.0	0.42	3.0	0.36
5. Subsidies	13.3	2.46	21.2	3.00	33.6	3.97
a. Energy	9.1	1.68	15.4	2.18	29.1	3.44
i. Fuel	4.3	0.80	9.1	1.28	18.8	2.22
ii. Electricity	4.8	0.88	6.3	0.90	10.3	1.22
b. Non Energy	4.2	0.77	5.8	0.82	4.5	0.53
6. Grants Expenditure	-	0.00	0.0	0.00	0.0	0.00
7. Social Expenditure	7.1	1.31	7.6	1.07	8.1	0.96
8. Other Expenditures	3.7	0.69	2.4	0.34	0.6	0.07
<b>II. Transfers to Region</b>	<b>29.6</b>	<b>5.49</b>	<b>37.9</b>	<b>5.36</b>	<b>46.9</b>	<b>5.53</b>
<b>1. Balancing Funds</b>	<b>27.6</b>	<b>5.11</b>	<b>34.9</b>	<b>4.92</b>	<b>39.6</b>	<b>4.67</b>
a. Revenue Sharing	7.3	1.36	10.1	1.43	11.0	1.30
b. General Allocation Fund (DAU)	17.9	3.32	22.4	3.16	25.7	3.03
c. Special Allocation Fund (DAK)	2.4	0.44	2.3	0.33	2.8	0.33
<b>2. Special Autonomy &amp; Adjustment Funds</b>	<b>2.0</b>	<b>0.38</b>	<b>3.1</b>	<b>0.44</b>	<b>7.3</b>	<b>0.86</b>
a. Special Autonomy Fund	0.9	0.17	1.0	0.14	1.2	0.14
b. Adjustment Fund	1.1	0.21	2.1	0.29	6.1	0.72
<b>III. Suspended Fund</b>	<b>(0.0)</b>	<b>(0.00)</b>	<b>(0.0)</b>	<b>0.00</b>	<b>(0.0)</b>	<b>(0.00)</b>
<b>C. Primary Balance</b>	<b>0.5</b>	<b>0.09</b>	<b>4.6</b>	<b>0.65%</b>	<b>1.0</b>	<b>0.12</b>
<b>D. SURPLUS / DEFICIT</b>	<b>(8.5)</b>		<b>(5.2)</b>		<b>(9.6)</b>	
Deficit (% of GDP)	(1.58)		(0.73)		(1.14)	
<b>E. Net Financing</b>	<b>10.8</b>	<b>2.00</b>	<b>10.1</b>	<b>1.42%</b>	<b>14.9</b>	<b>1.76</b>
I. Domestic Financing	12.3	2.28	10.6	1.49%	16.9	2.00
II. Foreign Financing, nett	(1.5)	(0.28)	(0.5)	-0.07%	(2.0)	(0.24)

Source: MoF-Go

## THE DYNAMICS OF DONOR-THINK TANK ENGAGEMENTS IN BANGLADESH

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*The objective of this paper is to explore donor perspectives on supporting think tank institutions and the implications of the donor funding preferences on the think tanks. Donors demonstrate a deep insight into the challenges the think tanks face in influencing policies in a divisive and confrontational political milieu. Yet, the donors expect to see concrete results or outcomes from the think tanks they fund. Thus, donor preferences gravitate toward isolated project-based engagements with think tanks rather than medium to long-term provision of operational and organisational support. The unpredictability and ad hoc nature of funding undermine the consolidation of research capacities and organisational development in the long run. The paper argues that funding organisations must re-orient their approach in supporting research and knowledge production with multi-annual and core support to think tanks. This will improve think tanks' ability to produce policy relevant research and analysis that will potentially contribute to the socio-economic development of Bangladesh.*

### **Introduction**

Think tanks (or policy research organisations) are generally referred to as “non-profit, non-partisan organisations engaged in the study of public policy” (Abelson 2009, 9). Think tanks play a mediating function between the government and the public; identify, evaluate, and articulate current and emerging issues, problems and proposals; and organise and transform issues and ideas into policy debates (McGann and Weaver 2000, 3). While considerable attention is paid to think tanks’ activities in policy research, analysis, advocacy, and various forms of liaison with governmental and non-governmental agencies, much less focus is given to think tanks’ resource mobilisation and financial sustainability, particularly in the global South.

Think tanks in developing countries rely on a range of domestic and international financial sources. These include funds from international governments and aid agencies (bilateral and multilateral), international foundations, domestic foundations, organisations, government agencies, and for-profit organisations. Think tanks also generate income through fees from

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training courses, publications, conferences, and various other activities. Increasingly, think tanks in developing countries are receiving significant attention and investment as donor countries and organisations believe that public policy is enhanced if it is informed by research-based evidence (Nachiappan et al. 2010). A survey conducted by International Development Research Centre (IDRC) (2011) revealed that the highest funding sources (in terms of percentages) for think tanks are international governments, aid agencies, international foundations, and International non-government organisations.

All of the different international aid agencies (hereinafter 'donors') have a wide variety of priorities, perspectives, and modalities of supporting and funding think tanks and research organisations. This study, taking Bangladesh as a case, explores whether any such discernible approaches or patterns of donor funding to think tanks exist and analyses the implications of the funding mechanisms to think tanks. The study deals with a very small piece of the much bigger puzzle of donor-think tank engagements, acknowledging there are numerous contextual, institutional, organisational, and situational factors that influence these relations.

Bangladesh provides an excellent context for initiating such a study. The country has a vibrant civil society, active media, and a long tradition of non-government activism. Bangladesh is reported to have more NGOs per capita than any other developing country (Kabeer et al. 2010). Civil society and non-governmental organisations have played a critical role in fostering socio-economic development and democratisation, and they continue to do so. Although the development of think tanks in Bangladesh is a relatively recent phenomenon, the country is reported to have 34 think tanks, which puts Bangladesh in the sixth position in Asia in terms of number of think tanks (McGann 2012, 25). Like in any other country, think tanks in Bangladesh range in size of staff and budget, and vary enormously in areas of specialisation, research output, and ideological orientation. Generally, though, a number of Bangladeshi think tanks have been successful in attracting donor interest as they present an opportunity to provide independent research data and analysis (Evaluation of Citizens Voice and Accountability 2008, 20).

Literature has highlighted different dimensions of donor-dependency of think tanks. Studies by Srivastava (2011), Mathur (2009), and Hay and Sudarshan (2010), revealed that resource constraints are one of the key challenges for South Asian think tanks, undermining their ability to influence policies. Nachiappan et al. (2010), studying think tanks in East and Southeast Asia, focused on the political nature of think tanks' work and noted that if donors expect think tanks to effectively contribute to policy, they should also be aware of the politics underpinning their existence. Sobhan (2000) observed that as Bangladeshi think



tanks became dependent on donors, they surrendered control of their research agenda to donor wishes. Mujeri (2009), exploring the research-policy links in macro-economic policymaking in Bangladesh, noted that a common feature of donor-funded efforts in public and private research institutions is the lack of sustainability. Mujeri cited examples in which donor-funded tools were developed to serve a specific purpose, often with the support of expatriate and domestic consultants hired from outside of the institution. In the absence of in-house capacity building, the tools became redundant to the normal work of the institution upon the conclusion of a project.

Other literature has reflected on donors' focus on results. Garrett and Islam (1998) noted that donors and clients want to know whether the research they fund makes any difference to not only public policy choices but also people's lives. Thus, donors are looking for demonstrable impact in thematic areas such as poverty, food insecurity, malnutrition, and environmental sustainability through policy influence. Crespin (2006, 439) noted that in many donor agencies, the search for efficiency creates incentives towards working for results on specific indicators at the expense of processes that actually deliver on the ground. Donors seek to support initiatives that ensure delivery of fast, concrete, and visible results.

Some perspectives on donor funding modalities to think tank research emerged from literature. Nair and Menon (2002) and Pronk (2009) reflected on funding models adopted by the Dutch Ministry of Foreign Affairs (DGIS) in 1992 through the "Multi-annual Multidisciplinary Research Programmes (MMRPs)." These MMRPs, carried out in nine Southern countries, emphasised adoption of research and analytical parameters based on local experiences and expertise. "Guidelines for Research in Partnership with Developing Countries" developed by the Swiss Commission for Research Partnership with Developing Countries [KFPE] (1998) reflected key principles of funding research organisations in the South, such as providing long-term trans-disciplinary collaborative research support, equal representation, a focus on methods rather than results of the research, and ensuring that research is visible and palpable for the local community. Some perspectives also emerged from two ongoing multi-country initiatives that support institutional strengthening of think tanks. These are the Think Tank Initiative<sup>17</sup> (TTI) of IDRC Canada, which provides core funding to 49 think tanks in 22 developing countries in Africa, Latin America, and South Asia, and the Think Tank Fund<sup>18</sup> (TTF), which supports independent policy

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<sup>17</sup>[http://www.idrc.ca/EN/Programs/Social and Economic Policy/Think Tank Initiative/Pages/default.aspx](http://www.idrc.ca/EN/Programs/Social%20and%20Economic%20Policy/Think%20Tank%20Initiative/Pages/default.aspx)

<sup>18</sup><http://www.opensocietyfoundations.org/about/programs/think-tank-fund>

centres in around 20 countries across Europe and the South Caucasus.

Against this backdrop, the key research questions of this study are:

- What are the key attributes sought by donors in think tanks and what are the donor preferences in terms of funding modality?
- What are the think tanks' perspectives on donors' expectations and funding modality?
- To what extent do donor and think tank perspectives converge or diverge, and what are the implications, particularly, of the divergences?

Since the notion of “key attributes” can be quite broad and fluid, the study mainly focuses on three dimensions: think tanks' research quality, organisational development, and policy linkages. In terms of funding modality, the study mainly looks at project-based funding (funding received to undertake a defined programme of research) and core funding (funding allocated as part of the budget for support of general research and other organisational activities).

### **Methodology**

Some of the initial ideas and research questions of this study were developed through a review of literature. However, substantively, this study is based on primary data, collected through key informant interviews conducted with representatives of five donors and five think tanks in Bangladesh. In selecting the donors, the main criterion was that the donor has collaborated and funded multiple Bangladeshi think tanks in the past five years. The study also aimed for a mixture of different sizes and types of donors. Based on their average annual development aid to Bangladesh, two of the five donors can be termed large, one medium, and two small. All the donors (four bilateral and one multilateral) are members of the OECD Development Assistance Committee (DAC). The donor representatives interviewed were senior management staff. The think tanks studied for this paper varied significantly not only in terms of size, age, and research focus, but also in terms of ideological orientation. All of the respondents were Executive Directors of think tanks.

The interviews lasted for about an hour on average. All of the interviews were recorded and transcribed. The data was organised by topic and by groups (donors and think tanks) to look across all respondents and their answers in order to identify consistencies and differences. Connections and relationships between the topics were explored and information was then identified and categorised into different themes. While some of the themes were pre-set, other themes emerged from the data. Finally, the data were interpreted to extrapolate the key findings. The identity of the respondents and the organisations are purposefully kept anonymous.

Statistics on flows of funds, disaggregated by donors and think tanks, would have been useful for this analysis. However, such data proved to be extremely difficult to obtain. Another challenge for this study is the scarce literature on the topic of donor funding to think tanks in Southern countries. Particularly, the number of studies focusing on Bangladeshi think tanks is extremely limited. While the literature provides some important insights, these do not directly relate to the topic of this paper. Hence, this study is exploratory in nature and raises as many questions as it tries to answer.

### **Major findings**

The views and perspectives of the donors and think tanks are categorised into six thematic areas: 1) contextual factors affecting donor-think tank engagements, 2) the results-focus, 3) research quality and research topics, 4) policy linkages, 5) organisational performance, and 6) funding modality. These themes are often closely interrelated and the insights shared by the respondents percolate across multiple themes. Therefore, even though the findings are presented in thematic sections, strict boundaries cannot be drawn between them.

#### *Contextual Factors Affecting Donor-Think Tank Engagements*

Donors demonstrated a very deep and insightful appreciation of the role of think tanks in a developing country like Bangladesh, particularly their role in producing knowledge. One respondent noted: "In a context where information can be scarce, think tanks are one of the main sources of knowledge and evidence-based analysis, be it in the form of a presentation, a published report, or a policy brief." Donor respondents stated that they themselves use this information and pay very close attention to think tanks' research and dissemination activities. Respondents noted that they maintain relations with the wider think tank community, even when they are not funding them.

The donors demonstrated a keen awareness of and insight on the different political dynamics that underpin think tanks' work. These include any perceived political orientation of the think tank or its leadership, and an understanding of sensitivities related to issues on which the think tanks are working. In other words, donors displayed a nuanced understanding of the different "positions" the think tanks are holding. Respondents noted that the some of the think tanks already have, or gradually develop, an inclination to one political ideology, or government, and this becomes evident when some think tanks turn out to be more active during one regime than the other. Donors generally do not want to be perceived as supporting a particular think tank or a figurehead of a think tank which can potentially be deemed partisan. Thus, the contextual factors, and in particular, the contentious nature of the political milieu influences the funding choices of the donors.

Aside from the funding considerations, the donors demonstrated awareness of the general conditions and constraints under which think tanks function. Respondents noted that think tanks in Bangladesh lack operational space to function effectively. Respondents remarked that think tanks are constantly balancing what topic they can research (and what topics they cannot), what kinds of meetings can be organised, and who can be invited.

Responses from think tanks closely echoed the insights shared by donors. Think tank Executive Directors highlighted the challenges they faced in making a compelling case for the credibility and relevance of their research, and for influencing policymakers. Furthermore, respondents noted that too often their recommendations are viewed through a prism of politics: political polarisation makes it difficult for the think tanks to have influence, because research findings are interpreted through a partisan lens. One respondent noted: "The government sometimes doesn't like knowledge because finding information and facts can be dangerous, if it turns out to be implicating the government itself." Respondents noted that a big challenge for think tanks and other research organisations is the general lack of appreciation for and confidence in the political leadership, media, and general public in terms of knowledge and research. Respondents underscored the critical importance of changing the mind-set of the government and bureaucracy.

The perspectives of donors and think tanks on contextual challenges are very similar, but this does have two important implications. First, reflections shared by donors seemed to indicate that they placed a special emphasis on assessing the political climate and the contextual sensitivities when funding think tanks. This is because of the closeness of the think tanks' policy-oriented activities to the political processes. While it is normal for donors to consider the contextual factors for funding any type of organisation, the funding agencies seemed particularly wary of the political implications of their support to think tanks, because of the nature of think tanks' work and the bearing it may have on the political debates. Donors' circumspect approach inevitably affects the funding levels and the choice of research topics.

Second, the responses suggest that due to the political nature of think tanks' work, donors are more inclined to have short-term, project-based, often one-off engagements with think tanks that provide them the leeway to be flexible in making and altering decisions about supporting think tanks. Three of the five donors stated that they provided core support to think tanks previously but currently no core funds are provided. This is possibly reflective of the increasingly intolerant, divisive, and confrontational nature of the political environment prevailing in Bangladesh.

### *The results focus*

The study demonstrates that while the donors have a keen understanding of political and contextual challenges encountered by think tanks, they also seek to showcase concrete results. Donor agencies have various levels and dimensions of accountability to their own governance structure and procedures, as well as taxpayers, politicians, civil servants, and other domestic constituencies. The accountability features also vary significantly because of the heterogeneity of the donors. Findings suggest that such pressures lead donors to seek more accountable results from their funding of think tanks. The defining elements of “results” vary depending on various factors, such as the type of donors and think tanks involved, the nature of collaboration, research topics, and timeframe.

Donors displayed different levels of expectations in terms of policy influence. One respondent underscored think tanks’ role in “supporting” the policymaking process, not necessarily “influencing” it. Another respondent noted that think tanks must complement the policy making processes, and raise the voice of the unheard. However, overall, all respondents acknowledged that the ideal role of think tanks – influencing policy making – is not always possible. One respondent noted that think tanks “ought to be close to the policymakers but they also should keep a certain distance to maintain independence.” Closeness of the think tanks to the government, in more cases than not, determines how influential they are. However, as previously noted, donors also seem to dislike being labelled as supporting any particular ideology or agenda.

The donors placed stronger emphasis on the consensus building function of the think tanks rather than the policy influence function. Respondents stated that they want to ensure that different views and perspectives are heard and taken into account, whatever the topic. From a donor perspective, it seemed critical that the policy recommendations and advice from think tanks be “balanced.” Thus, a key attribute sought by donors in think tanks is the ability to advance dialogues to bring about consensus and thereby enhance the likelihood of government adopting research-based policies. The emphasis is on playing a facilitative role – being independent, inclusive, and plural.

Having said this, some donor respondents raised concerns regarding the usefulness of research in a broader sense. Even if research is not directly influencing policies or building consensus, the research findings ought to be put to use in building policy capacity, informing discussions, forming the basis for future research, fostering knowledge-sharing, and creating regional or international networks. One donor respondent noted: “Too often, research is done just for the sake of doing research as a routine activity and there is an

obvious discrepancy between the number of research organisations coming up and the number (sic) of research put to use." Donor respondents seemed to be less likely to support think tanks with a purely academic focus, with little or no leverage over practical policy discussions that are unconnected to reality and politics.

Some donor respondents considered reputational gains as a desired outcome when funding a think tank. The value-added for donors is often the association with leading think tanks or a critical piece of research that addresses a policy problem in a timely and credible manner.

Respondents from think tanks expressed that the results-perspectives of the donors are often too short-term. Think tank executives noted that the donors typically want to see their supported research to have an influence on current policy discussions. Often the donors are reacting to isolated events or responding to something that is happening on the ground. While think tanks would like to study trends over several years in order to understand an issue, donors are generally not inclined to provide funding to research stretching over several years. One respondent stated: "Issues like poverty alleviation or terrorism require close monitoring and analysis over time but the donors are not always interested in long term engagement. The consequence of this is that we end up dealing with hypothetical trends." Respondents noted that because of this, donors do not maximise their return on investment and sometimes waste their resources. As studies are not followed up and continued, it becomes difficult to connect with and build upon previous pieces of research. Research is done in isolation, and issues are not connected to each other. "In project based collaboration, it is easier to establish indicators of short-term results, but on many occasions these indicators are superficial and have no strategic implications," one respondent noted.

The donor perspectives on short-term deliverable results are not shared by the think tanks. The divergences help explain two discernible trends. First, as the donors view that only few think tanks are maintaining acceptable standards of quality and performance, they tend to repeatedly support the same small set of "safe-bet" institutions that have retained a reputation of being competent, credible, visible, active, and well perceived by other donors, and who can deliver the "results." During anecdotal exchanges with donors, the name of the same think tanks kept reappearing. In fact, all five donors interviewed stated that they had supported one particular think tank more than once within the past five years. An insight shared by a donor respondent was that the donor has supported "the same think tank to accomplish very similar type of work over several years." Another respondent noted that donors are typically risk-averse, and are sometimes unwilling to take on a potentially relevant and innovative

project, if they are unsure about the credibility of the think tank or if they do not have any prior experience working with the institution. The reputational risks for donors when working with think tanks are high, because think tanks are trying to engage with the top echelons of political and policy-making circles. Second, donors end up supporting projects with a “reliable” institution even when that organisation does not have expertise in the issue area. In such cases, think tanks are forced to hire short-term external consultants to complete the projects or carry out the research. The core research areas of the think tank are gradually diffused. As one think tank executive noted: “Donors seem to like partners who have good reputation, accounting, and track-record of providing audited reports on time, rather than institutions that have substantive work and are challenging the status quo but don’t have anything to show for their efforts.” This trend of funding the same institutions in a cyclical manner leaves other think tanks constantly searching for projects and other scarce funding opportunities.

*Research quality and research topics*

Research quality is a critical issue for donors. All donor respondents stated that when they fund think tanks, they want a high quality of research maintained. Research quality will often be assessed using criteria such as quality of publications, presentations, and recommendations of the research findings. Respondents noted that in a project-funding scenario, assessment of the research quality is often easier since the terms of reference of the research are already agreed upon, and there are opportunities for close monitoring of research progress. Donors deemed incorporating reliable research approaches and methodologies important.

However, donors appeared to be less concerned about organisations’ core research competencies and continuity of research over time. One respondent noted that it is assumed that a think tank would not undertake research that does not fit within its long-term agenda. So when a donor is approached by a think tank, the donor tends to assume that this initiative is part of the think tank’s long-term goals and research agenda.

The think tanks’ Executive Directors noted that maintaining research quality is of critical importance for their survival and they are pleased to be evaluated on the quality of research publications, presentation of findings, and recommendations. Think tank respondents noted that while donors rightly emphasise quality of research, they also have a razor-sharp focus on specific themes and topics in which they are interested. The topic of research and proposed activities are rarely developed or decided on a bilateral basis.

A conclusion from this is that the perspectives of donors and think tanks do not

always converge in terms of research topic selection. The implication is that think tanks gradually refocus and reorient their research topic to suit the requirements of the potential donors. As the study has shown, the think tanks are more frequently approaching the donors with their “own” ideas and proposals for research. However, the ideas are often “revised” or “tweaked” to stimulate potential donor’s interest. Over time, some think tanks become experts in choosing topics and research areas that the donors are or may potentially be interested in. However, these topics may not always be core research areas for the think tank. Thus these institutions end up having little focus, and sometimes take on research that does not always have practical policy relevance. One think tank Executive Director stated: “Some think tanks are very good at picking issues that they can ‘sell’ to donors. With all-subject specialisation, and diffusion of core research focus, these organisations gradually become redundant.”

### *Policy linkages*

The importance of policy linkages seemed to vary depending on the size of the donors (categorised by annual aid figures to Bangladesh). Larger donors placed more emphasis on this than smaller donors. Policy linkages, here, refer to the think tanks’ efforts to engage with policy communities in an organisational context and must be distinguished from broader issues of policy influence discussed earlier. Policy linkages can be assessed in terms of type and extent of dissemination, meetings, and consultations with policy actors and other stakeholders, contacts with government officials, and media outreach. One large donor noted that in some instances, visibility and media coverage are one of the most important results sought. Visibility is often easier to obtain with project-based support, as the direct association of the donor to a piece of research or advocacy can be easily highlighted and communicated. Another donor noted that they are less concerned about the number of dialogues or contacts. Rather, the focus is on what policy-relevant information emerges from these consultations, contacts, and communications and to what extent stakeholders, such as other researchers, think tanks, media, and strategic partners are engaged.

Think tank respondents echoed many of the donor perspectives of policy linkages. Respondents noted that the organisations’ efforts to establish dialogue and linkages with policy stakeholders are important components of policy influence efforts. However, some think tank respondents noted that the language of the research could have important implications. They stated that donors invariably want the research to be conducted in English and rarely support research in the local language, Bengali. Respondents noted that research, dissemination, and advocacy in Bengali might have a better chance of influencing policy discourses.



The donor opinions in terms of strategies of policy linkages align with think tank respondents. However, think tanks emphasise the advantages of using the local language for research and dissemination activities; such use facilitates engagement at all levels from policymakers, practitioners to beneficiaries.

#### *Organisational performance*

Donor respondents displayed little interest in aspects of organisational development or performance. Respondents ranked organisational development as the least important attribute of the think tanks they are funding, in comparison with research quality and policy linkages. Organisational performance includes a number of issues such as recruitment and retention of staff, financial management, infrastructure, and improvements in funding situation. Respondents stated that governance can be an area of interest in some cases. When undertaking specific projects, donors are typically confined to assessing the terms of reference of research, and the profile of the assigned researcher. Respondents noted that they rarely go into a detailed assessment of overall standards of organisational practices or the qualifications of personnel. Donor respondents displayed a short-term perspective and ambivalence vis-à-vis questions about financial stability and sustainability of the think tanks.

In contrast to donors' observations, think tank respondents considered organisational performance an important aspect for their respective organisations. Respondents stated that in a typical project funding scenario, donors are rarely concerned with organisational aspects that can have far-reaching implications for think tanks. The development of human resources or capacity building is hampered as projects typically lack allocations for such activities. Think tanks often overextend their human resources across too many projects. Staff members are hired on a project basis and leave the organisations once a project ends.

These divergent views suggest that there is a mismatch between donors' short term perspective and think tanks' long term concerns of organisational sustainability. It must be stressed, however, that in project funding scenario, there is limited scope for incorporating organisational development issues. However, from the think tanks' perspective, it was apparent that the incorporation of elements of organisational development, even if on a small scale, could aid the organisation significantly in the long-term.

#### *Donor dependency and funding modality*

Issues of financial dependency and funding modality are closely tied to different perspectives discussed earlier, thus this section refers frequently to the previous findings.

The donors interviewed did not appear to have any special programmatic or strategic focus on supporting think tanks. Typically the funding to think tanks is made as a small grant covering time periods ranging from a few months to a year. Multi-annual engagements are less common. Donors acknowledged that decisions to fund think tanks are often made on a rather *ad hoc* basis.

In the course of the discussions with the donors, a clear and strong preference for project funding over core funding emerged. Respondents noted that with core, multi-annual funding, it is difficult to observe the results in the short-term. It can be clear in some instances (e.g. more people hired), but typically donors seek results in terms of other thematic indicators such as poverty reduction, improved healthcare, and higher education rates. Furthermore, not all topics that the think tanks are researching are relevant for donors and therefore providing core funding would not make sense. Thus it is more common for donors to select the specific research programme and activities that are relevant to their country priorities.

Respondents remarked that it is easier to manage and monitor project funding because shared objectives are established at the outset. Core funding support requires more substantive and sometimes strategic involvement and guidance of the donor.

Respondents noted that core funding can make the think tank overly dependent on one or two donors and thus financially vulnerable. Unpredictability and variability of funding can pose a risk to think tanks. Respondents also opined that project funding allows think tanks to work on different issues/areas, independent of other donors that are giving core funding. Project funding can facilitate new contacts and expand networks, respondents noted.

The perspectives of the think tanks were completely different in terms of preference of funding modality. While project collaborations can be fruitful, think tanks would prefer to have longer term collaboration and core funds, which can be used to help build stronger institutions.

Think tank respondents noted that there is an over-reliance on donor funding and the corollary to that is the inevitable fluctuation in the flows of funds. The study revealed that over 90 percent of funding of the five think tanks interviewed came from international donors. Review of financial statements of think tanks showed a high degree of fluctuation in the expenditure of think tanks from year to year. The fluctuations ranged from a 30 percent decrease to 130 percent increase year to year. Since 90 percent of the funds are provided by donors, this fluctuation can be attributed to variations in donor funding levels.

Four out of the five think tanks studied previously received or are currently receiving core funding.

Think tank Executive Directors noted that the nature of project-based collaboration leaves little room for experimentation and innovation. Think tanks are sometimes boxed in isolated research projects, which is detrimental to the generation of new research ideas. Respondents asserted that think tanks survive on the ability to think independently and creatively. As they perceive that some of the donors are more interested in deliverables and “box ticking” exercises, think tanks are discouraged from thinking. Respondents noted that there are risks of think tanks gradually functioning like a bureaucracy, instead of being mentally agile and creative.

Respondents stated that with project based funding, think tanks lose the ability and agility to react to policy windows. The nature of policy formulation processes in Bangladesh is often fragmented and irregular. Policies are made on an *ad hoc* basis and there is no clear policy formulation cycle. In many instances, policy formulation inputs are irrelevant. However, when policy windows open and opportunities arise, think tanks must act swiftly to take advantage. If project-supported initiatives start and end in the specified time, then think tanks cannot take advantage of such policy opportunities so easily. Respondents stated that with core funding think tanks can be agile in taking up issues and undertake research or other advocacy activities swiftly in order to access windows of opportunities.

With project-based collaboration, think tanks can sometimes lose credibility among stakeholders in the policy community. Think tank respondents noted that in project-based collaboration, they must highlight the support of the donor(s) funding the particular project. Particularly, in dissemination and advocacy activities, research pieces are tagged with the donor’s name. This can sometimes result in undermining the credibility of research among policy makers, media, and other stakeholders who may perceive, sometimes wrongly, that the research in question is entirely donor-driven and fulfilling a donor agenda. Respondents noted that with core support, the particular pieces of research are not associated with any donors, which bolster the credibility of the research initiatives and possibly have higher chances of making an influence on the policy discourse. Think tanks also noted that the dimension of accountability can be different in core funding. While think tanks are accountable for the core funds in an administrative sense, they are able to set their own priorities in undertaking research and other activities (instead of addressing donor priorities, as is the case with most project-funding scenario). One respondent noted: “With so many diverse donors and projects, sometimes the sense of accountability to the (national) government and the people we are

claiming to serve is diluted and undermined. With core support, this is less pertinent, because we are in the position to set our own agenda.”

The donor and think tank preferences on funding modality diverge significantly. There seems to be an association between the donor desire to demonstrate immediate results and their funding modality. From the donors' perspective the results they seek to showcase are effectively demonstrated with project based, short-term funding. Think tanks on the other hand deem that longer-term continued cooperation and core funds are more effective in enhancing research quality, organisational development, and policy linkages.

### **Conclusion**

This study has explored the donor and think tank perspectives vis-à-vis research quality, organisational development, policy linkages, and funding modality. Findings reveal that donor and think tank perspectives do not always align and each has different priorities, preferences, and expectations. While some divergences are expected, the extent of the divergences in several aspects is quite striking and has important implications. The donor preoccupation with seeing results and outcomes related to their respective thematic focus areas drives their short term project-based engagements with think tanks. The study shows that the donor agencies tend to collaborate with a small sub-set of think tanks that can deliver results in terms of conducting credible and independent research, complementing policy dialogues, building consensus, and enhancing visibility. The think tanks, on the other hand, prefer more long-term sustained research partnerships and core funding so that they are able to set their own priorities, maintain a long-term research focus, be in a position to be innovative and accountable, and influence policy processes.

These trends raise important development policy questions about the optimal utilisation of resources for research organisations. Notwithstanding the fact that donors are a heterogeneous set of institutions, who often function under stringent policies and priorities and are under increasing pressure to show results from their own domestic constituencies (such as taxpayers and media), the agencies can possibly re-orient their funding modalities and collaborative mechanisms, resulting in better functioning and stronger think tanks.

While this study raises a number of concerns, it does not suggest that effective collaborations are not taking place. There is evidence of the important contributions of donor agencies in building research capacities and supporting think tanks. Nevertheless, the following reflections emerge from the study that can contribute to establishing stronger collaborative mechanisms and enhance the efficacy of the think tank organisations.

- It is important that the donors adopt a balanced approach to supporting think tanks, combining short-term projects with longer term support and institutional strengthening. It is imperative that research initiatives that align with think tanks' core research foci are continued and followed up. There must be a deeper appreciation that some research topics and themes require longer-term engagement with the community or tracking of socio-economic indicators over time. Other issues require years of advocacy to be incorporated into the political agenda. Longer-term support will, more often than not, deliver the results that the donors seek, in terms of producing credible research that can influence policies. At the same time, think tanks should strive to maintain focus on core areas of research in order to build specialisation that will result in having a stronger stake in the policy debates.
- Promote partnership mechanisms that result in ownership of research topics by the think tanks and sustainability of research capacities. Special attention to these aspects should be given during the design phase of the research collaboration.
- Encourage institutional development of think tanks, even within a project-based collaboration. Capacity building of young researchers, as well as other functionaries in financial management, communication, and others, can be incorporated where relevant. Donors are sometimes well-placed to create networks and collaborative platforms at national and regional level that foster greater exchanges, sharing of ideas, and best practices. Think tanks themselves can collaborate and form strategic partnerships with other think tanks within the country. Indeed, perspectives shared by think tank Executive Directors seemed to indicate that such collaborations at national level rarely take place.
- Support initiatives that contribute to bolstering the confidence of the political leadership, attentive public, and media in knowledge and knowledge-based societies. This is a long-term perspective, and often challenging to address. However, collaborations that can demonstrate successes in finding "local solutions to local problems," building capacities of young researchers, and using indigenous methods and local language can favourably influence the policy makers and media.

This study has demonstrated that donor and think tank perspectives are not always based on common ground and this has implications for the efficacy of think tank organisations. Yet, as Mbadlanyana et al. (2011) noted, think tanks are potentially one of the best-suited organisations with intellectual capacities to develop innovative and advanced solutions to complex challenges facing the global South. Therefore, whether it is international donors or domestic governments supporting think tanks, it is critical that processes for effective collaboration are set into motion, emphasising tackling common problems

together, motivating all the partners to cooperate actively, offering the best chance of synergic effects, and ensuring that all those involved, right up to the end-user, really benefit from the research activities.

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## MULTIVARIATE ANALYSIS OF THE ASEAN5 FINANCIAL MARKETS INTEGRATION

Eduardo Lucio<sup>19</sup>

*The paper investigates the progress of the bonds and equities markets integration in the economies of Indonesia, Malaysia, Philippines, Singapore, and Thailand. The research assesses the integration using a combination of Principal Components Analysis, Cluster Analysis, and DCC-GARCH model. The analysis show that the group's equities market integration is improving over time and is more integrated regionally than globally. Conversely, the bonds market integration remains weak both at the regional and global level. The paper also show that both for equities and bonds market, the region clusters based on the each country's degree of market development. The relatively less developed equities markets of Philippines, Indonesia, and Thailand have a greater similarity, while the markets of Singapore and Malaysia tend to cluster together. Meanwhile, the bonds markets of Singapore, Malaysia, and Thailand have greater similarities within each other than the bonds markets of Indonesia and Philippines.*

### Introduction

The integration of the ASEAN economies has been a popular discussion topic among policy makers in Asia in recent years. This has promoted much academic interest in both quantitative and qualitative research to analyse the regional financial market integration. Despite this, there still remain many research voids which focus on the integration of the relatively young financial markets of Philippines, Indonesia, Thailand, Malaysia, and Singapore (ASEAN5). By combining popular statistical techniques to assess financial integration with a set of quantitative tools not typically applied to time series data, the paper is able to extract underlying patterns from the interaction of the ASEAN5 financial markets and provides a new understanding on the integration dynamics between these five countries over time.

The paper will begin with a discussion of the motivation towards a regionally integrated financial market, followed by a review of the related studies. It will then proceed with the presentation of the methodologies employed and

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discussion of results. The paper will conclude with a summary and policy recommendation.

### **Background**

The Asian financial crisis in 1997-1998 gave the region a realisation for a greater need to have a deeper and stronger financial market. The region's small and underdeveloped equities and capital market was one of the major causes of the financial crisis (Bhattacharyay 2011). The limited domestic funding alternatives directed the Asian economies towards too much reliance on the banking sector, which eventually led to the financial sector fragility through the 'double mismatch' problem<sup>20</sup>. Since then, the Asian economies have attempted to expand and develop their local equities and bonds markets to answer the necessity for a more stable alternative funding source. One of the main strategies of the region to achieve this is to promote financial market integration.

While there is no standard definition of financial markets integration, existing literatures define a market as financially integrated if three basic market characteristics are present. A market is financially integrated if it is financially open, allows free cross-border capital movement, and financial services are integrated with other markets. The concept of financial integration has been commonly related to the 'law of one price' which holds that assets of the same risk and return profile should be priced similarly. In addition, when markets are integrated, securities can be freely traded in different markets, with participants facing a single set of rules, and all instruments and services are treated equally regardless of which country or region they come from. The degree of financial integration is determined by two common measures: price-based measure and quantity-based measure. Price-based measures relate to the concept of law of one price, which is reflected by higher price correlation among securities, while the quantity-based measure reflects the concept of free cross-border transaction (Pongsaparn and Unterberdoerster 2011).

Financial market integration offers many benefits. It promotes financial market development, and hence economic growth (Fung et al. 2008), more efficient investment allocation, broader opportunity for risk diversification, and more stable financial market frameworks (Pauer 2005). However, these benefits do not come without any costs. With greater financial market linkages, an economy becomes more vulnerable to higher contagion risk.

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<sup>20</sup> 'Double mismatch' problem refers to the occurrence where the borrowing and use of fund does not match, both in terms of maturity and currency.

Policymakers in the ASEAN region established a roadmap for promoting monetary and financial integration towards a greater economic cooperation by 2015. This collaboration aims to harmonise and strengthen capital market, mobilise savings, and increase tolerance against external financial shocks (Park and Lee 2011). To achieve this objective, the ASEAN group focuses on improving key areas related to the capital market development, financial services liberalisation, better capital account mobility, and ASEAN currency cooperation. These principles guided the ASEAN group towards achieving major initiatives for financial integration. Since 1997, the group was able to establish the Chiang Mai Initiative (CMI), Asian Bond Market Initiative (ABMI), ASEAN+3 Research Group, ASEAN Capital Market Forum, among others.

### **Review of related studies**

A number of empirical studies have been undertaken to evaluate the costs and benefits of financial integration. A majority of the more recent studies in this field focus on the progress of the Asian region's financial integration.

After the Asian financial crisis, Demirguc-Kunt and Detragiache (1998) pointed out that there is strong evidence that countries with poorly developed financial markets are more vulnerable to financial crises. Meanwhile, Fung et al. (2008) measured the progress of financial integration in ten economies in the Asian region<sup>21</sup> through bonds and equities markets and found out that the degree of financial integration in the region remains limited. Similarly, Lee et al. (2011) employed both quantity-based and price-based measures to determine the degree of financial integration within the financial markets of ten Asian economies<sup>22</sup>. The result suggests that the degree of integration and financial openness in the region is increasing. Further, the equities markets in the region are more integrated globally than regionally, while the bonds market remains segmented in both areas.

The research of Garcia-Herrero et al. (2008) empirically analysed why Asian economies has greater integration globally than regionally. The study uses cross-border equity and bond holdings from 40 economies to understand this pattern. The findings reveal that market liquidity plays a crucial factor in explaining this occurrence. The inadequate liquidity in the Asian financial markets explains why Asian investors would rather invest outside the region than within the region. Furthermore, after comparing to other regions, the

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<sup>21</sup> The ten economies are China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan, and Thailand.

<sup>22</sup> The study uses the data of Hong Kong, India, Indonesia, South Korea, Malaysia, Philippines, Singapore, Taipei-China, and Thailand.

paper concluded that the importance of liquidity is peculiar to Asian investors.

### **Motivation and methodology**

This study looks at the regional financial integration through a different perspective. Although there have been a lot of papers published about the topic, most of these focuses on East Asian economies as a whole. Given the relatively small size of the ASEAN top five economies (Philippines, Indonesia, Thailand, Malaysia, and Singapore) compared to Japan, Korea, and China, the former is often overlooked. The ASEAN top five (ASEAN5) economies spearheaded the forming of the ASEAN group in 1967 through the ASEAN Declaration, and yet very few studies have focused on how these pioneer countries are performing in terms of financial markets integration. Hence, this research uses multivariate and time series techniques to analyse the performance of the ASEAN5 economies in terms of financial integration.

The Principal Components Analysis (PCA), correlation analysis, Dynamic Conditional Correlation – Generalized Auto Regressive Conditional Heteroskedasticity (DCC-GARCH), and cluster analysis were employed to create an insightful study on how countries within the region interact from over time. The main motivation of the research is to extract patterns from the equities and bonds markets of ASEAN5 and understand how the dynamics on the five countries in the region converge over time. With these procedures, the paper identifies which among the ASEAN5 countries developed most similarly and which countries lag behind the financial integration.

The paper uses various ASEAN5's equities and bonds market indicators from different data sources. The equities and bonds market indices were sourced from Bloomberg. Meanwhile, the equities and bonds market development statistics were downloaded from the World Bank's World Development Index and AsianBondsOnline, respectively. For simplicity, the details of each analysis and sample period used will be discussed prior to the presentation of results for each procedure. The analysis will start with the PCA, followed by the rolling correlation analysis and the DCC-GARCH. Lastly, the paper will present the cluster analysis.

### **Discussion of results**

#### *Principal components analysis*

The PCA method was applied to the time series of ASEAN5's equity and bonds markets. The PCA aims to reduce the dimensionality of the dataset in which there is a large number of interrelated variables. The procedure identifies a set of principal components (PCs), which are linear combinations of the original set of variables, while retaining as much variation present from the original dataset. The new set of PCs is characterised by two properties. First, each PC is

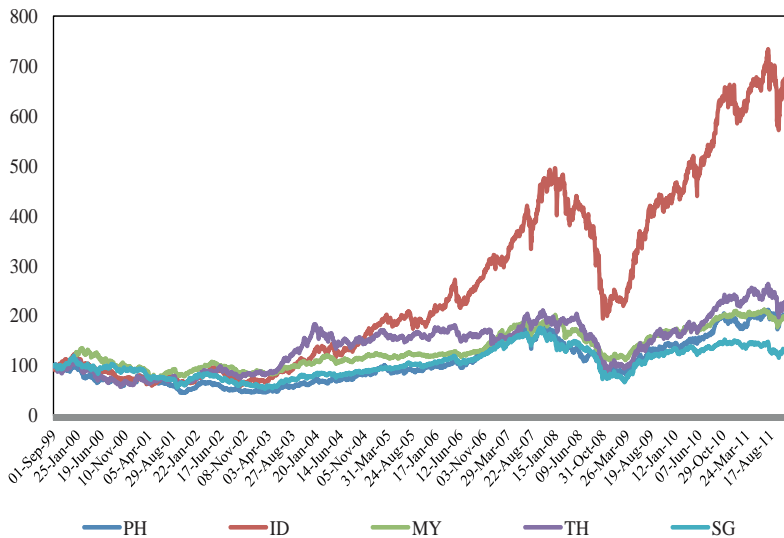
uncorrelated, and second, the PCs are arranged according to how much variation they possess (Sharma, 1996). The PCA from standardised variables was applied to the original time series to construct equity and bonds indices for the ASEAN Top 5 economies. This procedure was used to analyse the degree of interrelatedness of the region's time series.

Lansangan and Barrios (2007) studied the effect of applying PCA to non-stationary time series dataset and how to attain sparse loadings by using the sparse principal components algorithm developed by Zou et al. (2004). The study shows that applying the PCA methodology to non-stationary time series is valid and can effectively summarise the interrelatedness of the variables. However, it does not help in reducing the dimensionality of the dataset. Since the aim of the paper is to understand the degree of interrelatedness of the variables, attaining sparse loadings is not the main priority. The PCA analysis first presents the derived indices for both markets and then a discussion of results for comparison in both markets follows.

#### *Equity markets: principal components analysis*

The analysis uses the daily price indices from September 1, 1999 to November 30, 2011 of Philippine Stock Exchange Index for the Philippines, Jakarta Stock Exchange Composite Index for Indonesia, FTSE Bursa Malaysia KLCI Index for Malaysia, Stock Exchange of Thailand Index for Thailand, and the FTSE Straits Times Index for Singapore.

Figure 1: ASEAN5 Daily Stock Market Index



inferred from the plot that there are strong similarities in the movement of stock indices from the ASEAN5 countries. To provide a quantitative description of this co-movement, we resort to employing the PCA technique.

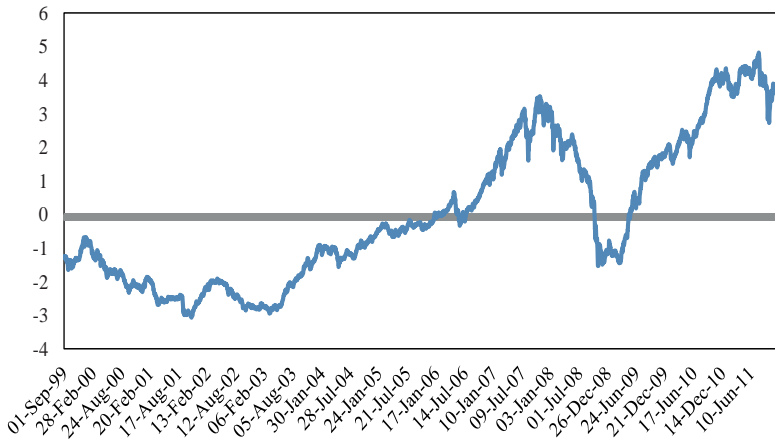
**Table 1: Equities Market: Principal Components Analysis**

Loadings (Variables):	PC 1	PC 2	PC 3	PC 4	PC 5
Philippines	0.460	0.142	0.230	-0.674	-0.511
Indonesia	0.453	0.165	0.586		0.651
Malaysia	0.460		0.192	0.737	-0.448
Thailand	0.428	0.726	0.536		
Singapore	0.434	0.646	0.529		0.338
Importance of components:	PC 1	PC 2	PC 3	PC 4	PC 5
Standard deviation	2.140	0.478	0.372	0.181	0.123
Proportion of Variance	0.920	0.046	0.028	0.007	0.003
Cumulative Proportion	0.920	0.963	0.990	0.997	1.000

Source: Author's computation

The result of the PCA on the ASEAN5's equity market indices is summarised in Table 1. We see from the table that the first PC holds the substantial portion of the ASEAN5's equity market variability. Approximately 92 percent of the original dataset's variability was contained in the first PC. Meanwhile, the remaining eight percent of variability was accounted for by the remaining four PCs. By closely analysing the loadings of the each PC, it can be inferred that the each loading has the same direction (sign) and almost equal weights to each country's equity market index. Hence, the first PC can be easily interpreted as the ASEAN5 Equity Index. On the other hand, the interpretability of the remaining PCs is not straightforward. Because of the ease of interpretation and the substantial variation that the first PC holds, we retain the first PC for the rest of the analysis in this paper. The time-series plot of the ASEAN5 Equity Index (first PC) is shown in Figure 2.

Figure 2: ASEAN5 Equity Index

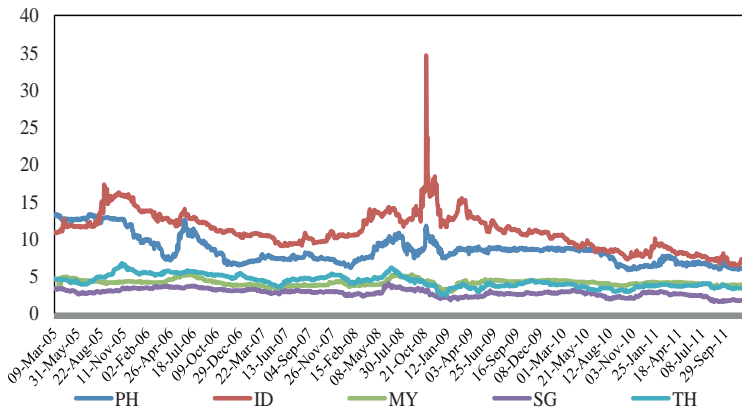


Source: Author's computation

#### *Bonds market: principal components analysis*

We perform a similar analysis for the ASEAN5 Bonds Market Yield Index and compare the results from the one we obtained for the equities market. For the bonds market analysis, we use the daily 10-year bond yield index beginning March 19, 2003 to November 30, 2011 from each country.

Figure 3: ASEAN5 10-Year Bond Yield Index



Source: Bloomberg

The plot of the bond yield data in Figure 3 suggests that the co-movement of yields in the bonds market is not as apparent compared to the equities market. To measure the degree of interrelatedness of the variables, we perform the PCA on the dataset and describe how the time series are interrelated.

**Table 2: Bonds market: principal components analysis**

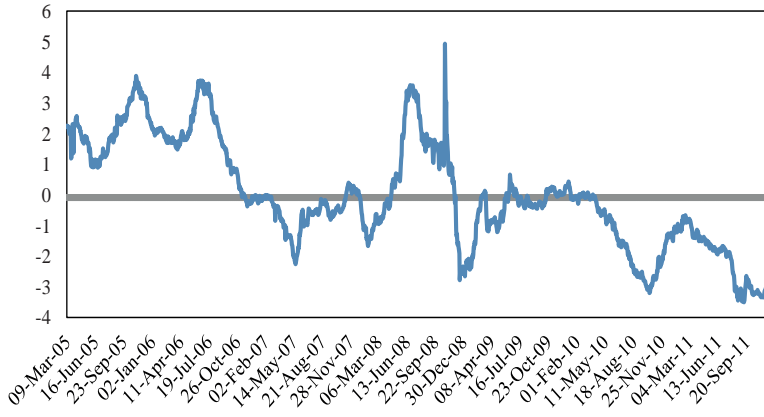
Loadings:	PC 1	PC 2	PC 3	PC 4	PC 5
Philippines	0.442	0.573	0.105	-0.682	
Indonesia	0.432	0.483	0.444	0.618	
Malaysia	0.402		0.826	0.349	0.181
Thailand	0.469	0.465	0.323	-0.167	0.657
Singapore	0.486	0.471			-0.73
Importance of components:	PC 1	PC 2	PC 3	PC 4	PC 5
Standard deviation	1.75	0.89	0.82	0.54	0.42
Proportion of Variance	0.61	0.16	0.14	0.06	0.04
Cumulative Proportion	0.61	0.77	0.91	0.96	1

Source: Author's computation

The result of the PCA in the bonds market dataset show weaker aggregation of variability compared to the equities market. The first PC summarised only 61 percent of the original dataset's variability, while the second and third principal components contain 16 and 14 percent of the variability, respectively. The remaining 10 percent is contained in the fourth and fifth PCs.

Similar to the equity market analysis, the first principal component can be easily interpreted as the Bonds Market Yield Index. The first PC shows the same direction and almost equal weights to each country's bond market. Meanwhile, the second PC can be interpreted as an index showing a contrast between the bond yields of countries with higher average yield and yield volatility, and countries with lower average yield and yield volatility. The first group contain Indonesia and the Philippines, while the second group contain Thailand and Singapore. On the other hand, while Malaysia is not included in the second PC, the third PC separately describes the yield of Malaysia (Table 2). The time-series plot of the ASEAN5 Bonds Index is shown in Figure 4.

Figure 4: ASEAN5 Bonds Index



Source: Author's computation

Comparing the results of the PCA on the dataset of ASEAN5's equities and bonds markets, we see that the ASEAN5 countries have higher degree of interrelatedness in the equities market. In addition, the result of the loadings in both markets suggests that the bonds market is more segmented than the equities market. For equities market, the first PC summarises almost the entire variability of the original dataset. Meanwhile, for the bonds market, the loading of the first, second, and third PCs partitions the region into 3 groups. The first index describes the weighted average of the bond yield for the whole region, while the second and third index describes the groupings of Indonesia and Philippines, Thailand and Singapore, and Malaysia.

#### *Rolling correlation analysis*

In the previous section, the paper presents the descriptive comparison of the degree of interrelatedness of the equity and bonds markets. To identify which country in the ASEAN5 has the highest/least correlation to the region, we compute for the price correlation for each market. The research subdivided the entire sample period into smaller sub-periods to reflect the changes in the degree of correlation over time. The index derived from the PCA method is used to measure how the region's correlation with the world index is changing.

#### *Equities index: rolling correlation*

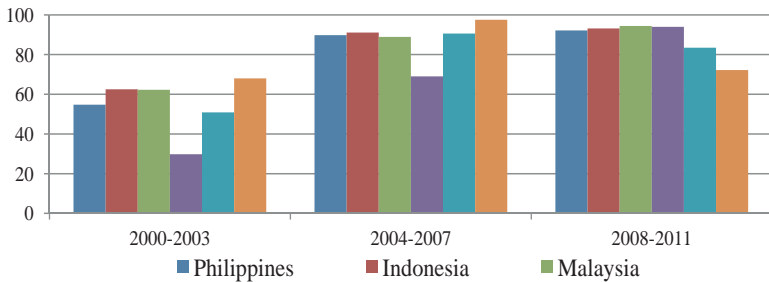
A simple correlation was computed on a 4-year rolling window from January 2000 to November 2011 for the equities market index of the ASEAN5. The purpose of this analysis is to determine the degree of the co-movement of each



market to the rest of the ASEAN5 equities markets. In addition, we use the ASEAN5 Equity Index computed from the previous section to measure the changing degree of correlation of the region with the world. The analysis uses the FTSE All World Index from Bloomberg as the world equity index.

Figure 5 below summarizes the average correlation of each ASEAN5 for periods 2000 to 2003, 2004 to 2007, and 2008 to November 2011<sup>23</sup>. The chart shows the general increase on the average correlation of the indices from January 2000 to November 2011 for the whole region. The Philippines, Indonesia, Malaysia, and Thailand all had an improvement in the level of correlation within the region for the entire sample period. In contrast, Singapore's average correlation with the other ASEAN5 countries and the ASEAN5 Index' correlation to the World Index both declined for the period 2008-2011 from the 2004-2007 sub-period. The similarity in the movement may imply that the Singapore's equities index may be more connected to the world than to the region.

Figure 5: Average Equities Index Correlation of Each Country to the Region



Source: Author's computation

#### *Bonds yield index: rolling correlation*

Moving on to the bonds market yield index, the analysis computed a simple correlation on a 2-year rolling window from March 2005 to November 2011. The sub-periods were identified as 2005 to 2006, 2007 to 2008, 2009 to 2010, and 2011<sup>24</sup>. Similar to the equities market, the ASEAN5 Bond Index from the PCA was used to measure the correlation of the ASEAN5 with the US. The US 10-year bond yield index from Bloomberg was used as a proxy to measure the bond yield outside of the region. Figure 6 shows that similar to the equities market, the bond market yields in the region are also growing at a steady pace<sup>25</sup>. However, for

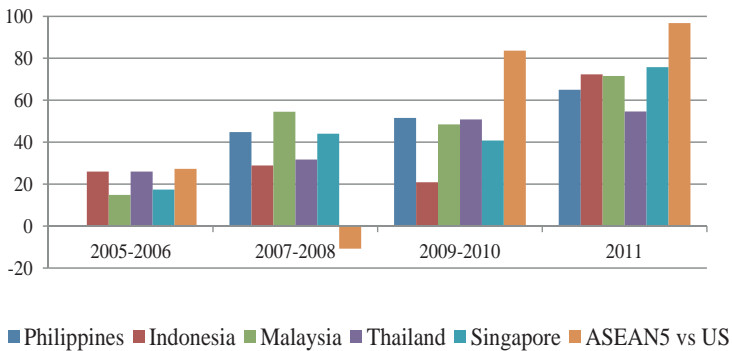
<sup>23</sup> See Appendix A for the computed correlation used in the chart.

<sup>24</sup> January to November 2011

<sup>25</sup> See Appendix A for a summary of the correlation used in the chart.

the entire sample period, the bonds market correlation is substantially weaker than that of the equities market. Furthermore, the result shows that while the equities market has higher co-movement within than outside of the region, the bonds market display the opposite. The ASEAN5 Bond Market Index shows higher average correlation with the US bond yield for almost all the periods except for the Global Financial Crisis of 2007 and 2008.

Figure 6: Average Bond Yield Correlation of Each Country to the Region



Source: Author's computation

For both the equities and bonds markets, the simple correlation analysis suggest no clear identification of which country in the ASEAN5 market has the most correlation regionally. However, the results support the differences in the ASEAN5's degree of integration in the equities and bonds market: the region's equities market index has higher correlation within the region than outside the region. In contrast, the bond market yield is more correlated to the US than to the region. The level of correlation within the bonds and equities markets supports the result of the PCA. The degree of correlation is consistently lower in the bonds market than in the equities market, hence, a weaker degree of interrelatedness in the former. Lastly, among the ASEAN5 countries, the equities market of Singapore shows a stronger interrelatedness to the world.

#### *Dynamic Conditional Correlation – General Autoregressive Conditional Heteroskedasticity (DCC-GARCH)*

The paper applies a DCC-GARCH model on equity prices and bond yields to measure how the price co-movement in the region is improving over time and identify which country is leading and lagging in the correlation. The DCC-GARCH procedure is a class of multivariate model proposed by Engle and Sheppard (2001) and Engle (2002). The procedure is designed to analyse the time-varying correlation among different asset types.

As a precursor to the analysis, the dataset has been pre-whitened by log-differencing each time-series. The unit-root test for the transformed equities and

bonds market time series suggest no evidence for a unit root. To measure the correlation of each country with the region and with the world, the section will follow a general outline. First, the research will attempt to build an ASEAN4 index on the log-differenced time series (i.e. four countries in the region less the country under measurement) using PCA. Second, this research will implement a DCC-GARCH model between the isolated country with the ASEAN4 index and with the World Equity Index.

*Equities market: DCC-GARCH analysis*

The summary of the dynamic correlation analysis in the equities market is shown in Figure 7 and Tables 3. The summary shows the average correlation of equity return for various sub-periods for ease of discussion. The analysis reveals that among the equities markets in the region, Singapore has the highest correlation with the region. This is closely followed by the equities market of Indonesia, Malaysia, and Thailand. Meanwhile, the Philippine equity market has consistently had the lowest correlation across the sample period. From 1999 to 2008, there had been a general increase in the degree of correlation of each country with the region. However, from 2009 to 2011, most of the correlation coefficient of the ASEAN5 countries have either stagnated or decreased. The growth rate of the equity index correlation of Indonesia with respect to the rest of the region is highest in the ASEAN5. Indonesia's average correlation coefficient grew by 84 percent to 0.65 in 2011 from 0.35 in 1999-2000. This is followed by Malaysia with 51 percent increase, Philippines and Singapore both with 32 percent, and lastly by Thailand with 24 percent.

Likewise, the correlation coefficient of each ASEAN5 equities market with respect to the World Index had been witnessing a similar upward trend, albeit at a weaker degree. The correlation coefficient of each country have gradually increased from 1999-2000 to 2007-2008. Also, the correlation coefficient of most equities market of the region with respect to the World Index have either fallen or remained at the same level after the 2008 Global Financial Crisis. Similar to the regional correlation, the Singapore equities market leads the four countries with 0.50 correlation coefficient for 2011. Meanwhile, the equities markets of Indonesia, Thailand, and Malaysia have almost the same level of correlation for 2011 with 0.37, 0.32, and 0.29, respectively. Lastly, the Philippines remained with the least correlation to the World Index with an average of 0.18 for 2011.

Figure 7: Equities Market - DCC GARCH Result

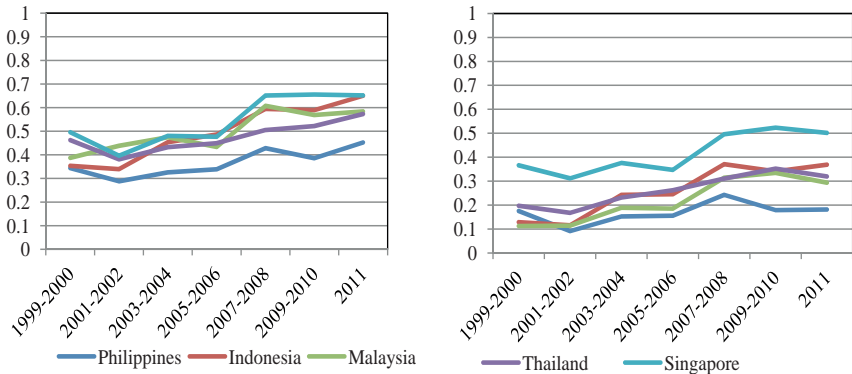


Table 3: Equities Market Dynamic Correlation

## Correlation to the Region

	1999-2000	2001-2002	2003-2004	2005-2006	2007-2008	2009-2010	2011
Singapore	0.50	0.40	0.48	0.48	0.65	0.66	0.65
Indonesia	0.35	0.34	0.45	0.49	0.59	0.59	0.65
Malaysia	0.39	0.44	0.47	0.43	0.61	0.57	0.58
Thailand	0.46	0.38	0.43	0.45	0.51	0.52	0.57
Philippines	0.34	0.29	0.33	0.34	0.43	0.39	0.45

## Correlation to the World

	1999-2000	2001-2002	2003-2004	2005-2006	2007-2008	2009-2010	2011
Singapore	0.37	0.31	0.38	0.35	0.50	0.52	0.50
Indonesia	0.13	0.12	0.24	0.25	0.37	0.34	0.37
Thailand	0.20	0.17	0.23	0.26	0.31	0.35	0.32
Malaysia	0.11	0.11	0.19	0.19	0.31	0.33	0.29
Philippines	0.18	0.09	0.15	0.16	0.24	0.18	0.18

Source: Author's computation

In a country by country comparison, Singapore almost always has the highest correlation with the other countries in the ASEAN5. Specifically, Singapore ranked first in terms of correlation with the equities markets of Indonesia, Malaysia, and Thailand. Meanwhile, Indonesia is the second most correlated with each of the country, followed by Malaysia and Thailand. Finally, the Philippines consistently had the least correlation with the rest of the countries in the ASEAN top 5. The summary of result is displayed in Table 4.

*Bonds Market: DCC-GARCH Analysis*

A similar procedure used in the equities market was followed for the bonds market dynamic correlation analysis. However, unlike in the equities market analysis, the PCA applied on the return series of the bonds market failed to aggregate and produce a suggestive regional bonds index. This supports the previous findings on the greater segmentation in the ASEAN5's bonds market compared to the equities market. Hence, the paper instead directly analyses the interaction of the bond market returns of the countries within the ASEAN5 and with the US bond market returns.

The result of the bonds market's dynamic correlation analysis is summarised in Table 5. The summary shows the rolling average dynamic correlation of each country with other countries and with the US. The result of the DCC model remains consistent. The ASEAN5's bonds market remains segmented as compared to the equities market. This is true both for returns correlation within and outside of the region (i.e. correlation with US).

Although all countries show a very weak pairwise correlation in the bonds market, the analysis suggest that from the sample period 2005 to 2011, some specific countries have higher degree of interrelatedness than with other countries. Specifically, the bonds markets of Singapore, Malaysia, and Thailand are more correlated within each other with an average correlation coefficient of 0.1. Meanwhile, bonds markets of Indonesia and the Philippines remain segmented with almost zero correlation coefficient. Lastly, the bonds market of Singapore has the relatively highest correlation with the US. The correlation of its bonds return with the US has consistently played within 0.19 to 0.20 from 2005 to 2011. The figures in Table 5 are sorted according to the degree of bilateral correlation of returns based on the 2011 average.

Table 4: Country by Country Equities Market Dynamic Correlation

	1999- 2000	2001- 2002	2003- 2004	2005- 2006	2007- 2008	2009- 2010	2011	Aver age
<b>Philippines to</b>								
Malaysia	0.263	0.249	0.275	0.269	0.422	0.375	0.404	0.322
Indonesia	0.213	0.243	0.275	0.294	0.364	0.335	0.399	0.303
Singapore	0.245	0.219	0.245	0.244	0.373	0.315	0.338	0.283
Thailand	0.284	0.181	0.224	0.251	0.281	0.28	0.354	0.265
	1999- 2000	2001- 2002	2003- 2004	2005- 2006	2007- 2008	2009- 2010	2011	Aver age
<b>Indonesia to</b>								
Singapore	0.357	0.302	0.4	0.439	0.545	0.541	0.551	0.448
Malaysia	0.251	0.29	0.363	0.33	0.471	0.438	0.474	0.374
Thailand	0.289	0.266	0.322	0.359	0.412	0.431	0.465	0.363
Philippines	0.213	0.243	0.275	0.294	0.364	0.335	0.399	0.303
	1999- 2000	2001- 2002	2003- 2004	2005- 2006	2007- 2008	2009- 2010	2011	Aver age
<b>Malaysia to</b>								

Singapore	0.35	0.358	0.401	0.375	0.534	0.499	0.498	0.431
Indonesia	0.251	0.29	0.363	0.33	0.471	0.438	0.474	0.374
Thailand	0.304	0.314	0.322	0.324	0.405	0.397	0.413	0.354
Philippines	0.263	0.249	0.275	0.269	0.422	0.375	0.404	0.322
Thailand to	1999- 2000	2001- 2002	2003- 2004	2005- 2006	2007- 2008	2009- 2010	2011	Average
Singapore	0.41	0.357	0.395	0.387	0.469	0.492	0.509	0.431
Indonesia	0.289	0.266	0.322	0.359	0.412	0.431	0.465	0.363
Malaysia	0.304	0.314	0.322	0.324	0.405	0.397	0.413	0.354
Philippines	0.284	0.181	0.224	0.251	0.281	0.28	0.354	0.265
Singapore to	1999- 2000	2001- 2002	2003- 2004	2005- 2006	2007- 2008	2009- 2010	2011	Average
Indonesia	0.357	0.302	0.4	0.439	0.545	0.541	0.551	0.448
Thailand	0.41	0.357	0.395	0.387	0.469	0.492	0.509	0.431
Malaysia	0.35	0.358	0.401	0.375	0.534	0.499	0.498	0.431
Philippines	0.245	0.219	0.245	0.244	0.373	0.315	0.338	0.283

Source: Author's computation

Table 5: Bonds Market Dynamic Correlation

<b>Philippines</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>Average</b>
Indonesia	0.034	0.036	0.042	0.045	0.039	0.037	0.043	0.039
Malaysia	0.027	0.021	0.025	0.021	0.026	0.025	0.028	0.025
US	0.014	0.002	0.005	0.006	0.005	0.006	0.014	0.007
Thailand	0.008	0.007	0.007	0.014	0.004	0.001	0.008	0.007
Singapore	-0.009	0.006	0.012	0.005	0.008	0.009	-0.005	-0.008
Average to ASEAN Correlation to US								0.016 0.007
Indonesia to	2005	2006	2007	2008	2009	2010	2011	Average
Thailand	0.058	0.054	0.059	0.055	0.057	0.06	0.052	0.056
Philippines	0.034	0.036	0.042	0.045	0.039	0.037	0.043	0.039
Malaysia	0.019	0.036	0.028	0.028	0.031	0.029	0.021	0.027
Singapore	0.023	0.02	0.022	0.025	0.022	0.022	0.02	0.022
US	0.017	0.012	0.011	0.011	0.014	0.016	0.015	0.014
Average to ASEAN Correlation to US								0.036 0.014
Malaysia to	2005	2006	2007	2008	2009	2010	2011	Average
Thailand	0.098	0.107	0.099	0.113	0.102	0.105	0.102	0.104
Singapore	0.1	0.103	0.096	0.103	0.104	0.101	0.112	0.103
Indonesia	0.019	0.036	0.028	0.028	0.031	0.029	0.021	0.027
Philippines	0.027	0.021	0.025	0.021	0.026	0.025	0.028	0.025
US	0.021	0.02	0.013	0.024	0.016	0.021	0.022	0.02
Average to ASEAN Correlation to US								0.065 0.02
Thailand to	2005	2006	2007	2008	2009	2010	2011	Average

Malaysia	0.098	0.107	0.099	0.113	0.102	0.105	0.102	0.104
Singapore	0.102	0.098	0.098	0.105	0.102	0.103	0.097	0.101
Indonesia	0.058	0.054	0.059	0.055	0.057	0.06	0.052	0.056
US	0.023	0.026	0.025	0.034	0.021	0.024	0.024	0.025
Philippines	0.008	0.007	0.007	0.014	0.004	0.001	0.008	0.007
							Average to ASEAN	0.067
							Correlation to US	0.025
Singapore to	2005	2006	2007	2008	2009	2010	2011	Average
US	0.187	0.193	0.185	0.195	0.191	0.202	0.192	0.192
Malaysia	0.1	0.103	0.096	0.103	0.104	0.101	0.112	0.103
Thailand	0.102	0.098	0.098	0.105	0.102	0.103	0.097	0.101
Indonesia	0.023	0.02	0.022	0.025	0.022	0.022	0.02	0.022
Philippines	-0.009	0.006	0.012	0.005	0.008	0.009	-0.005	-0.008
							Average to ASEAN	0.054
							Correlation to US	0.192

Source: Author's computation

To summarise the result of the equities and bonds market dynamic correlation analysis, the model suggests that the ASEAN5's equities market is more correlated than the bonds market. Furthermore, for the equities market, the countries in the region are more correlated within themselves than with the world and the trend of the correlation has been generally improving. In contrast, the bonds market does not show signs of improvement in terms of market return correlation. The levels of bilateral correlations in the bonds market remain weak. Among the countries in the region, Singapore's bonds and equities markets has the highest correlation within and outside the region. Meanwhile, for the equities market, Indonesia, Malaysia, and Thailand have almost the same degree of correlation within the region and with the world. The bonds market analysis also shows that Singapore, Malaysia, and Thailand have the highest correlation within themselves. The result of the analysis shows that the Philippines remained the weakest in the region in terms of correlation for the bonds and equities market.

#### *Cluster analysis*

As a final analysis of this research, a multivariate procedure was applied to equities and bonds market data to identify which countries in the ASEAN5 possess most similarities and to determine the regional clustering. Cluster analysis is a commonly used data mining technique which explores observations in each group are similar to each other, while keeping every group dissimilar from the other group (Sharma, 1996). In employing the procedure, each observation in the dataset was treated independent of time. By treating the dataset as such, the paper can explore not only how each country groups together, but also how time series cluster. Two sets of data were used for the analysis, one describing the equities market development, and another one for

the bonds market development. Each set consists of each countries market size, market depth, and market returns.

For the equities market cluster analysis, the paper used the ratio of equities market capitalisation to GDP to indicate market size, turnover ratio to measure the market depth, and equity index return. The data were sourced from the World Bank's World Development Indicators database using annual data from 1996 to 2010. Meanwhile, the bonds market development indicators were downloaded from the AsianBondsOnline database of the Asian Development Bank. The analysis used the annual data from 2005 to 2010. This include the size of local currency bond as a ratio to GDP, size of foreign currency bond market as a ratio to GDP, government bonds turnover ratio, and annual return of the local currency bonds.

*Equities market: cluster analysis*

The paper divided the sample data into three equal time periods and implemented the cluster analysis for each sub-period. The identified sub-periods were 1996 to 2000, 2001 to 2005, and 2006 to 2010. Each subset consists of 25 observations, consisting of 5 countries with 5 annual set of data each. The results of the analysis revealed the changes in the equity market sub-groupings in the ASEAN5 region. If we consider the distance between clusters as a tool to measure how fast the markets are integrating, then we find some interesting results (Appendix B.1).

Table 6: Equities Market Development Indicators as of 2010

	Singapore	Malaysia	Thailand	Philippines	Indonesia
Market Capitalization to GDP	166.18	172.64	87.11	78.82	51.01
Equity Index Return	18.44	35.06	52.14	56.67	37.89
Equity Market Turnover Ratio	126.69	37.93	68.36	13.42	18.33

Source: World Bank's World Development Index

For the time period 1996 to 2000, Indonesia, Philippines and Thailand clustered together at a very early stage, and it was followed by the grouping of Malaysia and Singapore. Most observations from the two groups (22 of the 25 observations) finally converged from the cluster distance of 0.79, while the clustering of all observations was attained at a cluster distance of 1.66.

Meanwhile, country groupings slightly changed for the succeeding sub-period. For the window 2001 to 2005, Indonesia and the Philippines still form the same



group, while Thailand moved to the group of Singapore and Malaysia. This time, the speed of clustering of these two groups are of a similar pace. The speed of clustering also improved compared to the previous sub-period – 21 out of the 25 observations converged at the cluster distance of 0.78, while total clustering was achieved at 1.51.

Lastly, for the sub-period of 2006-2010 the groupings regressed similarly to the 1996-2000 sub-period. Most observations of Indonesia, Philippines, and Thailand clustered together in one group while Malaysia and Singapore formed another group. Interestingly, for the Global Financial Crisis year 2008, all countries except Singapore formed one cluster. The speed of convergence also slowed down for this period compared to the previous sub-period. 23 out of the 25 observations formed one group only on the cluster distance of 0.96. Meanwhile, all observations finally formed a single cluster at a slightly higher distance of 1.54. In general, the degree of integration still improved for this period. The cause of the partially slower speed of convergence is the dissimilarity of Singapore in 2007 and 2008, and the 2008's data of Indonesia, Philippines, Thailand, and Malaysia. This result supports the findings in the earlier sections. The isolation of most the 2007 and 2008 observation for Singapore from the rest of the ASEAN5 countries is indicative of the fact that the former is less identical to the rest of the region.

To summarise, from 1996 to 2010, the cluster analysis show that the equities markets' degree of similarity in the region is heightening. The lesser developed equities market group together, while the most developed markets form another group. The cluster of the less developed equities market has more similarities within each other compared to the cluster of the more developed markets. The Philippines and Indonesia formed the group of less developed markets, while Malaysia and Singapore clustered the more developed markets. Meanwhile, Thailand's equities market plays somewhere in between the two groups.

For the sub-period 2005 to 2006, the most developed bonds market in the region clustered at the earliest stage. Three main groups were formed before the whole group formed one cluster. Malaysia and Singapore clustered almost instantly, followed by the grouping of Philippines and Thailand. This grouping was then followed by the integration of these two groups. For 2005 to 2006, Indonesia was isolated from the region. The whole ASEAN5 bonds market finally formed one group, with Indonesia joining, at cluster distance 1.13.

Table 7: Bonds Market Development Indicators as of 2010

	Singapore	Malaysia	Thailand	Philippines	Indonesia
Local Currency Bond to GDP	75.50	98.60	69.50	35.40	14.90
Foreign Currency Bonds to GDP	22.70	11.00	2.40	19.00	3.20
Local Currency Returns	2.66	5.11	5.28	12.07	21.12
Gov. Bonds Turnover Ratio	0.81	0.61	0.87	0.65	0.27

Source: AsianBonds Online

The country grouping changed for the 2007 and 2008 sub-period but the speed of regional grouping almost remained the same. Two main subgroups were formed for this sample period. One is the group of Malaysia, Singapore, and Thailand, and the other is the group of Indonesia and the Philippines. Similar to the 2005 to 2006 sub-period, Malaysia and Singapore bonds markets clustered the fastest. Thailand's improvement in the bond market may have prompted this change in grouping. The whole region clustered in one group at the cluster distance of 1.11.

The 2009 to 2010 sub-period showed the increasing gap between the groups of the more developed market and the less developed market. While the countries maintained the same groupings from the previous sub-period, the cluster distance at which both groups were formed and when the whole ASEAN5 clustered into a single group became larger. Malaysia, Thailand, and Singapore clustered at the cluster distance 0.54, while Philippines and Indonesia clustered at 0.61. However, the region formed a single group only at the cluster distance 1.20. This result suggests that the region should intensely monitor each member country and put pressure to ensure that everyone is pursuing market development strategies.

The disparity between the more developed and less developed markets is more prominent in the bonds market than in the equities market. For the bonds market, Singapore and Malaysia, and eventually Thailand form a single group for the more developed markets, while Indonesia and the Philippines belong to the less developed markets group. The degree of similarity within the more developed markets group is increasing, but becoming more segmented from the less developed market group.

Meanwhile, for the equities market, Indonesia, the Philippines, and Thailand have the greater similarities with each other, hence forming a single cluster. On

the hand, though Singapore and Malaysia almost always join in the same cluster, the degree of their similarity is much lesser compared to the previous group. This can be attributed to the relatively more advance stage of equities market development of Singapore relative to the rest of the group. To be specific, for the period with the global financial crisis, Singapore became the most dissimilar market in the region, thus pulling the speed of clustering for the whole region at a later stage. This result is supported by the other analysis in this paper. The simple rolling correlation of equities index and the DCC of the equities return show that Singapore has the highest correlation outside the region.

### **Conclusion and policy recommendations**

The results of the PCA, correlation analysis, and DCC-GARCH model provide evidence for the better integration in the equities market than in the bonds market. The degree of interrelatedness of the equities market indices in the region has been high and continuously growing. A similar pattern is happening in the bonds market, although the degree is much lower compared to the equities market. Meanwhile, in terms of equities and bonds returns, the former still provides evidence of an improving level of correlation within the region, while the latter remains weak and stagnant. Moreover, the ASEAN5's equities market is more correlated within than outside the region, while the reverse is true for the bonds market. This finding can be related to the size and level of development for each market. The higher degree of development in a market drives better integration in the region.

Looking at the micro-level, the equities and bonds markets of Singapore are leading the region in terms of financial integration. This is followed by the equities and bonds markets of Indonesia, Malaysia, and Thailand. Meanwhile, the equities and bonds markets of the Philippines had the weakest correlation with the region.

The country groupings tell a similar story. For the equities markets, lesser developed markets tend to cluster faster than more developed markets. The analysis shows that the equities markets of Indonesia, Philippines, and Thailand have the greatest similarities, while Singapore and Malaysia have greater similarities between each other. Meanwhile, for the bonds market, the more developed markets group much faster than the smaller markets. Specifically, the bonds markets of Singapore, Thailand, and Malaysia group together faster than those of Indonesia and the Philippines.

The cluster analysis also suggests that least developed markets should cooperate with the more developed markets to achieve better regional integration. Otherwise, the market will remain fragmented and the gap

between the lesser developed and more developed bonds and equities market will just widen. To achieve this, policy makers in the region should put pressure on lagging countries to instil an enabling environment for the development of their local equities and bonds market. Further, the region should establish cooperative strategies to aid in the development of each country's financial markets. This may include removing capital controls within the region to allow freer funds mobilisation within the ASEAN5 economies and creating infrastructures that will enable cross-country trading. The development of ASEAN5's financial markets will not only improve financial integration, it will also attract local investors to invest locally within the region. Referring to the research by Garcia-Herrero, Yang, and Wooldridge (2008) which highlights the importance of market liquidity for Asian investors, by deepening the region's financial market, funds can be repatriated within the region from other more developed economies.

From the result of this analysis, policymakers can establish faster regional integration by establishing regional sub-grouping first, then gradually merging these sub-groups to form a regionally integrated market. With this strategy, lesser developed markets will not be left out and will help prevent the creation of possible larger gaps with the more developed markets. Rather than merging all the markets simultaneously, market integration could run in parallel. To be more specific, in the equities markets, since the lesser developed markets have far greater similarities within each other in comparison to the more developed markets, it would be theoretically easier to merge these markets. While there is an ongoing initiative to fully merge the equities markets of Singapore and Malaysia, the markets of Indonesia, Philippines, and Thailand should have a simultaneous attempt to integrate as well. Likewise, for the bond market integration, the markets of Singapore, Malaysia, and Thailand could create a subgroup. Meanwhile, the Philippines and Indonesia should cooperate with each other to foster faster market expansion and infrastructure development.

The European Union's financial market integration provides evidence that regional cooperation is beneficial not only for developing the depth of the financial market, but also in promoting regional economic development (Pasadilla, 2008). Integrated financial markets facilitate the development of other economic linkages by answering the financing constraint that is traditionally present to small and underdeveloped economies. The disparities in the depth and degree of development among the countries in the ASEAN5 region, as well as the cultural and language differences, have naturally driven these countries to develop their own markets based on their own preferences (ADB, 2012). However, for the financial integration to occur, financial market regulations and policies of various countries must be adjusted and aligned at the earliest time possible.

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### Appendix A.2 Bond Yield Cross-Correlation (2005-2011\*)

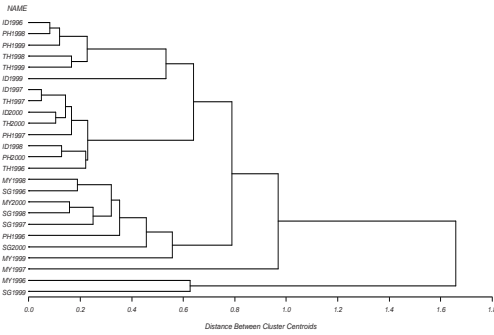
	Philippines				Indonesia				Malaysia				Thailand			
	2005-2006	2007-2008	2009-2010	2011	2005-2006	2007-2008	2009-2010	2011	2005-2006	2007-2008	2009-2010	2011	2005-2006	2007-2008	2009-2010	2011
<b>Philippines</b>																
<b>Indonesia</b>	38.43	74.25	61.89	69.38	38.43	74.25	61.89	69.38	29.67	56.35	50.83	65.04	-25.21	12.27	48.31	59.95
<b>Malaysia</b>	29.67	56.35	50.83	65.04	-7.70	44.23	7.37	78.31	-7.70	44.23	7.37	78.31	61.22	-10.14	25.06	55.32
<b>Thailand</b>	-25.21	12.27	48.31	59.95	61.22	-10.14	25.06	55.32	1.65	54.78	68.47	47.48	1.65	54.78	68.47	47.48
<b>Singapore</b>	-44.20	36.38	45.08	65.57	11.97	7.11	-10.84	86.34	35.67	62.81	67.33	95.35	66.17	69.86	61.64	55.76
<b>ASEAN5 Index</b>																
<b>Average</b>	-0.33	44.81	51.53	##	##	##	##	##	14.82	##	##	71.55	##	31.69	##	##
	<b>United States</b>															
	<b>Singapore</b>				<b>ASEAN5 Index</b>											
	2005-2006	2007-2008	2009-2010	2011	2005-2006	2007-2008	2009-2010	2011	2005-2006	2007-2008	2009-2010	2011	2005-2006	2007-2008	2009-2010	2011
<b>Philippines</b>	-44.20	36.38	45.08	65.57	51.35	74.61	82.11	76.54	-55.57	-31.31	59.60	70.03				
<b>Indonesia</b>	11.97	7.11	-10.84	86.34	69.72	60.27	50.29	90.41	-10.85	-55.22	6.67	83.10				
<b>Malaysia</b>	35.67	62.81	67.33	95.35	59.39	90.07	80.79	94.17	40.28	-21.57	78.77	93.25				
<b>Thailand</b>	66.17	69.86	61.64	55.76	58.31	62.11	81.56	65.88	59.63	34.73	70.89	58.71				
<b>Singapore</b>					44.72	74.85	72.32	98.02	83.85	43.75	90.28	97.63				
<b>ASEAN5 Index</b>									27.27	-10.77	83.64	96.78				
<b>Average</b>	17.40	##	##	##	##	##	##	85.01								

\*Daily Bonds Yields, from March 9, 2005 to November 30, 2011.

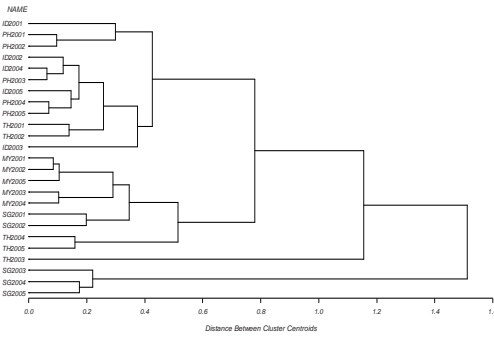
Source: Author's Computation

## Appendix B.1

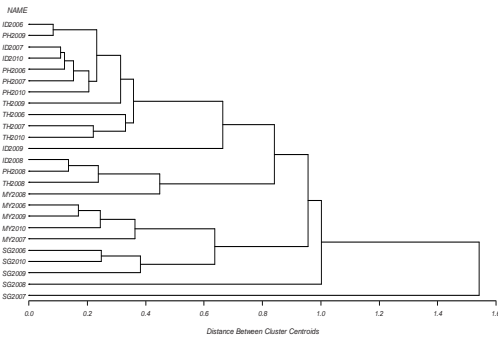
### Equities Market Clustering: 1996-2000



### Equities Market Clustering: 2001 to 2005



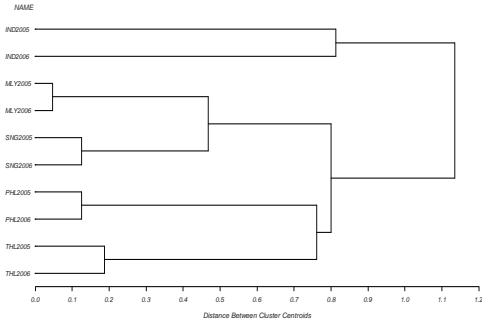
### Equities Market Clustering: 2006 to 2010



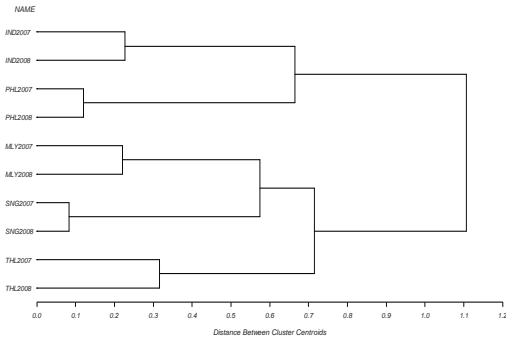


## Appendix B.2

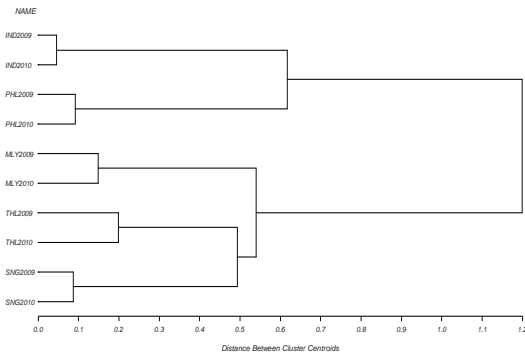
### Bonds Market Clustering: 2005 to 2006<sup>i</sup>



### Bonds Market Clustering: 2007 to 2008



### Bonds Market Clustering: 2009 to 2010



## DYNAMICS OF STATE, SANGHA AND SOCIETY IN MYANMAR: A CLOSER LOOK AT THE ROHINGYA ISSUE<sup>26</sup>

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Mary Kate Long<sup>27</sup>

*This paper aims to shed light on the origins and conditions of inter-communal violence between Rakhine Buddhists and Rohingya Muslims in Rakhine State, Myanmar. First, it reviews the history of the Rohingya community in Myanmar. Then, it explores the interactions and dependencies between the state, the Buddhist monastic community and Burmese lay society to understand the complex dynamics that have emerged from a traditional Burmese Buddhist cosmology to condition Myanmar's current cultural, religious and political institutions. Tracing historical re-formulations of Buddhist identity, moral authority and political legitimacy contributes to a deeper understanding of the origins of cultural prejudice against the Rohingya minority. Finally, this paper explores the mass lay vipassanā meditation movement in Myanmar, its growing popularity during the past 50 years under authoritarian rule, and its potential to contribute to positive social change.*

### Introduction

Myanmar, formerly known as Burma, has long been torn apart by violent conflict. Today it finds itself on the verge of leaving behind this violent history and embracing new opportunities and resources for reform, growth and reconciliation. While the majority of Myanmar's population is of ethnic Burman origin, many localized ethnic minorities also reside there. Tragic inter-communal violence between Arakanese Buddhists and Rohingya Muslims in Rakhine State in the country's northwest, previously stifled under years of authoritarian rule, has again erupted on the social and political scene. Like many other ethnic minority groups in Myanmar, the Rohingya Muslim community has suffered systemic persecution, notably under General Ne Win's

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<sup>26</sup> The former State Law and Order Restoration Council (SLORC) – known as State Peace and Development Council (SPDC) since 1997 – adopted Myanmar as the official name of the country formerly known as Burma in 1989. I will refer to the country as Myanmar except when explicitly discussing historical events before 1989, when I will refer to it as Burma. This is not intended as a political statement.

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26-year rule. Rendered stateless<sup>28</sup> by Myanmar's exclusive citizenship laws, the Rohingya have no recourse to legal protection, are strictly regulated, and denied access to employment, education and healthcare. Now, the Rohingya are also in direct conflict with their Buddhist neighbours. On May 28, 2012, Rohingyas and Buddhists clashed over the reported rape and murder of a young Buddhist woman by a group of Rohingya men (Hay 2012). So far, hundreds of thousands have fled the country or taken refuge in ill-equipped, neglected refugee camps (The Economist 2012), and over 100 have been killed directly. Subsequently, lay Buddhists; members of the *sangha* (monastic community), and political leaders have called for the Rohingya to be forced out of the country.

The basic framework of this paper is to use the recent conflict between Buddhists and Rohingya Muslims in Rakhine State as a case study for understanding the formulations of Burmese Buddhist identity that have created the conditions for this conflict situation to emerge. Grounded in this context, the paper considers implications of this historical and ongoing narrative for Myanmar's future, as it stands on the cusp of democratic reform and re-emergence into the international system. This paper first reviews the history of the Rohingya community in Myanmar. Then, it traces the dynamics between the state<sup>29</sup>, the *sangha*<sup>30</sup> and the laity<sup>31</sup> in Myanmar to see how they have shaped and conditioned Myanmar's current cultural, religious and political institutions. In Myanmar, religion and politics are intrinsically tied and mutually dependent. What emerges from an examination of this relationship is a complex narrative of a Buddhist nation's encounter with modernity. The state, sangha, and laity have adapted to and resisted modernity at the public, institutional level, and the private, individual level, transforming identities and reformulating roles and responsibilities. This context will contribute to a deeper understanding of the origins of systemic persecution of the Rohingya minority. Before going further, it is essential to draw out some of the assumptions that often accompany discourse on Buddhism, politics and violence. An "orientalist" view of Buddhism, posited by Max Müller and Max Weber, has informed many Western perceptions of it as an "other-worldly" spiritual system that operates apart from social and political forces (Schober 2011). However, contemporary scholarship shows that Buddhism is in fact intimately linked to constructs of

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<sup>28</sup> The 1954 UN Convention Relating to the Status of Stateless Persons defines statelessness as "a person who is not considered as a national by any State under the operation of its law." The full text of the Convention is available from <http://www.unhcr.org/3bbb25729.html>.

<sup>29</sup> For the purposes of this paper, "state" is defined as the government, ruling parties and military bodies.

<sup>30</sup> "Sangha" refers to ordained members of the Buddhist monastic community.

<sup>31</sup> "Laity" refers to Myanmar's lay Buddhist majority.

political power and social forces. Related to the orientalist view is a common impulse to pin down a static concept of Buddhist doctrine that has influenced the cultural and political history of Myanmar. To presume this would undermine the more important undertaking of tracing the processes of interpretation that Burmese Buddhists have engaged in at certain historical conjunctures. These processes of interpretation reflect their attempt to conceive of themselves as Buddhist in a changed and changing environment. Furthermore, efforts to try to locate the impetus for violence within a normative Buddhist doctrine would be misleading and unproductive. Rather, a more interesting and important exercise is to understand how people have sought to define the terms of their identity based on confrontations and exchanges with moments of modernity. This framework points to colonisation, a destructive encounter with the West, as a turning point for Burmese Buddhism's encounter with modernity. This does not imply, however, that before the influence of colonialism, the dynamics of Buddhism, politics and violence were static. The colonial period serves as a point of reference only.

### **Rohingya origins**

It is necessary to establish an understanding of how the Rohingya people came to live in the country now known as Myanmar. This is not easy, as there is only a small body of work that pertains directly to Muslims in Myanmar, and what is there offers little help in clarifying the confusion that surrounds the Rohingya's ethnic and national origins. There seem to be two basic lines of thought concerning how the Rohingya came to be in Myanmar. One explanation is that they were the indigenous inhabitants of Arakan State. The name 'Rohingya' derives from the ancient name of Arakan, which was Rohang. Ethnic Arakanese Buddhists and Rohingya Muslims shared the same dress and regional culture, but differed in religious tradition. The Arakanese may have even suffered similar discrimination by ethnic Burmans as did the Rohingya, until later when the Burmese nationalist movement sought to unite the broad Buddhist community with less regard to ethnic status. Separated from the rest of Burma by a mountain range, Arakan developed as a distinct state, independent of the Burman kingdom to the east and the state of Bengal to the west. There were occasional conflicts between Arakan and Bengal that continued when Bengal came under rule of the Mogul Empire of Delhi. Defeated by the Moguls in 1666, Arakan was so weakened that the Burmans were able to conquer it and annex Arakan to Burma in 1785. The Rohingya maintained a community in northern Arakan and were also dispersed among some other areas within the state and throughout Burma (Minihan 2002). Explanations along these lines are upheld by human rights organisations and Rohingya advocacy groups like the Arakan Rohingya National Organisation (ARNO) with hopes that affirming the Rohingya as an ancient indigenous group will help earn citizenship status in Myanmar (ARNO 2006).

The explanation preferred by Myanmar governments since the military regimes installation in 1962 is that Rohingyas came to settle in Arakan after 1823 when the British were in control of the region. They came as migrants from India to work as civil servants and skilled laborers. Based on this explanation, the government manipulated a 1982 Citizenship Law to deny citizenship expressly to the Rohingya (International Observatory on Statelessness). Chapter 3, Article II of the law states, "Nationals such as the Kachin, Kayah, Karen, Chin, Burman, Mon, Rakhine or Shan and ethnic groups as have settled in any of the territories included within the State as their permanent home from a period anterior to...1823 A.D. are Burma citizens" (UNHCR 2012). General Ne Win's military government labelled the Rohingya illegal Bengali immigrants, however, Bangladesh also does not accept them as citizens (The Irrawaddy 2012).

### Tracing a legacy of discrimination

Until the colonial period, it seems that Muslims and Buddhists coexisted in peace in Burma. Both maintained vibrant religious identities and traditions, but to some degree assimilated clothing styles, regional culture and language. There is little evidence of direct conversion efforts between Buddhists and Muslims. Issues began to emerge, however, when large influxes of Indian migrants came to settle throughout Burma after 1823, especially in Rangoon. General feelings of resentment grew among Burmese who were forced out of work by the influx of Indian migrants, many of whom were prepared to accept lower wages (Yegar 1972).

Buddhist-Muslim intermarriage was widespread in the 19<sup>th</sup> and early 20<sup>th</sup> centuries, but in the 1920s, marriage law<sup>32</sup> emerged as a point of contention between Buddhists and the migrant Indian Muslim community. Dispute over marriage law, resentment for dispossession of jobs, and broad-reaching socio-economic distress resulting from the worldwide economic depression of the 1930s became the sparks that ignited anti-Indian and anti-Muslim riots in 1930 and 1938 (Yegar 1972). The 1930 riot began with a conflict between Indian and Burmese dockworkers in Rangoon. A newspaper report of the event explains that police forces attempted to subdue violence on both sides, but the atrocities did not cease. Members of both communities were "being disembowelled and limbs were being hacked off with daggers and hatchets" (The Argus 1930). Atrocities against women and children were reported on both sides. The scale and types of violence bear witness to escalating hatred between Indian migrants

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<sup>32</sup> Traditionally in Burma, a marriage is not religiously sanctioned and does not require a ceremony or formal declaration. Husband and wife, once cohabitating, share equal property rights. A Buddhist woman cohabitating with a Muslim man might assume she is his wife according to her own culturally inherited rights, but according to Muslim *nikah* (marriage contract) she is not a legal wife (Ikeya 2006).

and Burman workers. The report also shared that the “assistant commissioner of police was attacked by a Burmese priest with an iron bar” and police forces found armed Burmese being sheltered in a nearby monastery (The Argus 1930). It is evident that the some members of the Sangha did not shy away from political involvement even as early as this event.

A second series of riots in 1938 was directly targeted at Muslims and resulted from rising tensions over the marriage law issue. Newspapers explicitly incited violence against Muslims “who have taken possession of the wealth of the Burmese people and also their daughters and sisters” (Yegar 1972). Tension hit an all-time high on July 26, 1938, when a rally was held at the Shwedagon Pagoda in Rangoon, the holiest site for Buddhists in Myanmar. During the rally, speakers demanded punishment for *all* Muslims, just by nature of religious identity. They also called for acts by the government like the “Buddhist Women Special Marriage and Succession Bill,” which would create an option for civil union and guarantee property rights for Buddhist wives of Muslim men. Publication of this news in the following days caused riots to erupt throughout Rangoon and in several other districts. There were hundreds of casualties on both sides and 113 mosques were burned. After investigating the riots, a Committee of Inquiry convened by the Governor—made up of two British legislators, two Burmese Buddhists and two Muslim leaders—proposed limitations on Indian immigration to Burma as the most viable solution to the ethnic and religious tension. The governments of India and Burma signed the Indo-Burma Immigration Agreement in 1941 to set quotas for Indian immigration to Burma. The agreement was heavily protested in India and contested by members of the Indian community in Burma. However, the Japanese occupation of Burma began before the agreement went into effect (Yegar 1972).

A third conjuncture in the history of violence between Buddhists and Muslims in Myanmar, and specifically in Arakan State, came after World War II. Just as the British evacuated Arakan before Japanese occupation began in 1942, massive conflicts were breaking out between Arakenese Buddhists and Muslims in the state. The violence was attributed to the same deteriorating socio-economic conditions as had lead to previous Buddhist-Muslim conflicts in the rest of Myanmar. Entire villages were burned to the ground. Hundreds of thousands fled into northern Arakan, the Muslim majority stronghold, and many fled across the border to India. When refugees reached northern Arakan and shared news of the violence inflicted in the south, Arakanese Buddhists fled south to avoid retaliation by their Muslim neighbours. In this way, Buddhist and Muslim communities became polarized in the south and north of Arakan State, respectively. The British granted north Arakan the status of Muslim National Area when they re-conquered the State. But when the Anti-

Fascist People's Freedom League (AFPFL) led by Aung San and U Nu took on leadership of Burma, this status was not maintained. Religious polarisation continued in Arakan. In 1946, a group of particularly rebellious Muslims that had migrated to Arakan from Chittagong (in present day Bangladesh), appealed to Ali Jinnah to annex the region to the new state of Pakistan that would be formed in 1947. Jinnah and AFPFL leader Aung San rebuffed this proposition. In 1948, Arakanese Buddhists began returning to their land and rebuilding villages, but the rebel Muslim faction declared a *jihād* against them in pursuit of an independent Muslim state. Known as the Mujahid Rebellion, the group maintained an insurgency against the AFPFL and contributed to tensions between Burma and East Pakistan (present day Bangladesh) until the rebels surrendered in November 1961 (Yegar 1972). It is important to note that the Mujahid group did not represent all Muslims in Arakan, and the rebellion did not attract wide support from Rohingya leaders (Matheison 2009). At the time, both Prime Minister U Nu and later, Prime Minister U Ba Sue recognized the Rohingya as one of Burma's ethnic groups (Constantine 2012). A reconciliation effort by U Nu's government was abandoned when Ne Win's military regime took power in 1962 (Yegar 1972).

#### **Timeline to today: the Rohingya**

This legacy of discrimination and distrust was institutionalized and systematically implemented by Ne Win's military regime. After overthrowing the AFPFL in 1962, Ne Win's Burmese Way to Socialism would directly affect the livelihoods of the Rohingya communities in Arakan, renamed Rakhine State in 1974. In 1978, Operation Naga Min (Dragon King) executed a massive sweep of the entire country in order to identify individuals without national identity papers. Military forces used brutal tactics against the Rohingya and around 250,000 Rohingya fled across the border to Bangladesh. Responding to outcry from the international community, the United Nations Refugee Agency (UNHCR) facilitated an agreement between Bangladesh and Burma, Operation Shwe Hinthta (Golden Bird), to repatriate the Rohingya refugees back to Rakhine State. When the State Law and Order Restoration Council (SLORC) took over in 1988, it continued the onslaught. Pyi Thaya Operation (Clean and Beautiful Nation) consisted of "abuse, forced labor, harassment, rape, arbitrary land seizure, destruction of property and executions of Rohingya in North Rakhine" (Constantine 2012). Over the next year, hundreds of thousands of Rohingya fled to Bangladesh and were resettled in refugee camps there; however, international human rights and health organisations were not permitted access. In 1992, the security force called Nay-Sat Kut-Kwey Ye, or NaSaKa, was created to monitor the border between Bangladesh and Rakhine. This body has been the main force responsible for human rights abuses in Rakhine for the past decade (Constantine 2012). Without citizenship status, the Rohingya have no rights to own property, are restricted from leaving their

villages, are barred from accessing education, may not upkeep religious buildings, and cannot marry or have children without being granted permission by the government. Rohingya are subjected to menial, low-earning jobs described by some as “modern-day slavery” (UN Daily News 2012).

In May 2012, the reported rape and murder of a young Buddhist woman by a group of Rohingya men sparked a series of riots across Rakhine State, forcing Rohingya families into hiding or into refugee camps near the Bangladesh border that were already at capacity. Another series of attacks took place in October 2012. Mobs of civilians attacked entire villages, setting fire to homes and religious sites. Over one hundred people were killed in the two spasms of violence in June and October 2012, and thousands still languish in refugee camps without enough health resources or food (Fuller 2012). Human Rights Watch has identified 4,855 destroyed structures over 348 acres of mostly residential area (Human Rights Watch 2012). On a December 2012 visit to camps in Sittwe, the capital of Rakhine State, UN Under-Secretary-General for Humanitarian Affairs, Valerie Amos, described “The large numbers of people... in camps, 78,000 Rohingya here in Sittwe, thousands more in the northern part of the state, in very difficult conditions, poor sanitation, cooped up because of the fear of the security situation” (UN Daily News 2012). Some Rohingya have also attempted to flee across regional borders sea. Bangladesh, India, Thailand, Indonesia, and Malaysia have all become destinations for Rohingya refugees leaving the country on ill-equipped boats. Many Rohingya are towed back out to sea, interned in squalid conditions, or eventually trafficked into other countries when they cannot afford the return trip to Myanmar. In 2009, UNHCR regional coordinator for Asia, Raymond Hall, said, “the suffering of the Rohingya is about as bad as it gets. Other people in this situation often have homes they can return to, but for these people, they have nowhere they are welcome... It is a terrible plight” (Mathieson 2009). Since then, conditions for the Rohingya have continued to decline.

From all this, it seems that Muslim identities have frequently been co-opted, presumed and incriminated. While some violence and separatist activities by members of Myanmar’s Muslim community may be seen as historical threats to national security, ordinary Rohingya villagers have unfortunately suffered from scapegoating. Furthermore, it is evident that arguments for and against Rohingya citizenship find little clear, substantive basis in historical facts. Conflicting claims are confusing, and there exists no definitive history of Rohingya origins or migration in Arakan/Rakhine State. The United Nations, European Union, United States, and regional powers like Australia, India, Bangladesh and member nations of the Association of Southeast Asian Nations (ASEAN) must put pressure on Myanmar’s leaders to grant citizenship status to the Rohingya on the same basis as others born in Myanmar or who hold long-



term residency, so that international human rights standards can be upheld and enforced on their behalf.

### Political involvement of the Sangha

What is striking about this 2012 conflict is that military and security forces have not been solely responsible for the violence. There are civilian mobs of Rakhine Buddhists who are attacking Rohingya villages, burning homes, mosques and assaulting Rohingya people including women and children. Even more striking, in October 2012, Buddhist monks across Myanmar marched together to show their support of Thein Sein for maintaining the denial of Rohingya citizenship and seeking to deport the Rohingya out of Myanmar. Buddhist monks often assume positions of community leadership in Southeast Asian Buddhist countries, but outside observers have been shocked to see them marching and speaking out against the Rohingya. Many observers point out that the sangha could be a positive public force to resolve this conflict, if only it would discourage the conflict and march for peace. However, groups like the All-Arakanese Monks' Solidarity Conference have made their views clear and public. This group has "urged locals to distribute images of anyone alleged to be supporting the stateless minority group to all townships in the region, potentially opening them up to violent attacks" (Hindstrom 2012). Monks have also protested the opening of an office of the Organisation of Islamic Cooperation (OIC) that sought to establish itself within Myanmar to provide financial aid and assistance to Rohingya communities and refugee camps. Because of this protest, the government decided to dismiss the OIC's request to set up an office in Myanmar (Radio Free Asia 2012).

The last time Myanmar's Buddhist monks came out to march in force it was to protest the longstanding military regime. During the Saffron Revolution of September 2007, at least twenty thousand monks and one hundred thousand lay people marched through cities throughout Myanmar. According to the *vinaya*,<sup>33</sup> the monastic code of conduct, monks must not engage in public, worldly affairs but for one exception: when the *sāsana*—the dispensation of the Buddha, or in general, the Buddhist religion—is perceived to be under threat. In such a case as this, the sangha, as a collective entity, "is permitted to issue what is regarded as the ultimate moral rebuke" (Jordt 2008). This act, known in Pali<sup>34</sup> as *patam nikkujjana kamma*, is the sangha's formal decision to refuse donations or alms. When the sangha marched quietly through the streets in 2007, they marched with their alms bowls turned over, an act called *thabeik hmauk*—

<sup>33</sup> For a widely read translation of the Pali Vinaya see "The Bhikku Pātimokkha: The Bhikkus' Code of Discipline," <http://www.accesstoinsight.org/tipitaka/vin/sv/bhikkhu-pati.html>

<sup>34</sup> Pali is the canonical language of Sri Lanka and South-East Asian Buddhism. See Rupert Gethin, *The Foundations of Buddhism*, (Oxford, UK: Oxford University press, 1998), xvii.

literally, 'turning over the bowl' in Burmese (Schober 2011). This act indicated that they would refuse alms from anyone associated with the government and military regime, thereby depriving the regime of the opportunity to earn merit. With this act, "the monks effectively removed the spiritual condition sustaining the regime's power" (Jordt 2008). In her analysis of the September 2007 protests, anthropologist Ingrid Jordt deftly distinguishes between the anti-political position of the monks and the pro-democracy position of the lay people who joined the protests on behalf of the National League for Democracy (NLD). Jordt (2008) explains, "[t]he mass protests by monks stemmed specifically from the regime's refusal to be morally corrected by the Sangha and to amend its behavior in accordance with the monks' rebuke." By refusing to function as "fields of merit" for military regime supporters, the monks delegitimized the regime.

The sangha, as the traditional guardian of morality in Buddhist cosmology, has certain priorities dictated by the vinaya, namely to protect the sāsana. To protect the sāsana from the perceived threat of the Rohingya Muslim community, the sangha has called for the forceful expulsion of the Rohingya from Myanmar, and rallied and marched with Buddhist followers to gain popular support. Perhaps the sangha's priorities do not necessarily match up with those of the state or the laity, a dynamic that could hinder Myanmar's path toward reconciliation.

It is clear that the political landscape of authority and legitimacy in Myanmar is inherently religious, and in turn, the religious cosmology that has shaped Myanmar since its origins as a Buddhist nation is also political. In order to understand how and why the Rohingya conflict has come to be, what factors sustain it, and what possibilities there are for resolution, we must now turn to the religio-political forces present in Myanmar and how they have both effected and been effected by Myanmar's encounter with modernity.

### **Buddhist origins in Burma**

Theravada Buddhism is the predominant form of Buddhism practiced throughout Southeast Asia. Archeological and textual evidence indicate that lineages of the Theravada sangha were well established by the early eleventh century CE, and probably existed in some form in the Pyu and Mon kingdoms (now Burma and Thailand) as early as the fifth century CE. King Anawratha founded the first Burmese kingdom, with its capital at Pagan, in 1044 CE (Gethin 1998). Since then, Buddhism has inserted itself into the political and social formation of the state in a complex, dynamic web of power, patronage, authority and legitimacy. Buddhist cosmology and institutions have shaped these intricate interactions of history and culture. A very basic concept of Buddhist cosmological framework involves a cyclical system of death and

rebirth, *samsara*, in which people are reborn into different realms of existence based on *karma*<sup>35</sup>, actions of body, speech and mind. Very generally, when one performs meritorious acts with good intentions, one accrues positive karma or merit. The more merit one can accrue in a lifetime, the more likely one will continue to be reborn in a realm of existence where one can continue to accrue positive merit. This system is what makes the sangha's decision to deny offerings so grave. Monks, as fields of merit, allow members of the state and the laity to accrue positive merit, and these groups rely on this system steadfastly or risk serious consequences.

About ninety percent of the total population of Myanmar practices Theravada Buddhism in some form. Three main groups emerge to populate this Buddhist framework: the state, the sangha, and the laity. To examine the dynamics of the different relationships between these groups and understand how they have formulated Myanmar's current religio-political landscape (including prejudice against the Rohingya), anthropologist of religion Juliane Schober (2011) traces the state's history of public policy toward the sangha as a symbol of its attempts to co-opt the sangha's longstanding moral authority to build up its own legitimacy. Simultaneously, the sangha is able to maintain its position as a social stronghold by the nature of its relationship to the state. Furthermore, anthropologist Ingrid Jordt (2007) explores how lay Buddhists have re-interpreted traditional roles and responsibilities within the Buddhist cosmology in order to find their way in a contemporary Myanmar reality. These processes are situated against the backdrop of British colonisation and how a new, foreign concept of the secular dislodged the hegemony of Buddhism as the organising structure of Burmese state and society.

### **Becoming nationalists**

Schober (2011) uses the framework of an economy of merit to outline the state's reliance on the sangha throughout Myanmar's history. She points to the encounter with British colonists' ideal of secular political power as a juncture in Myanmar's history that incited and reinforced distrust of those who did not engage in the Buddhist merit earning system. The discussion here applies this historical trend of distrust to formations of Buddhist nationalist identity and the "othering" of non-Buddhist minorities like the Rohingya.

When the British occupied and colonized Burma, they brought with them a concept of the secular that did not previously exist in the Burmese Buddhist cosmology. As the colonial administration undermined traditional Burmese political institutions, it simultaneously undermined the Buddhist worldview and installed a "radically changed social order that lacked the totalising

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<sup>35</sup> This is the more widely recognized Sanskrit term. The Pali term is *kamma*.

conceptual coherence of a traditional Theravada polity” (Schober 2011). The British colonists’ strategy of neutrality toward religion created a profound sense of distrust between them and the Buddhist population. When British leaders were installed, the Buddhist population, having minimal experience with leaders and governance systems of any kind but their own, expected them to fulfill the same duties and responsibilities that a traditional *dhammaraja*, or Buddhist king, would. A dhammaraja derived power from a sense of moral authority that surrounded the position of leadership. He was considered both politically and spiritually powerful, having earned his position as a result of positive merit he would have accrued over many lifetimes. Appropriating sacred Buddhist spaces as military garrisons – as the British did to the Shwedagon Pagoda in Rangoon – and other acts like removing the Burmese Lion Throne, a tangible symbol of the dhammaraja’s power, were “grave affronts to the cultural and religious sensibilities of the Burmese, who soon came to experience that in this new colonial reality, political power had been stripped of its religious foundations” (Schober 2011). The British debased institutions of moral legitimacy and authority present in Burmese Buddhist society. Secularism was established as a strange and suspect system of governance and anti-colonial sentiment was a strong.

Anti-colonial sentiment, based on the British administration’s ignorance of Buddhist values, was channeled into the Burmese nationalists’ independence movement. Rejection of the British thus also implicated the rejection of the Rohingya, who were perceived as a foreign, imposing force, and became targets of fear and hatred. The nationalist movement turned toward traditional Buddhist sources of authority and legitimacy that had since been altered by the colonial experience. This commenced the processes of interpreting traditional sources of power in a new, modern context. In the country’s emergence from the colonial period, the sangha was perhaps the only pre-colonial institution that remained somewhat intact as a moral authority. It affirmed its status as both a religious and political force, as the sequence of post-independence regimes sought to either control or win the support of the sangha in order to enhance state legitimacy. Starting with U Nu’s leadership in 1948, the state-sangha partnership became essential to maintaining a sense of social order, and Myanmar’s history bears witness to subsequent regimes’ struggle to do this.

After independence, the state could not return to the previous totalising Theravada Buddhist system. In order to maintain perceptions of moral legitimacy, regimes sought to “infuse political ideologies with Buddhist meaning” (Schober 2011). Thus, U Nu advocated democracy by naming it the “Burmese Buddhist Way to Socialism” (Schober 2011). U Nu himself was a deeply religious person, and he was committed to combining the post-independence nationalist energy with a Buddhist revival. During this period,

lay meditation became extremely popular throughout the country – a point whose significance will be explored later in this paper. A brief period of prosperity seemed to further legitimate U Nu's and Burma's success as a collective "karmic consequence of Burma's religious practice" (Schober 2011). Hoping to capitalize on this and garner even more support from the sangha, U Nu focused his efforts on institutionalising Buddhism as the state religion. In so doing, however, the tensions between Buddhists and non-Buddhist minorities were aggravated and insurgencies began to develop. Ultimately, U Nu's focus on Buddhist revival led him astray, as he was not able to meet the country's demands for economic growth and infrastructure development. Schober concludes that the "tensions surrounding Buddhism and its relations to other religious communities among citizens...opened the door for a secular, military power under Ne Win to take over Burma's government," which it did in a coup d'état in 1962 (Schober 2011).

During the military regime, Ne Win's strategy for maintaining moral legitimacy was to attempt to convert Buddhism into a civic religion and maintain a monopoly on the nation's access to merit. He accomplished this by controlling the sangha through monastic reforms, a tactic that dated back to the traditional dhammarjas. Ne Win co-opted the sangha's role as a field of merit, and replaced it with civic rituals like public donation drives that benefitted the state's social welfare programs. Ne Win's system worked initially because it mimicked the totalising Buddhist cosmology that had structured pre-colonial Burma and capitalised on the distrust of secular politics after the colonial period (Schober 2011).

In U Nu's government, non-Buddhist minorities were simply left out of state-sponsored religion. In Ne Win's regime, they were specifically targeted as obstacles to a harmonious, homogenous Burmese Buddhist laity. Rallying government support around the moral authority and legitimacy of the sangha and around Burmese Buddhist identity in general contributed to the internalisation of nationalistic xenophobia. The early nationalist movement and military regime both targeted the Rohingya by associating the community with the destructive colonial "other," so that they sustained the brunt of anti-colonial sentiment after the departure of the British. Ne Win's ethnic cleansing operation, Naga Min, and the 1982 Citizenship Law drew legitimacy for the regime by purporting to protect Burmese Buddhists and the *sāsana* from a perceived threat and further ingrained the widespread public perception of difference and the need to disassociate from the Rohingya (Schober 2011).

### Lay meditation and new forms of moral legitimacy

Turning towards the laity's role in interpreting Myanmar's new religio-political modernity, Ingrid Jordt (2007) offers a look at how the *vipassanā*<sup>36</sup> (insight) meditation movement has come to play a dynamic part in the laity's power to base legitimacy on individual moral grounds, as opposed to the traditional dynamic of conferring moral legitimacy through ritual merit earning practice mediated by the sangha. Jordt (2007) describes *vipassanā* meditation as both "a first-person, empirical investigation of cognitive procedures and mechanisms" and "a practical technique and method for *moral* empirical theory of knowing, praxis, and being." *Vipassanā* began gaining popularity during U Nu's government, although the movement seems to have already been gaining ground of its own volition when U Nu's state promotion of meditation practice in 1954 capitalized on the movement. Interestingly, *vipassanā* meditation practice surged greatly in popularity during Ne Win's regime (Jordt 2007).

Jordt's (2007) work presents a reformulation of roles and responsibility within the Buddhist framework. In the traditional economy of merit, lay people are the providers of donations and materials so that monks can sustain themselves in their practice and education and then share public teachings with the laity. This is the classic cycle for the perpetuation of the *sāsana*. However, the mass movement of lay meditation upends this system. Lay people now have access to the "penultimate pursuit of enlightenment" (Jordt 2007) but without the requirement of world renunciation. They still carry on normal lives with family, work, and keeping a home. This "New Laity" as Jordt (2007) labels them, become individual arbiters of moral legitimacy, without necessarily relying on the sangha or the state to set a moral agenda. Meditation therefore becomes "a core reliable source of knowledge verifying what the goals of society are, what the obligations and rights of the state are, and how the individual is situated in relation to state, society, and soteriology" (Jordt 2007). This development in the modern Myanmar Buddhist worldview presents a massive shift in traditional constructs of power and moral legitimacy and reflects a compelling response to the harsh oppression imposed by Ne Win's military regime. Jordt (2007) asserts, "Where public space is suppressed and controlled by a repressive regime, Burmese Buddhists claim control over *the private space of their intention* in pursuit of creating better future life circumstances" (Jordt 2007). This is exemplified by Aung San Suu Kyi's claim to have practiced *vipassanā* while enduring fifteen years under house arrest, a practice to which she attributes her ability to bear no anger toward the regime that kept her away from her family

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<sup>36</sup> A non-sectarian form of *vipassanā* meditation has become increasingly accessible worldwide since the establishment of international *vipassanā* centers by S.N. Goenka, an Indian raised in Burma who studied in the *vipassanā* lineage and began teaching in 1969. See <http://www.dhamma.org/en/>.

and work (Hammer 2012). Finally, Jordt (2007) points to the mass lay meditation movement's capacity to develop its own "native criteria for legitimacy," that could allow for continued reformulations of lay views of good governance and regime legitimacy based on moral grounds (Jordt 2007).

Myanmar is now emerging from fifty years of authoritarian, military rule. With a new era of democratic reform and unprecedented participatory governance being ushered in by President Thein Sein, the country is once again at a new intersection with modernity. Could the mass lay meditation movement become a positive force for social change and impact Myanmar's political reality? Or is meditation practice too much of an individual, private experience to develop any sort of collective organisation? Are non-Buddhist religious communities or individuals also engaging in mass lay meditation as they are in the international vipassanā movement? If not, is there potential for them to do so? Or will mass meditation in Myanmar continue to exclude minorities like the Rohingya? With Myanmar on the cusp of reform, some of these questions may begin to be answered over the course of the next generation.

### **Conclusion**

That Aung San Suu Kyi, a calm, resilient, outspoken defender of human rights, non-violence and democracy, has thus far remained quiet on the Rohingya issue is a telling signal of how polemic this issue is for Myanmar's leaders. Some critics of her silence level the charge that Suu Kyi has opted for "political pragmatism" rather than principled leadership, now that she is faced with the pressure to earn a majority vote in 2015 (McGowan 2012). Would standing up for the Rohingya detract from widespread public support of her and the NLD? Or is it possible that Aung San Suu Kyi believes that Myanmar would be a stronger nation as a Buddhist nation? Ultimately, the question remains, if democracy is to obtain in modern Myanmar, what will it look like and how will the imminent changes in governance affect the plight of the Rohingya?

It is evident that today's religious identities and political institutions in Myanmar have emerged from continuous processes of interpretation throughout history. These processes are likely to continue as Myanmar becomes more and more engaged in the world system. One practical conclusion to be gleaned from this examination of Myanmar history with respect to the Rohingya community is that the Myanmar government must be pressed by other concerned states to grant citizenship to the Rohingya and uphold international human rights legislation. Furthermore, understanding that the conditions of conflict between Rohingya Muslims and Burmese Buddhists are rooted in systemic exclusion and discrimination sustained by Buddhist nationalism, Myanmar's leaders must address this aspect of nationalist identity

in order to attempt national reconciliation and bring an end to conflict between Rakhine Buddhists and the Rohingya community.

There is potential for social change to emerge from within Myanmar society. With the rise of the mass lay meditation movement, moral guardianship has begun to pass into the realm of the laity, who are expanding their capacity and protecting their right to pass moral and pragmatic judgment over the state and sangha. What remains to be seen is if the state can guarantee a democratic platform for the laity to voice their moral and pragmatic concerns. If it can, then perhaps morality *and* pragmatism will prevail, and the culture of xenophobia that arose through the historical narratives discussed here may be reformulated into a new, more inclusive modern Myanmar identity.

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## ETHNIC VIOLENCE: A CASE STUDY ON ETHNIC RIOTS IN SRI LANKA

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*Madhawa Palihapitiya*<sup>37</sup>

*This case study analyses the “root causes” and the rhythm of a prominent ethnic riot in eastern Sri Lanka to deepen the existing knowledge on ethnic riots and for the formulation of broad policy recommendations for political decision-makers and civil society actors to predict and prevent ethnic violence. The analysis highlights prominent political science and international relations theories that provide reasonable explanations for the occurrence of ethnic violence. Specific theories on ethnic riots are also examined. The study recommends the use of conflict early warning systems for the prediction and prevention of ethnic riots and the broader application of international norms for holding perpetrators accountable for the violence. The study is based on the author’s own experience as the head of a citizen-based conflict early warning system in Sri Lanka from 2002 to 2006.*

### **Introduction**

*The eastern province of Sri Lanka*

The Eastern Province constitutes 15 percent of the total land area of Sri Lanka and houses roughly seven percent of the country’s entire population. The Province consists of the three Administrative Districts of Trincomalee, Batticaloa and Ampara. The main occupations of the people in the East are agriculture, animal husbandry and fishing.

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<sup>37</sup> *Madhawa Palihapitiya is the Associate Director at the Massachusetts Office of Public Collaboration, University of Massachusetts Boston. Previously he was Director of Programs at the Foundation for Co-Existence (FCE) in Sri Lanka where he implemented a novel citizen-based third-generation early warning system.*

<sup>38</sup> The Sinhalese are an ethnic group native only to Sri Lanka who speak the Sinhala language and are predominantly Theravada Buddhists.

<sup>39</sup> Sri Lankan Tamils are an ethnic group native to the north east of Sri Lanka who are predominantly Hindu and speak the Tamil language. Some Tamils are Christians.

Table 1: Ethnic composition of the Eastern Province

District/ Ethnicity ( percent)	Sinhalese <sup>38</sup>	Tamils <sup>39</sup>	Muslims <sup>40</sup>
Ampara	38.7	17.4	43.6
Batticaloa	1.2	72.6	25.5
Trincomalee	27	30.6	40.4
Total ( percent)	22.3	42	36.5

Source: Department of Census and Statistics.<sup>41</sup>

The Sinhalese are a minority in the multi-ethnic Eastern Province, as indicated in Table 1. The Tamils are the majority in the East and the Muslims are the smallest minority in Sri Lanka comprising only 9 percent of the island's population. However, Muslims are the second largest ethnic population in the East, making up 36.5 percent of the population in the East. The Sinhalese, though a minority in the East, are the majority population in Sri Lanka. Prior to 2007, the Liberation Tigers of Tamil Ealam (hereafter referred to as the LTTE) was in control of parts of the Eastern Province comprising of the Trincomalee, Batticaloa and Ampara districts.

#### Historical context of riots<sup>42</sup> in the eastern province: pre-cease-fire<sup>43</sup> period

Communal violence first broke out on 22 May 1958, led by the Ilankai Tamil Arasu Katchi (Sri Lanka Tamil Federalist Party-ITAK), following the anti-*Sri* protests by the Tamils<sup>44</sup>. This protest soon turned into an ethnic riot (Selvaratnam 2006; Tambiah 1986). Many people were killed and shops attacked and looted by mobs (Selvaratnam 2006). On May 25, 1958, the Jaffna-bound mail train was derailed at Polonnaruwa and the Tamil passengers were attacked and killed (Ibid.). In Trincomalee City alone, 23 Tamil people were killed by Sinhala mobs (Ibid.). Tamil houses and many shops were burnt. Two months of organised violence left the city in ruins and many homeless.

<sup>40</sup> Muslims in Sri Lanka largely belong to the ethnic category known as Sri Lankan Moors, who are followers of Islam. Sri Lankan Moors predominantly speak the Tamil language.

<sup>41</sup> "Sri Lanka Census of Population and Housing, 2011", Department of Census and Statistics, accessed November 9, 2012, <http://www.statistics.gov.lk/PopHouSat/CPH2011/index.php?fileName=pop42&gp=Activities&tpl=3>.

<sup>42</sup> Stanley Tambiah cites seven 'occurrences of mass violence' perpetrated by the Sinhalese against the Tamils since independence. Deadliest were in 1958, 1977, 1981 and 1983 (Tambiah 1986, 13). He also cites the Sinhala-Muslim riots fuelled by 'religious irritations and commercial competitions' in 1915.

<sup>43</sup> Relates to the 2002 Cease-Fire Agreement signed by the Sri Lanka government and the LTTE which was in tatters by 2007 despite repeated denials at that time by both sides that it was in tatters.

<sup>44</sup> 'Towards the end of March 1958, the National Transport Board sent a fleet of new buses to the North with Sinhalese letters on the license plates, the Federalists defaced them and substituted Tamil letters' (Tambiah 1992, 48).

Violence broke out again in the early 1970s over the dispute of a Hindu Temple in Seruvila Trincomalee (Ibid.). The temple known as 'Kaattuppilliar Alayam' was administrated under the Divisional Secretary<sup>45</sup> division of Seruvila. Tamils of that area strongly opposed the Sinhalese' demand for the participation in the temple's activities (Ibid.). This unresolved dispute ended with small-scale violence between Sinhalese and Tamils during the annual celebrations of the temple in 1960 (Ibid.).

Small-scale violence continued in 1973, 1975 and 1977 (Ibid.). In 1977, ITAK decided to bring its leader S.J.V. Chelvanayagam's ashes to Trincomalee. On that day, communal violence erupted in Trincomalee (Ibid.).

In June 2002, riots broke out in the towns of Muttur and Vallachenai in the East, after Muslims allegedly destroyed 14 crosses erected by a Catholic church (Rupesinghe 2002). An alleged member of the LTTE assaulted a Muslim man driving a taxi (Ibid.). The Muslims retaliated by attacking an LTTE office to which the LTTE responded with a hartal<sup>46</sup>. Muslims responded by imposing a counter-hartal, provoking ethnic clashes, burning of houses and damage to places of religious worship (Ibid.). "The security forces eventually quelled these incidents. The intervention of the security forces, the LTTE, and citizens committees helped to calm the situation. However, news and rumours surrounding the incident quickly spread to other towns. Vallachenai experienced the worst violence. (Ibid., 7). At least 12 people died in the clashes and more than 100 were injured (Ibid.). An estimated 235 shops belonging to both Tamils and Muslims were destroyed (Ibid.).

The Eastern Province witnessed a much more serious escalation of ethnic violence in April 2006 – this time between the Tamils and the Sinhalese. This riot will be analysed in detail later in the case study.

### **Understanding ethnic violence**

Ethnic violence has been defined as "violence perpetrated across ethnic lines, in which at least one party is not a state (or a representative of a state)" in which "the violence is coded as having been meaningfully oriented in some way to the different ethnicity of the target." (Brubaker and Laitin 1998, 428).

The mere existence of ethnic conflict is not a sufficient explanation of the outbreak of ethnic violence (Ibid.). This is because "violence is not a quantitative degree of conflict but a qualitative form of conflict, with its own dynamics" (Ibid., 426). In this study, we will focus on the theories that have

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<sup>45</sup> An administrative sub-division.

<sup>46</sup> Hartal is a protest that involves the stoppage of work.

made a reasonable connection between ethnic conflict and the occurrence of ethnic violence followed by the grounding of these theories on ethnic riots in eastern Sri Lanka.

Some constructivist, rationalist and primordialist theories have made reasonable conclusions about the connection between ethnic conflict and violence. A popular theory among them is elite manipulation or elite persuasion (Snyder 2000). This theory suggests that leaders in countries (particularly when the country is transitioning to democracy) may consider democratic change a threat to their hold on power and manipulate ethnic nationalism and violence to thwart the democratic transition (Snyder 2000). "Nationalism, a doctrine of rule in the name of the people but not necessarily by the people, provided a way for elites to be popular without being fully democratic" (Snyder 2000, 36). The decision to use ethnic nationalism to expand elite power depends on how threatened the elites are by democratisation (elite motivation) and the opportunities for such manipulation that exist within the democratising society (elite opportunity) (Snyder 2000).

Ethnic violence is also caused by more practical conditions like the lack of formal inter-ethnic associations (Varshney 2003). Formal inter-ethnic associations, according to Varshney, are efficient, formally organized face-to-face interactions between different ethnic/religious groups, which may prevent the occurrence of ethnic violence in urban areas (Varshney 2003). However, studies indicate that spontaneous violence can occur despite the existence of formal interethnic associations. For example, some of the violence instigated against Tutsis during the Rwandan genocide was spontaneous and was perpetrated by civilians (Prunier 1995). "The degree of compulsion exercised on them varied greatly from place to place but in some areas, the government version of a spontaneous movement of the population to 'kill the enemy Tutsi' is true" (Prunier 1995, 247).

Although there is reasonable evidence that suggest elite manipulation, an important question remains: *What motivates ordinary people to be mobilised by predatory elites?* One argument is that weak leaders facing the risk of losing power tend to outbid and outflank their opponents by instilling fear in the mind of the citizenry. This strategy is called "gambling for resurrection" (Figueiredo and Weingast 1999, 263), which offers an explanation as to why ordinary citizens often support the violent agenda of predatory elites, although they may not necessarily gain from it themselves. Sections of the public can easily be mobilised since "ethnic publics are conditioned or constituted by ethnic discourses that predispose them to violence against the ethnic Other" (Fearon and Latin 2000). Evidence suggests that the motivation for engaging in

violence against the other can be purely personal<sup>47</sup> and that “ordinary folk involved in communal violence are in fact pursuing their own diverse agendas that may have little to do with communal antipathies per se.” (Fearon and Latin 2000, 855-856). Ethnic violence can also spiral because of political contestation over group boundaries that are not the result of elite manipulation (Fearon and Latin 2000, 872).

Elite manipulation theory is ruled out in instances where there is a rise of an “ethnic security dilemma” (Posen 1993). Here, the violence is the result of circumstantial or structural conditions that exist in countries transitioning to democracy. According to the ethnic security dilemma, “special conditions that arise when proximate groups of people suddenly find themselves responsible for their own security” can be a far greater cause of violence than the “short-term incentives for new leaders to play the nationalist card to secure their power” (Posen 1993: 27, 29). According to Posen’s theory, political leaders are mere bystanders as structural elements drive ethnic groups towards violence. The ethnic competition theory argues that violence is often the consequence of ethnic group competition for economic goods (Olzak 1994). Ethnic violence increases when different ethnic groups find themselves competing for key resources like jobs and housing (Olzak 1994).

Other theories compel us to rethink the labelling of violence as ethnic or communal and to look closer at the contexts within which such violence occurs (Brass 1997). By reframing violence as ethnic or communal, predatory elites and other powerful stakeholders can avoid responsibility for gross atrocities (Brass 1997). Only an objective analysis of the causes and effects of each incident can reveal the true causes of ethnic violence (Brass 1997).

### **The ethnic riot**

Not all ethnic conflicts result in ethnic violence and not all-ethnic violence is perpetrated in the form of ethnic riots (Brubaker and Laitin 1998; Horowitz 2001). Violence categorised as ethnic riots is different from genocide, feud, terrorism, ethnic fights and gang assaults, and have distinct characteristics that set them apart (Horowitz 2001). Among these characteristics is the target and membership of the riot both of whom are civilian. Unlike in terrorism, there is no political ideology that motivates the rioting mobs. The weapons used by the mobs are often primitive and readily available and the attackers are often not highly trained killers but ordinary citizens (Ibid.). The violence is unrestrained

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<sup>47</sup> A clear example of this is the motivation of some rioters during the 1983 July riots in which it was found that the attackers were “made up largely of impoverished and unemployed youth [who] attacked Tamils in their houses and shops, settling old scores and looting” (Kapferer 1988, 101).

and the main objective of the mob is to harm people and destroy their property. However, the boundaries between the categories of violence can merge 'under certain conditions' (Horowitz 2002, 4). Riots can also contain an element of spontaneity, yet, in the selection of targets and group members, riots demonstrate a considerable degree of organization and planning (Ibid., 17-18, 124, 225).

An important analytical concept for understanding ethnic riots lies in the analysis of the precipitants, targets, supporting conditions, organisation, participants, locations, methods and effects of a riot (Ibid., xiii).

Donald L. Horowitz's seminal book on ethnic riots, *'The Deadly Ethnic Riot'* indicates that there are at least six phases to a riot's rhythm (Ibid., 71- 123). The first phase is where precipitating violence occurs. In the second phase, the violence takes the form of a single shocking incident, yet no killings take place. In the third phase there is a lull indicating that both groups are preparing for a violent attack. This phase also indicates planning and mobilisation. In the fourth phase, sporadic and isolated attacks take place where members of one ethnic group (or religious group) attack members of another ethnic group (or religious group). The fifth phase indicates continuous unrestrained violence perpetrated by one ethnic group against another and sometimes vice versa. The sixth and final phase is when the violence ends abruptly following a series of stray attacks. Usually at this phase, law enforcement agencies take control of the situation (Ibid.). This does not however mean that the violence has completely ceased.

Horowitz's theories on ethnic riots become meaningful when applied on an actual riot in Sri Lanka. The riot chosen for this case study is the April 2006 Tamil-Sinhala riot in the town of Trincomalee.

### **Applying Horowitz's theory to the April 2006 riot in Trincomalee City**

#### *The precipitants*

The precipitants can be events beginning in the distant past that continues until just before the riot. Precipitating events assist the mob in selecting leadership, which is assumed on the spot. It also leads to spontaneous violence and creates a hostile atmosphere where the strength of the sentiments can decide the scale of violence (Horowitz 2001, 225, 226). In the case of the April 2006 riots, the first precipitant can be traced back to May 2005 (see below). The second main precipitant occurred four months before the actual riot. It is also clear that within the two precipitating events are many sub-events.

### *Placement of a Buddha statue*

A Buddha statue was placed in the middle of the Trincomalee town on 19 May 2005, amidst opposition from the Tamil population in the area<sup>48</sup>. Tension prevailed in this area as a result, culminating in violence and counter violence by the Sinhalese and Tamils (Selvaratnam 2006; Foundation for Co-Existence 2006). This resulted in the town and its adjacent areas becoming highly militarised with the deployment of additional members of the Armed Forces (Selvaratnam 2006).

### *Killing of Tamil youth*

Another incident that played a contributory role in increasing the racial disharmony in the area was the killing of five Tamil youths in the Dutch Bay area of Trincomalee on January 2, 2006, which was allegedly masterminded by a top police officer<sup>49</sup>.

### *Vigneshwaran's assassination*

Vanniyasingham Vigneshwaran was a bank employee as well as the President of the Trincomalee Tamil People's Forum, and was considered an LTTE sympathiser<sup>50</sup>. Vigneshwaran played a major role in ensuring the victory of the TNA contesting as ITAK at the said polls, where the campaign focus was mainly on the issue of the Buddha statue (he was a prominent Tamil activist who was extremely vocal at the time when the statute was placed<sup>51</sup>) and the killing of the Tamil youths in Dutch Bay. It is learnt that Mr. Vigneshwaran has been considered as replacement to succeed slain TNA Member of Parliament Mr. Joseph Pararajasingham on the TNA national list seat<sup>52</sup>.

Vigneshwaran was assassinated on April 7, 2006<sup>53</sup> just days ahead of peace negotiations between the Sri Lanka government and the LTTE, precariously endangering the cease-fire<sup>54</sup>.

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<sup>48</sup> Wickremasinghe, Nanda. "Erection of Buddha Statue Produces Communal Tensions in Sri Lanka". *World Socialist Web Site*, June 9, 2005. <http://www.wsws.org/en/articles/2005/06/sril-j09.html>

<sup>49</sup> Jeyaraj, David Buell Sabapathy. "Trinco Police Supdt Masterminded Tamil Youth Killing Says UTHR (J)". *Transcurrents*, April 4, 2006. <http://transcurrents.com/tamiliana/archives/123>

<sup>50</sup> "Cease-fire Endangered by Sri Lanka Killings." *New York Times*, April 7, 2009. <http://www.nytimes.com/2006/04/07/world/asia/07iht-srilanka.html? r=0>

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> "Vigneshwaran Shot Dead in Trincomalee". *Tamilnet*, April 7, 2006, <http://www.tamilnet.com/art.html?catid=13&artid=17691>

<sup>54</sup> "Cease-fire Endangered by Sri Lanka Killings." *New York Times*, April 7, 2009. <http://www.nytimes.com/2006/04/07/world/asia/07iht-srilanka.html? r=0>



## The lull

This is where the rhythm of the 2006 riot differed from Horowitz's theory. The lull in the case of the 2006 riot occurred before the unsettling event. Three days passed peacefully between Vigneswaran's assassination on April 7 and the next violent incident on April 11 (Foundation for Co-Existence 2006). Tamil and Sinhalese armed groups remained dormant but actively planning the next phase of violence (Selvaratnam 2006). Isolated reports indicated stockpiling of gasoline and sharp as well as blunt weapons. Yet, there was no clear evidence of organisation. As Horowitz argues, "this is not to say that all riots are organized, no matter how organized they appear. Undoubtedly, some are spontaneous, and many others are organized ad hoc by participants and leaders who improvise plans during the lull." (Horowitz 2001, 225). During this time, the funeral arrangements for Vigneswaran went ahead. A date and a time were set for the funeral.

## A single unsettling event

An LTTE front organisation named the "Tamil Upsurge Force" issued notices warning of attacks against the Security Forces (Foundation for Co-Existence 2006). On April 11, the day of Vigneshwaran's funeral, a claymore mine<sup>55</sup> planted by the LTTE exploded in Thambalagamam, killing 10 Navy personnel and one civilian<sup>56</sup>. Eight sailors were seriously wounded. In Horowitz's theory, the violence takes the form of a single shocking incident, yet no killings take place. In the case of the 2006 Trincomalee riot, killings did take place and those killing were the single unsettling event. This is another instance where the 2006 Trincomalee riot diverges from Horowitz's theory.

## Sporadic and isolated attacks

The Sinhalese living in Abeyapura had removed the black flags hoisted in the area in protest of Vigneshwaran's killing and instead replaced them with white flags to mourn the killing of the Navy personnel (Selvaratnam 2006). Jaffna District TNA MP Nadaraja Raviraj,<sup>57</sup> who was in Trincomalee for the funeral, was attacked by a mob on his return journey (Foundation for Co-Existence 2006). On the same day, three Tamil youths were severely injured in a grenade attack by unidentified persons at Alles Garden, Trincomalee (Selvaratnam 2006). On April 12, a police vehicle was targeted by the LTTE in

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<sup>55</sup> A claymore mine is an explosive device widely used by both the Sri Lanka Government and the LTTE.

<sup>56</sup> "Sri Lanka Timeline - Year 2006". *South Asia Terrorism Portal*, <http://www.satp.org/satporgtp/countries/shrilanka/timeline/2006.htm>

<sup>57</sup> Member of Parliament Jaffna District from the United National Party who was later assassinated

Kumburupiddy, resulting in the killing of two policemen. And two others sustained injuries in this explosion (Foundation for Co-Existence 2006).

By this time it is evident that the riot is considerably well organised and that the riot has lost its original spontaneity. The logistics, weapons, precipitants, methods of fighting and the intensity of violence (Horowitz 2001, 227) indicates this organisation.

### **A massive deadly attack**

Just prior to the Sinhala and Tamil New Year, which falls on April 14 each year, at around 3.20 pm, when the Trincomalee public market was teeming with shoppers, a bomb, concealed in a parcel attached to a bicycle parked nearby exploded, and its assailants remain unknown (Foundation for Co-Existence 2006). The majority of the victims were Sinhalese. It is reported that five people including two Security Forces personnel were killed on the spot (Selvaratnam 2006).

In the ensuing melee, security personnel stationed at a nearby checkpoint rushed to the scene and opened fired (Foundation for Co-Existence 2006). This provoked elements from the fisher folk dwellings – the main elements of the market gang – to start attacking the Tamils (Selvaratnam 2006; Foundation for Co-Existence 2006). While at the same time, Tamil youths exploded three grenades – at 3.45 pm, 3.55 pm and 4.00 pm in the town (Selvaratnam 2006; Foundation for Co-Existence 2006). There were no casualties.

Around 4.15 pm, gangs of Sinhalese had arrived in vehicles (Foundation for Co-Existence 2006). They started assaulting people in the Central Road and the shops owned by Tamils (Selvaratnam 2006). Tamils were killed and 48 businesses were looted (Ibid.). Street vendors were attacked and relieved of their merchandise. Around 15 vehicles were burnt and 60 smashed (Ibid.).

### **Sporadic attacks**

More claymore attacks were carried out by the LTTE. One targeting an army vehicle resulted in a few injured soldiers (Selvaratnam 2006; Foundation for Co-Existence 2006). Three Air Force men were killed in Kappalthurai. On April 17, two unidentified men on a motorbike fled from an Army check point at Maligathiv after throwing a hand grenade and firing at a soldier on duty with a pistol (Foundation for Coexistence 2006).

On April 18, two more people on a motorbike hurled a grenade at the Security Forces sentry point in Muttur. Two more claymore bombs were discovered by troops on patrol on April 18 and 19 and were diffused before they exploded (Foundation for Co-Existence 2006).

On the April 21, a home guard was killed and Security Forces personnel wounded in yet another claymore attack at the 58<sup>th</sup> Mile Post on the Dehiwatta – Kiliveddy Road (Foundation for Co-Existence 2006). In the aftermath of this, a double cab carrying police personnel along with an Assistant Superintendent of Police to control the tense situation was attacked, resulting in five personnel being injured (Foundation for Co-Existence 2006). On the same night, a bus carrying civilians to Vavuniya from Trincomalee was attacked at Abeyapura, injuring three. On the April 23, six persons were killed and four injured (all Sinhalese) in Gomarankadawala by unidentified persons (Selvaratnam 2006).

Three dead bodies of Tamil youths were discovered near Barathipuram and Poddankadu on April 22 and 23 respectively (Foundation for Co-Existence 2006). In another incident, a Tamil youth had been shot dead at Kappalthurai in the China Bay Police Division, in an Air Force firing incident, when he tried to attack the personnel on patrol (Selvaratnam 2006). The riot ends abruptly.

### **The nature of the violence and aftermath**

#### *The methods of attacking*

Some of these attackers had clubs, iron-rods, knives and swords (Foundation for Co-Existence 2006). Reports indicate that they singled out Tamils for assault. Many vehicles and shops owned by Tamils were either smashed or burnt (Selvaratnam 2006). Tamils on motorcycles or three wheelers on the Kandy Road and Nilaveli Road respectively were attacked and some killed (Ibid.). It is said that Tamil women had been hacked with knives and swords. Some of these claims were later cleared as rumors (Ibid.).

The violence continued into the following day. The body of a Sinhalese youth from Mihindupura, who had been hacked to death, was discovered on April 14, which gave rise to more violence (Foundation for Co-Existence 2006). In addition, a Sinhalese middle-aged person transporting bread in Andankulam was killed close to Mahindapura on the Trincomalee – Anuradhapura Road. In the aftermath of these killings, Sinhalese people from the area set fire to at least 100 Tamil houses (Selvaratnam 2006).

#### *Rumours*

Rumours spread in the Sinhala community of an imminent LTTE attack. Rumors spread in the Tamil community that Tamil women had been hacked with knives and swords (Foundation for Co-Existence 2006). Inability to accurately verify these reports led many to act on the rumours.

The rhythm of the 2006 riot is similar to the rhythm identified by Horowitz, although the sequence of events is slightly different. The precipitants of the 2006 riots are by far the most notable. 11 killing occurred in the second phase of

the riot and Horowitz's theory on ethnic riots seems valid on almost every other level with regard to the 2006 Trincomalee City riot. But this is inconclusive. The 2006 Trincomalee Riot is one of many that have taken place in Sri Lanka (and also the world. Therefore, deeper analysis is needed to determine how Horowitz's findings on the rhythm of a riot hold true when applied to multiple riots.

### **Horowitz's classification of the rhythm of a riot applied to ethnic riots in**

#### **Sri Lanka**

In the following diagram, Horowitz's rhythm of the riot is applied to three prominent riots in Sri Lanka, namely the infamous 1983 July Riot (Or "Black July"), the 2002 riot in the Eastern Province, which erupted soon after the last cease-fire agreement was reached between the government and the LTTE, and the 2006 riot. As the diagram indicates, the rhythm described by Horowitz is generally applicable to all three riots.

#### **Analysis**

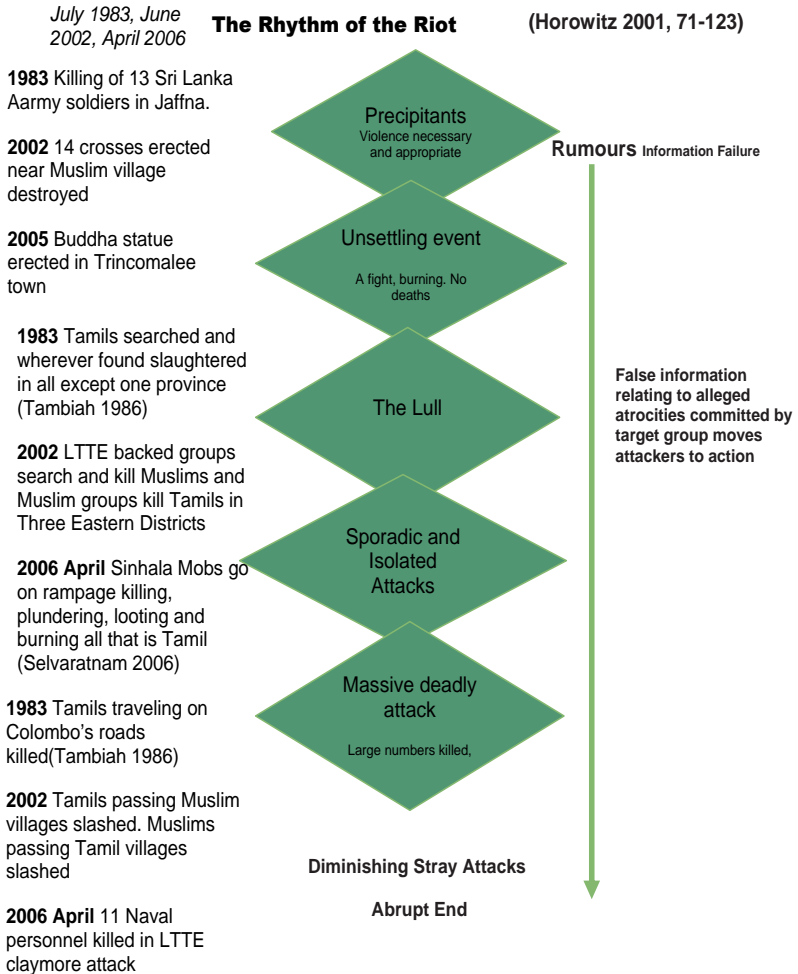
The failure of the institutions of law and order in quelling the 2006 riots, and the riots before that in 2002 (Rupesinghe 2002) and in 1983 (Tambiah 1986) indicate a pattern of elite manipulation. The government certainly had at its disposal all the resources to control the 2006 Trincomalee City riot in particular, for example, the availability of manpower. The Sri Lanka Navy operates a large naval base in Trincomalee City, the Sri Lanka Air Force maintains a large base at China Bay, only miles away from Trincomalee City and the Army Special Forces maintains their base at Monkey Bridge, further away from the city. The police also have a Deputy Inspector General (DIG), a very high-ranking officer stationed for the most part in Trincomalee City. Protocol suggests that, in times of crisis, the Navy and the Army are called up to assist the police (Selvaratnam 2006). However, these resources were not adequately mobilised to prevent or successfully mitigate the violence (Selvaratnam 2006).

The targets chosen for attacks, which were all successful Tamil businesses, the timing of the attacks, which was after a claymore attack that killed 10 sailors and hours before the Sinhala Tamil New Year, the organisation of the attack, planning, and also the fact that the riot continued for many days without proper intervention (Selvaratnam 2006) clearly indicate significant elite manipulation.

Attacks on business establishments and targeting of inter-ethnic economic associations between Tamils and the Sinhalese are also significant indicators that the 2006 riot was well planned and not spontaneous. There was a gradual and deliberate build-up to the violence with careful selection of Tamil businesses for attack. While spontaneity must not be ruled-out, attacks on

business establishments cannot be planned on a whim, particularly given the close proximity of Tamil businesses with Muslim and Sinhalese businesses. Given the importance of economic collaborations between different ethnic groups, the attacks resulted in a serious reduction in inter-ethnic associations that crippled the local economy for months (Foundation for Coexistence 2006).

Figure 1



It also cannot be a coincidence that the violence erupted on such large scale, in a city prepared for war, particularly when the political leadership of the country had changed hands allowing for a more hard-line Southern leadership to emerge in the form of Mahinda Rajapaksa. Prime Minister Mahinda Rajapaksa was elected President at the Presidential Elections held on November 17, 2005

in a closely contested race with the Opposition Leader Ranil Wickremesinghe. Soon after the defeat, the opposition claimed that the LTTE had prevented Tamils in the North East from voting for Wickremesinghe<sup>58</sup>. Ironically, years earlier, Wickremesinghe had signed a cease-fire agreement with the LTTE and had won the General Election through a campaign of peace. The then President Chandrika Kumaratunga outbid and outflanked Wickremesinghe by initiating a hostile takeover of the Ministry of Defence citing national security concerns<sup>59</sup> and subsequently dissolved Parliament<sup>60</sup>. President Rajapaksa was also greeted to office by a grave national security situation in the form of a spate of bomb attacks launched by the LTTE. This 'welcome' included the events that occurred in Trincomalee during the 2006 riots.

The attacks claimed the lives of a number of security forces personnel. Although Rajapaksa had initially made clear indications that he was going to pursue peace, as Wickremesinghe had done before him, he had a difficult rise to the top of his party and was forced to surround himself with Kumaratunga loyalists. The Trincomalee attacks combined with the closure of the Mavil Aru reservoir in Trincomalee District by the LTTE and Rajapaksa's pact with ultranationalist parties like the People's Liberation Front may have influenced his decision to select the military option. Rajapaksa would have feared being outbid and outflanked by his own party if he was soft on the LTTE.

Therefore, it is reasonable to suggest that the 2006 riots in Trincomalee City was only the precipitating event of the final war between the Sri Lanka government and the LTTE. Trincomalee became the epicentre of violence as ethnic rioting that started in January 2006 and culminated in the start of the last major offensive against the LTTE at Mavil Aru reservoir, which was captured by the Sri Lanka Army on July 21, 2006. As the designated Capitol of the LTTE's state of Tamil Eelam, it was only natural that the LTTE and the Sri Lanka government chose Trincomalee as their first battleground in the 'final war'. In May 2009, the Commander of the Sri Lanka Army, Lt. Gen. Sarath Fonseka said that he considered Trincomalee the best place to commence the final war against the LTTE<sup>61</sup> (as opposed to another part of the contested North East).

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<sup>58</sup> Jeyaraj, David Buell Sabapathy. "Tigers Deprive North-Eastern Tamils of Franchise". *Tamilweek*, November 20-26, 2005. [http://www.tamilweek.com/Tigers\\_deprive\\_NE\\_Tamils\\_franchise\\_1120.html](http://www.tamilweek.com/Tigers_deprive_NE_Tamils_franchise_1120.html)

<sup>59</sup> "I Took Over Ministries in the Interest of National Security –President". *Daily News*, November 5, 2003. <http://www.dailynews.lk/2003/11/05/new04.html>

<sup>60</sup> "Sri Lanka Leader Sacks Parliament". BBC, February 8, 2004. [http://news.bbc.co.uk/2/hi/south\\_asia/3469261.stm](http://news.bbc.co.uk/2/hi/south_asia/3469261.stm)

<sup>61</sup> Sriyananda, Shanika. "Army Commander Assures LTTE is Finished." *Sunday Observer*, May 17, 2009. <http://www.sundayobserver.lk/2009/05/17/sec05.asp>

Geographically and strategically, the capture of Trincomalee by the Sri Lankan military paved the way for the Sri Lankan government to systematically root-out the LTTE from the Eastern Province, and to then engage in successful military operations against the LTTE in the northern provinces<sup>62</sup> where they completely rooted-out the LTTE by May 19, 2009.

### **Policy recommendations**

All violence is not ethnic and not all ethnic conflict result in violence and/or riots. It is best to study each episode of ethnic riots in its proper political context. As the experience from Sri Lanka demonstrates, actual eruptions of ethnic riots may vary depending on the context in which the riot occurs. An analysis of the rhythm of a riot can reveal important clues – increasing possibilities for predicting the violence.

An analysis of the ethnic riot will be futile without discussing some actions that can be taken to predict and/or prevent the ensuing violence<sup>63</sup>. A clear recommendation to political decision-makers, the civil society and the international community is to implement conflict early warning systems<sup>64</sup> in regions with a history of ethnic riots or a potential for an outbreak of ethnic riots. Early warning is an analytical as well as a practical tool to predicting and preventing political violence. The design of such a system must take into account the meaning and causes of the violent events it attempts to prevent/manage so that the events can be appropriately categorised for preventive action (Brubaker and Laitin 1998). A successful community-based early warning system was used in the Eastern Province of Sri Lanka to predict and prevent ethnic violence<sup>65</sup>, including riots, with a considerable degree of success (Bock 2012; Rupesinghe 2009). The early warning system in Sri Lanka comprised of an information centre and an early response unit with active community-based early warning and early response. The system was capable of assessing precipitants and informing the government, Security Forces and the LTTE of impending violence in a timely fashion using technology as simple as text messaging. Before dissemination, the information was verified by in-house experts and distributed to identify actors with a speed that rivalled the spread

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<sup>62</sup> Ibid.

<sup>63</sup> Predicting riots can be problematic given the “degree of the ambiguous and elastic concept of violence” (Brubaker and Laitin 1998, 426).

<sup>64</sup> Early warning has been defined as “an information system which can provide timely information to decision makers on impending conflicts, humanitarian disasters and the mass exodus of peoples” (Rupesinghe 2002, 10).

<sup>65</sup> The early warning system was designed and implemented by the Foundation for Coexistence in Sri Lanka.

of rumours. A study found credible evidence that the community-based early warning system established in Sri Lanka, coupled with early action, resulted in a 23 percent reduction in the lethality of deadly violence between groups of different ethno-religious identities (Bock 2012).

An unfortunate and fundamental failure of early warning systems was the lack of political interest among decision-makers to act on the warnings. In order to improve early action, it is recommended that early warning systems target actors at multiple tracks (Diamond and McDonald 1993)<sup>66</sup> depending on their ability and interest to prevent violence. In order to increase early intervention, it is recommended that a critical mass of actors are identified to receive the warnings and their actions to prevent violence is assessed by local and international actors for purposes of public accountability.

As a broader, global recommendation, the scope of the United Nation's Responsibility to Protect initiative (R2P) should be extended to include smaller-scale cyclical violence like riots. The R2P initiative currently focuses on preventing mass atrocities like genocides and should be deepened to cover smaller-scale violence such as ethnic riots, which often precede mass violence. By starting at the level of the riot and holding governments, its institutions and non-state actors responsible for the violence (instead of waiting for the eruption of larger scale violence), the opportunity to predict and prevent mass violence can increase.

The readiness to respond to violence should also be increased at the institutional-level in societies susceptible to ethnic violence. This readiness should be on par with that of preparedness for natural disasters. The training, resources, methodology and the overall readiness of governments, the civil society and international actors must be continuously monitored by responsible national and international bodies.

## Conclusion

From Trincomalee to Jos, Nigeria, each year, violent ethnic riots destroy valuable lives and property leaving behind fractured societies with growing ethnic/religious animosities that, if unaddressed, can cause wide-spread chaos. Therefore, predicting and preventing violent ethnic riots is an important policy choice.

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<sup>66</sup> A broader range of actors can be engaged – from Track 1 level government actors; Track 7 religious leaders to Track 8 funders.



As this case study from Sri Lanka highlights, documenting violent riots in terms of their precipitants, targets and conditions according to available theoretical frameworks is significant for purposes of conflict analysis and resolution. It also highlights the underlying social, political and economic conditions of a riot and the importance of the application of available theories on ethnic violence to gain a better theoretical understanding of the observable elements of a riot. The study also recommends measures to prevent ethnic riots, based on the experience and learning from Sri Lanka. The findings and recommendations contained in this study may provide a template for the analysis of similar riots in other parts of the world.

The body of knowledge on managing ethnic riots has gradually expanded, yet more research and analysis is needed, particularly to identify warning signals early-on in the cycle. Prediction is important and the cyclical nature of riots may warrant numerous opportunities for early warning and early action. International initiatives such as R2P and methodologies like conflict early warning can provide important policy frameworks and practical tools to address deadly riots in global hotspots. It is hoped that the experiences and learning from Sri Lanka that is contained in this study will become a valuable source of knowledge for decision-makers and Track II peace builders as we progress towards more scientific approaches to addressing ethnic violence.

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## GPPN 2012: TURNING THE TIDE; POLICIES FOR A CHANGING WORLD

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*Nirmali Sivapragasam*<sup>67</sup>

The Lee Kuan Yew School of Public Policy (LKY School) had the distinct honour of hosting and organising the 2012 Global Public Policy Network (GPPN) student conference<sup>68</sup> held on 9-11 December 2012 at the LKY School campus. The conference brought together over 80 students from the GPPN network, which included: Institute of Public Affairs, London School of Economics (UK); School of International and Public Affairs, Columbia University (USA); Sciences Po (France); Graduate School of Public Policy, University of Tokyo (Japan); Hertie School of Governance (Germany), and the LKY School.

Titled, "Turning the tide: Policies for a changing world", the conference sought to encourage a rethink of traditionally-dominant modes of economic growth, and the extent to which Asia, a growing continental power, could play in the move towards more inclusive and sustainable growth. Three sub-thematic questions the conference specifically sought to address were: Can the current dominant economic system still "raise all boats"? Given growing income inequalities, what kind of policies can best promote social equity and more inclusive measures of growth? What roles can Asian nations play in a changing global order?

The conference was organised by a core student committee of eight persons at the LKY School with support from other students, the Academic Affairs team, and colleagues at participating institutions. The conference was co-chaired by Midhfa Naeem and Sue Helen Hernandez. The two-day conference consisted of four plenary talks and 40 student presentations. Kishore Mahbubani, Dean of

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<sup>68</sup> The GPPN Conference is an annual student conference run by GPPN schools and associated institutions. Since its inception in 2006, the conference has become a highly anticipated event, bringing together policy students from around the world to discuss and exchange ideas on policy, governance and economic development.

LKYSPP gave the opening address. Dean Mahbubani asserted that a key challenge policymakers and policy students face in an increasingly interconnected world is responding to global problems with a *global* mind-set. Dean Mahbubani argued for stronger (and, more effective) multilateral decision-making, including a wider presence of emerging economies in global policymaking talks and meetings. The opening address was followed by a roundtable discussion with Deans from the five GPPN partner schools, on how characteristics of global leadership can and should be redefined, in light of changing geopolitical and disciplinary landscapes.

The third plenary of the conference was the keynote speech by Chandran Nair, author of the provocatively-titled book, *“Consumptionomics: Asia’s Role in Reshaping Capitalism and Saving the Planet”* and Founder of the independent pan-Asia think-and-do tank, The Global Institute for Tomorrow. In line with the first subtheme of the conference, the lecture elaborated on the economic, social and environmental consequences of consumption-led growth, and explored alternative strategies and its implications for nation states, particularly, those in Asia. Given rapidly depleting natural resources and growing environmental concerns, Nair opined that Asia should (and, daresay, cannot) aim to follow the West in promoting consumption-driven growth; rather, countries should aim at achieving and maintaining a standard of living that is environmentally sustainable in the long run. Nair argued natural resource management needs to be placed at the center of policymaking. Moreover, Nair asserted that if countries are to aim at equitable levels of inter-generational resource sharing, the promotion of collective welfare over individual rights should be encouraged.

In line with this theme, a student policy challenge on the topic of “Strategies for De-growth” was organised with the aim of promoting debate among students on ways in which economic “de-growth” could be encouraged and incentivized. Policy suggestions ranged from public finance, labour and education to media/communications and urban planning. Some of the suggestions included progressive taxation on household and commercial energy use, promotion of self-sustaining neighbourhoods and communities (thereby, reducing transport costs), and taxes on advertisements. Professors Charles Adams and Dodo J. Thampapillai adjudicated the competition. The session proved both enlightening and entertaining for all!

Finally, participants were treated to a Roundtable discussion on social inequality, led by Donald Low, Senior Fellow and Assistant Dean at LKY School and Veronica Gamez, Executive Director of Aidha, a micro business school which serves to nurture the entrepreneurial talent of domestic workers in Singapore. Low asserted he considered inequality to be one of the three great

problems – others being, climate change and economic instability – facing the world, post the 2007-08 Global Financial crisis. He argued that from an academic angle, one needs to reassess the ways in which economics is taught and positioned in the face of growing inequalities and related problems. Reforms in institutions and redistributive tools are also needed. Gamez argued for the need to understand such issues from the perspective of those who seek change, and provide them with the opportunity of making their own decisions.

Aside from the plenaries, 40 student papers were presented, based on the aforementioned subthemes. Topics ranged from proposals aimed at building an “ideal” global economic architecture that incorporate the best elements of capitalist, statist and socialist systems to those examining the role Asian nations could play in a changing global order. Overall, GPPN 2012 proved to be an enjoyable and intellectually-stimulating two days, a great experience we are not likely to forget in years to come!

## BOLSA FAMÍLIA: A WAY OUT OF POVERTY OR A WELFARE TRAP? A 2030 BACKCASTING OF THE BRAZILIAN CONDITIONAL CASH TRANSFER PROGRAMME

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*Rafael Barreto Souza*<sup>69</sup>

*Benefiting over 16 million people, the Brazilian conditional cash transfer programme, Bolsa Familia, is currently the largest programme of its kind in the world. It provides monthly cash deposits to poor households through personalized banks accounts. Strong conditionalities related to healthcare and school attendance are imposed. The policy aims to tackle extreme poverty while creating a virtuous cycle within a generation's time in which a healthy and educated youth would be able to climb up the social ladder. Started in 2003, and massively expanded thereafter, it has registered virtually every eligible family. Hence Bolsa Familia has made significant impact in reducing extreme poverty in Brazil. Nevertheless, attaining long-term objectives of tackling the poverty trap remain unclear. This paper will adopt the "backcasting" Futures Studies methodology for examining key drivers of multi-generational poverty in Brazil, with 2030 as the timeframe. Policy recommendations for reaching this desired future are proposed.*

### **Introduction**

Brazilian conditional cash transfer programme, Bolsa Familia, is currently the largest programme of its kind in the world. It provides monthly cash deposits to poor household heads, preferably to women, through personalized banks accounts. All low-income Brazilian households are eligible for receiving the benefit; however, strong conditionality's are imposed with regards to schooling and healthcare follow-up. Started in 2003 and currently reaching almost 14 million families nationwide, Bolsa Família has massively expanded and has made a significant impact in reducing extreme poverty, as most eligible Brazilian families are registered, and have benefitted significantly under its auspices. The goals from this policy are two-fold: (i) tackle immediate hunger and extreme poverty; and (ii) create a virtuous cycle within a generation's time where a healthy and educated youth would be able to climb up the social ladder.

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Nevertheless, the long-term objective of ending the poverty trap for the next generation is still uncertain. The complexity of the poverty phenomenon and the intricate decentralized governance peculiarities of Brazil have to be closely considered as well as wider healthcare and education policies and their impacts. These durable goals face a lot of scepticism, as critics argue that the cash transfers are mere handouts, which further stimulate the cycle of poverty through lethargy and apathy. They claim that in time Brazil will face, instead of a *poverty trap*, a financially dangerous *welfare trap*. Empirical evidence has so far led to inconclusive findings. These issues demand deeper analysis from a futures-based perspective seems in accordance with the issue's complexity.

This paper initially presents a background contextualization of how Bolsa Família came about and how it currently functions. Next, as a result of the literature review, main trends and emerging issues are discussed. Subsequently, the Futures Studies methodology of Backcasting is adopted for examining drivers of multi-generational poverty in Brazil with the timeframe of 2030. Contrasting with traditional foresight methods in which multiple prospective scenarios planning take place, backcasting goes in the other direction by establishing a preferred future or a vision, and then traces it back to its driving forces and influential strains. For the purposes of this study, the desired future is one in which there is no more extreme poverty in the country and in which the conditional cash transfer (CCT) programme is no longer a necessary social policy intervention. This future is referred to as "Bolsa Família Ends". This backcasting exercise intends to open policy-makers minds for the multi-sectorial outlook demanded for ensuring successful policies in the country. Backcasting also aims to adopt adequate parallel policies in order for Bolsa Família not turning into a self-feeding socially trapping programme.

### **Bolsa Família – Background**

Bolsa Família started officially in 2003 during the first year of former president Luís Inácio Lula da Silva's administration. However, the programme's conceptual phase started much earlier. In 1991, Congress discussed a bill – Projeto de Lei n. 80/1991 – in order to institute a guaranteed minimum income programme equivalent to the minimum wage for every Brazilian citizen over 25 years old (da Silva e Silva 2007). This initiative brought the issue to national level debate, and in 1995, the municipalities of Campinas and Brasília introduced experimental conditional cash transfer programmes with positive results.

Only in 2001 was the federal government able to take a stand on the issue and implement conditional transfers under an umbrella programme called Fome Zero (Hunger Zero), inspired by the Millennium Development Goals that called for halving hunger and extreme poverty by 2015 (Hall 2006). Bolsa Escola was

the first programme put in place, which transferred cash to heads of families under the condition that school-aged children would regularly attend classes; it was run by the Ministry of Education. Next, Bolsa Alimentação provided funds for families to serve their basic food necessities. It was managed by the Ministry of Health. Other programmes were also implemented such as Auxílio Gás, a cooking gas subsidy given by the Ministry of Mines and Energy. Lastly the child labour eradication programme, PETI (Portuguese acronym), started by the Ministry of Labour and Employment, was set out (Hall 2006). Limited in scope and reaches these policies had reduced impacts in the country as a whole.

These programmes only got a universal scope after 2003, when the Worker's Party, under Lula's leadership, took office. Bolsa Família came about as a flagship programme that unified all existing programmes under the management of the newly created Ministry of Social Development and Fight against Hunger (MDS, Portuguese acronym). They all stood under the same management, budget and policy implementation structure (Hall 2006). Legally formalized by the bill (lei) n. 10.836/2004 – the programme instituted a means-testing policy in which families were eligible based on per capita household income.

The Bolsa Família defines two categories of beneficiaries. Families with monthly per capita income from BRL 70-140.00 (USD 40.00-90.00) are eligible as long as there are children in schooling age, from 0-17 years old<sup>70</sup>. On the other hand, families in extreme poverty, that is, earning per capital lower than BRL 70.00 (USD 40.00) per month, are eligible regardless of age. Furthermore, cash transfers are conditional upon compliance with certain activities: 85 percent school attendance for students between 6-15 years old and 75 percent for those between 16-17<sup>71</sup>; following of infantile vaccination calendar and routine prenatal care for pregnant women; as well as presence to 75 percent of social service activities towards children under risk or relieved from child labour. (MDS. Ministry of Social Development and Fight against Hunger n.d.).

The federal government created a consolidated registration software system to manage data from all beneficiaries in the country, called Cadastro Único para Programas Sociais (CadÚnico). The system provides comprehensive information to Bolsa Família's administrators, avoids double-registration of recipients, and improves measurement and compliance mechanisms. Further,

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<sup>70</sup> Young babies make families eligible due to post-natal health conditionalities and, as of two and three years old, children are considered in schooling age since they can go to public child care facilities.

<sup>71</sup> Brazilian laws 16-17 year old youngsters to work part part-time as apprentices, thus they might not be able to attend 85 percent of classes.



monthly transfers are made electronically through a direct deposit to beneficiaries' individual bank accounts through the largest Brazilian public bank, Caixa Econômica (Caixa Econômica Federal n.d.). The latter makes the process free of human intervention and virtually eliminates resource misuse by the intermediaries and paternalist agendas by physically handing out money. As Fenwick cogently puts it: "the programme is designed for one family, one application, one responsible local office, one payment, and one federal registry." (Fenwick 2009, 116). Further, as a social control mechanism, Bolsa Família's law determines the creation of local councils by regular citizens; their structure and functioning is to be defined by municipalities.

Bolsa Família's aims are twofold. Firstly, the urgency of poverty and hunger needs to be addressed. It is a short-term humanitarian-like policy for indigence alleviation. Secondly, the programme seeks to stop the vicious cycle of poverty where the uneducated poor reproduce, put their children to work to help make ends meet, and these children, unable to attend school, once older, replicate the cycle when establishing their own families. The programme endeavours to break such a cycle through education, healthcare and job creation policies directed to poor families, and provide a springboard for development, creating employment and income-earning opportunities through strategies of social risk management (Hall 2006).

### **Environmental scanning**

In analysing recent literature regarding this issue, one can identify a number of trends and emerging issues in public discourse as well as in policy. These incipient developments have been clustered into four main trend groups: (i) policy trends, (ii) economic trends, (iii) political trends, and (iv) social trends.

### **Policy trends**

#### *Bolsa Família's increasing budget share*

This is perhaps the most dangerous trend in Brazil, not necessarily because social spending towards poverty reduction is undesirable, but mostly due to its effect on other long-term essential social spending. Its share rose from 23 percent of the social assistance budget (BRL 2.4 billion) in 2002 to 38 percent (BRL 6.5 billion) in 2006, while social assistance's GDP share itself grew from 0.7 to 0.9 percent over the same period (Hall 2006, 693). Hall argues this share is becoming larger than e.g. all federal educational programmes, with the exception higher education (Hall 2006, 707). Between 2002 and 2004, sanitation and housing lost around 46 percent, in real terms, of their budget allocation (Hall 2008, 816). Further, in 2012, in the midst of the largest federal budget cuts in Brazil's history, the MDS has remained practically intact, while education and health have lost almost BRL seven billion altogether. Further, federal

government recently passed an amendment to Bolsa Família law (Lei n. 12.512/2011) extending the benefit from the maximum of three children per household to five, and has been annually readjusting the grant between 8-10 percent over the regular inflation rate. This trend is particularly worrisome taking into account that Bolsa Família is not seen as a self-ended programme, but as a temporary inter-generational out-of-poverty scheme (PSTU 2012). However, due to the programme's support amongst the low-income classes and the political advantages resulting therefrom, it has remained an unquestionable priority regardless of its current – or future – outcomes. Notwithstanding, other political developments are reshaping this tendency, in October 2012, the lower house of Congress approved the National Education Plan, establishing the allocation of 10 percent of GDP for education, the highest worldwide share, above the Danish 8.7 percent already extraordinary percentage (The Economist 2012).

### **Decentralisation to municipalities**

The Brazilian federal system is unique in the world as it recognizes the federal government, states and municipalities as equally federated counterparts. Local governments, therefore, enjoy autonomy and parity towards states. This peculiarity plays a very important role in national policymaking and implementation especially after the Organic Law of Social Assistance (LOAS, Lei n. 8.742/1993) was passed, directing the execution of all programmes confronting poverty to the municipal level. In practice, central social policies “generate a direct relationship between the federation and citizens in situations of social vulnerability with as little intermediation as possible” (Fenwick 2009, 110). Bolsa Família, in particular, leaves most of its implementation to municipalities, including data collection, registration of potential beneficiaries, and monitoring of adherence to conditionalities (Hall 2006, 697). There has been a reduction in administrative costs and facilitated user access at local level through the CadÚnico municipal-level registry, and bankcards. It is likely that the trend of a strong direct relationship between Brasília and the 5,565 municipalities will persist, keeping states' political elites out of the intermediation. Some analysts have even argued that this strategy of bypassing state governors has determined the success of delivering public goods federation-wide in the area of non-contributory social protection policy (Fenwick 2009, 102). In the long term, this might lead to weakening governors and their regional clientelist political influence, while the federal and local politics take the spotlight.

### **Mediocre quality of education and health**

Over the last decade, access to health and education has been expanding in Brazil. However, quantity has not necessarily translated into quality. In the OECD Programme for International Student Assessment (PISA), a 65-country assessment, Brazil ranked at the bottom in all categories even though there has

been improvement over the years (OECD 2012). The prospect of additional increase in resources due to the 10 percent GDP threshold plan is unlikely to – by itself – promote any change in this scenario. Brazil has also succeeded in primary healthcare – preventive and non-hospital-based – expansion to the remotest municipalities through the Family Health Programme (PSF, Portuguese acronym) moving from a little more than 4,400 municipalities in 2003 to 5,251 in 2009, to almost the totality of the country's 5,565 municipal units (Ministry of Health n.d.). Also, family health teams have increased from 8,503 in 2000 to 33,000 in 2010 (Sánchez-Ancochea and Mattei 2011, 310). Nonetheless, quality concerns have alerted experts. While there are progressive regulatory rules, there has not been sufficient improvement in the quality of public health. This trend basically reveals growing expenditure and outreach efforts without a corresponding effect in quality. Both doctors and teachers lack comprehensive career plans, performance-based incentive mechanisms and other quality related policy tools (Santos n.d.) (Viacava 2004).

### **Information technology advancements**

The establishment of the CadÚnico solved intra-bureaucratic chaos that was caused by multiple programmes benefiting the same people. Valid concerns now focus on improving data collection in view of persistent problems such as the underreporting of incomes and political bias in recipient selection (Hall 2006, 702). Reducing error and administrative costs, and data centralization under nation-wide databases has turned into a visible trend encompassing other social policies undertaken by states and municipalities in the domains of housing, sanitation etc.

The 2011 Right to Access Information bill (Lei de Acesso à Informação, Lei n. 12.527/2011) is also a benchmark of consolidating IT in all Brazilian government levels by determining public access to budgets, up-to-date expenditure, salaries of government officials, amongst others, in open-access official websites. Moreover, the use of electronic banking system for cash delivery to beneficiaries is currently the standardized nationwide policy, while parallel mechanisms have been eliminated. This has improved efficiency and knocked most of the corruption out of the equation. Another innovation that was announced in 2010 and is gradually being implemented is the use of cellular phones for receiving the monthly transfers and for purchasing goods and services. This technological aid intends to reach every Brazilian family regardless of the remoteness of their residence. While Caixa Econômica bank agencies are not present ubiquitously, cell phone coverage extends to virtually all municipalities (Folha de São Paulo 2010). This tech-based policy changes seem to be ever more present and are prone to deepen in scope and depth.

## Fiscal restrictions on social policies

On fiscal policy front, Brazilian lawmakers have indicated negative signs towards expanding the social budget, in opposition to Workers' Party administrations. Vivid critiques directed to Bolsa Família's flaws and recipient mis-selection have dictated debate in the legislative houses. Moreover, in 2007 an important health/education-related tax on financial transactions, the CPMF (Portuguese acronym), was abolished, with the support and backing of the private sector, banks and right-wing politicians, leaving a BRL 2.8 billion breach in the federal budget (Revista Portuária 2008). Kerstenetzky argues that, paradoxically, the easiest way to win support for the programme would be by making it more expensive (Kerstenetzky 2009). Expanding its "creating opportunities" dimension would stir the policy towards its long-term emancipatory goal, thus making it more accepted and popular amongst non-beneficiary segments.

## Economic trends

### *GDP growth slowdown*

Brazilian economy has seen a moderate and steady growth in the last decade, which has resulted in increased formal employment. The latter, coupled with greater budget allocations conveyed by Bolsa Família to poor households and simpler credit access schemes, has led to massive growth in the retail sector (8.9 percent in 2010) and in durable goods consumption (5.4 percent in 2010) (Serrentino 2012). Hence, the middle class expanded and boosted its purchasing power. GDP growth however has been largely due to commodity exports to the Brazil's largest trading partner – China. Therefore, growth trends are connected to Chinese projections, which indicate a likely gradual slowdown in the next years. Impressive GDP figures fuel foreign and national investment, which in turn leads to more employment opportunities and income generating activities. Therefore, economic prospects are conjectural and tending towards waning.

### *Formal employment deadlock*

Though formal employment rates have risen in the country, the role that Bolsa Família has played in it is still unclear. Economic theory supposes that the increased money supply boosts formal employment since Bolsa Família's beneficiaries enter the consumption market previously unexplored by them. More consumption, more sales, more production, all leads to creation of additional job opportunities in the production, distribution and retail sectors. Ideally, today's beneficiaries, holding at least secondary school diplomas and other skillsets, will eventually become the employees and entrepreneurs of tomorrow's formal economy, thus coming full circle in escaping the current structural poverty trap. Whether this corresponds to reality now – or if it ever

will – is yet unknown. As argued before, others elements contribute to employment creation like growth in non-retail sectors like automobile and construction industries, more credit access and employment of non-Bolsa Família eligible workers.

Empirical studies carried out with a focus on Bolsa Família recipients have presented dubious results and mostly unimpressive outcomes. Hall observes that three-quarters of beneficiaries are employed, an almost identical proportion to that of the wider Brazilian population (Hall 2008, 815-816). However, unemployment is significantly higher amongst (Serrentino 2012) cash transfer recipients in urban areas. For example, in 1991 in São Paulo, “54 percent of workers were formally registered, compared with only 30 percent in 2004, while the informal sector doubled in size to 51 percent over the same period.” He concludes, “CCTs have not been very successful to date in forging links with productive employment.” On the other hand, Soares *et al.* found that Bolsa Família did not change the average working hours amongst men, but raised their participation in the formal sector (Soares and Sátyro 2009). For women, there was a drop in average working hours but no difference on their participation in employment share. Nonetheless, he clarifies that, though statistically relevant, the magnitude of these effects is so small that it can be considered non-existent. Many reasons may help explain why in more than 10 years of conditional transfers, employment insertion is still problematic, but notably, a poor quality secondary school system and lack of general professional qualification definitely stand out. It is noteworthy that complementary professional training schemes like the Próximo Passo programme (Next Step) are sidelined. Santos contends that capacity building actions are frail, inadequate towards demand, vastly unknown amongst beneficiaries and have overwhelmingly scarce openings (Bocca Santo 2010, 1215-20). While cash transfers situate in a 2-digit million dimension, professional training schemes are in the mere thousands (Blog do Trabalho 2011). Hence, the employment trend leans toward a deadlock, that is, Bolsa Família, as it is currently implemented, does not appear to contribute to job insertion of its recipients.

### **Political trends**

#### *Sustained popular support*

Bolsa Família is very popular in the country: a 2009 study from Universidade de Brasília shows that over 70 percent of Brazilians believe that Bolsa Família brings “good things” to Brazil. However, results differ amongst people who know Bolsa Família’s beneficiaries – 77 percent consider that it is good – and amongst those who do not know any beneficiaries – 18 percent thought it did not make a difference, and 16 percent said it was bad for the country (de Oliveira de Castro, *et al.* 2009, 339). One could look at these findings as if people

who know recipients are more familiar with the programme, understand it better and are more favourable, however one could also argue that their proximity to beneficiaries makes their opinions biased. In either case, the programme's popularity is likely to remain robust, especially amongst low-income groups.

### **Increasing clientelism and political patronage**

Alternatively, the programme has impacted local politics by reinforcing patronage linkages and paternalist practices, which caused concern to the Minister of Social Development. The Minister accused some mayors of establishing a 'poverty industry', where they refrain from levying local land and housing taxes for not undermining popular support, confident that the federal government would make up any budget deficit via cash transfers (Hall 2008, 814). In some of the poorest municipalities, CCTs account for as much as 40 percent of local budgets. This is also a resistant to change, as traditional political arrangements tend to adapt around new policies. However, with increase in technology-based transfers and wider information access, it is possible that there may be some improvement.

### **National hegemony of the workers' party**

Intentionally or not, the programme has profoundly affected national politics, particularly in the impoverished Northeast region. Historically ruled by traditional land-based and monopolists elites, Northeastern states have been dominated by right-wing or right-leaning centrist parties. But after Lula's Bolsa Família structure of bypassing state governments was introduced, these elites have lost some political leverage and, since the 2006 elections, have been losing ground in favour of the Workers' Party. Fenwick claims that Bolsa Família has been used as a political tool for winning over opposition-led states in the Northeast (Fenwick 2009, 124). This trend is complex since states' elites have tried aligning with federal government, at least in discourse, for gaining political support. In general, nonetheless, elected representation is undergoing uncertain political developments and might continue to do so in the future.

### **Social trends**

#### *Diminishing inequality gap reduction*

Income inequality has consistently decreased in Brazil and the Gini coefficient has moved from 0.535 in 2004 to 0.521 in 2007. Bolsa Família has played an indisputably crucial role in such progress by addressing Brazil's bottom of the pyramid (Rocha 2011, 127). Although there is still a segment of eligible population not yet included in Bolsa Família, this gap has become narrower by the day and, as adherence rate approximates 100 percent, the inequality reduction potential tends to stagnate, then decline and eventually disappear.

Unless recipients successfully leap forward towards self-sustaining economic activities or cash transfers amounts keep increasing, additional equality gains are improbable.

### **Persistent locational difference in impacts**

Disaggregated data shows that spatial issues matter in poverty reduction. The one-size-fits-all structure of Bolsa Família has quite evidently distinct geographic impacts. The urban/rural divide is manifested in comparative study indicating that the relative effect of the transfers on the urban poor was often insufficient to move households out of poverty. A similar difference also applies regionally; Northeastern beneficiaries have lower health per capita expenditure, than their Southeastern counterparts, thus reducing both compliance with health conditionalities and the quality of care (Sánchez-Ancochea and Mattei 2011, 307-309). It appears that unless policies are catered on locational specificities or grants increase greatly; impacts will continue to be dissimilar and desired outcomes will remain unreachd.

### **Backcasting and policy recommendations**

Having considered the essential trends related to Bolsa Família, a policy-oriented Backcasting technique is hereinafter drafted. The vision, or ideal future, is “Bolsa Família Ends,” a 20-year projection in which the programme’s goals are achieved, and the Bolsa Família is discontinued. In short, this is a future where there would be no extreme poverty and no one would be eligible for the grant, hence it would not be needed anymore.

For the purposes of this paper, six main elements have been chosen as essential factors in achieving the “Bolsa Família Ends” goal, though these are considered central they are not, in any case, all-encompassing of the problématique. They are: (i) sustainable livelihoods; (ii) social security; (iii) access to quality public services; (iv) lower inequality; (v) political empowerment; and (vi) information & technology tools. These are naturally connected to specific policies and can therefore be affected by it, thus a set of policy recommendations is proposed along with each backcasted driver. The drivers and policy recommendations have been elaborated according to the global study and analysis of Bolsa Família. Further, in this exercise, final policy recommendations have also been wind tunnelled against the four main trends clusters previously discussed. Figure 1 illustrates the backcasting exercise.

### **Sustainable livelihoods**

Sustainable livelihoods is a key driver because it directly impacts households’ incomes, and thus, means-tested eligibility criterion. Two main elements can be

pointed out as livelihood promoters: employment and bottom-of-the-pyramid (BoP) entrepreneurship. Accessing employment depends on the interlocked elements of professional qualification and job opportunities. Professional qualification depends on three mutually inclusive policies: vocational training (particularly through the *Próximo Passo* programme), basic secondary education, and wider access to higher education. On the other hand, job creation in the formal economy is fundamentally related to economic growth, which is determined by stable macroeconomic environment, investment, research & development, strengthening enterprise capacities, and infrastructure. The latter can be targeted by government's macroeconomic policy portfolio as complementing parts for attaining the poverty elimination goal. As for BoP entrepreneurship development, there are four driving factors: tax benefits and formalization simplification, access to credit, access to markets, and management skills. For these actions, the federal government should sponsor pro-microbusiness legislation, productive microcredit schemes, cooperative initiatives and management tools training for these new small entrepreneurs.

Particularly, a strong recommended policy would be the linking the current "S" System, made up of federal business capacity building institutes such as the national services for entrepreneurship (SEBRAE), industry (SENAI), agriculture (SENAR), cooperativism (SESCOOP) and commerce (SENAC), with the *Próximo Passo* Programme to create a consistent nation-wide policy for Bolsa Família beneficiary professionalization. These institutes were founded in the 1940s; they possess autonomy, experience, facilities and qualified teaching staff. Though limited in funding due to reliance on employee and employer compulsory contributions, the "S" System could suitably perform the necessary tasks for ensuring the virtuous cycle out of poverty if federal funds from the Ministry of Social Development could be poured into the existing programmes. A possible setback of outsourcing capacity building to autonomous entities is that federal government would abdicate programme implementation and oversight over training sessions, which might cause problems in terms of control of fund usage and curricula.

### **Social security**

On the social security node, three issues arise: pensions system, unemployment insurance, and social assistance. Social security is extremely important for poverty alleviation principally for those unfit or unable to work due to old age, severe disabilities, maternity leave, work-related accidents or temporary unemployment. Brazilian legislation is very progressive with regards to these issues. There is national fund for social security (*Previdência Social*), which is made up from compulsory contributions formal employees/employers and the



legally registered entrepreneurs. Only the elderly poor, disabled and regular contributors, once in retirement age, are eligible to access these social security benefits. Informal workers and working age poor have no insurance for senility. Therefore, the policy recommendation is to maintain the existing legal structure and plan for future inclusion of new beneficiaries originating from new jobs and micro enterprises. Further, raising the retirement age to 65 for women and 70 for men is recommendable, in order to tackle social security deficits and insure fiscal soundness while redistributing wealth for underprivileged groups.

### **Access to quality public services**

High quality services require both sufficient budget allocation and effective governance. On the budget front, resources for education, health, sanitation and housing have to be safeguarded in relation to budget cuts and political fluctuation in spending priorities. Effective governance is, on the other hand, a more complex matter, which takes into consideration public management practices, institutional cultures, individual and team-based financial incentive mechanisms, and accountability. Actions are needed for safeguarding enough resources and, chiefly, for improving Brazil's still backward governance mechanisms. Recommended policies include professionalization of public institutions by demanding public sector managerial skills for heads of government bodies, establishments of goals, incentive tools for civil servant performance and constant monitoring and evaluation. Putting forward these changes will require altering the current practice of putting party members and coalition politicians in charge of public institutions, in disregard to competence and fitness for the position. This presents both a policy and a political challenge.

### **Lower inequality**

Income inequality is another vital aspect for achieving Bolsa Família's goals, since it intrinsically encompasses the notion of relative poverty, a notion perceiving poverty in a comparative spectrum within societies; i.e. the richer some people are determines how poor others are. In this sense, narrowing income inequality is extremely important, and involves two fundamental policy strategies: instituting progressive taxation (in order to lower the high-income ceiling), and increasing BoP revenue (to raise the income floor). Holding an already progressive taxation regime, it is recommended that the government enforces current tax collection and reduces corporate tax avoidance. Further, for boosting the low-income segment, a policy that raises the minimum wage about inflation rate and promotes conditional cash transfers is also suggested.



### **Political empowerment**

Empowerment of citizens has a positive indirect effect on Bolsa Família's outcomes. Engaged citizens aware of their rights are able to see past paternalism, demand accountability from politicians and government officials, and seek better work and living conditions for themselves. Hence, raising awareness of citizens' rights through media campaigns and upgrading handbooks and information materials on Bolsa Família are highly recommended. Concerning social control and participation, the local councils determined by law are an ideal forum for policy implementation debate, knowledge sharing, corruption exposure, and community empowerment; therefore this space is in need of careful attention. The government should promote councillors capacity building, mainly in remote and Northeastern municipalities and liaise with other stakeholders like non-governmental advocacy organisations and the public prosecutor's office (Ministério Público, in Portuguese) for investigating irregularities and indicting corrupt officials.

### **Information & technology tools**

Technology is extremely important for any contemporary policy, poverty-related or not. In Bolsa Família's case, e-Governance plays a central role through the management of the centralized CadÚnico and compliance with the right to information law. Official websites need to display up-to-date disaggregated information on funds disbursement and provide procurement transparency. Also, electronic banking as well as mobile banking are emerging subjects in public management that are recommended to be fully adopted for Bolsa Família administration and for other federal and local programmes. New communication tools also need to be further explored, such as social networks and direct online complaints/suggestions mechanisms.

### **Critical analysis**

Brazil is facing a momentum of massive changes. The institutional framework set out in the 1988 democratic Constitution is starting to shape a strong Brazilian state where the rule of law, accountability and better governance are being put forward. This founding legal instrument consolidated political as well as economic and social rights, thus making their realization a constitutional obligation by the state. All civil service positions have to be filled through competitive examinations, a rule extended to janitors, tax collectors, prosecutors and judges (Brazilian 1988 Constitution, art. 37 II). Officials' salaries in the Judiciary and in most government agencies were also legally determined at high values in order to avoid corruption. Total public procurement has to follow a strict competitive and open bidding process. Further, efficiency, impartiality and transparency have been instituted as public administration legal principals. However, during the first years of democracy, individuals occupying state administrative positions during the dictatorial period remained in office; they were customarily embedded in paternalistic and unaccountable conducts (Bresser Pereira 1996). Only as time passed were changes beginning to become visible.

New highly qualified authorities – due to difficult competitive exams – tend to have less affiliation with traditional elites and better perform their jobs according to their mandates, thus making administration more accountable, transparent and efficient. Nevertheless, this is by no means to say that Brazil has a corruption-free government

or even a remotely high-performing one, but positive changes are taking place. Recent events seem to confirm this tendency. In a recent historical corruption trial, Brazilian Supreme Court convicted 25 out of 37 defendants in the biggest corruption scandal to date involving the Workers' Party ruling elite during Lula's administration (BBC 2012). For this critical analysis, the Futures Triangle framework is used, and three elements: (i) Push of the Present, (ii) Weight of the Past, and (iii) Pull of the Future are examined.

### **Push of the present**

This context helps understanding how drivers of change are playing the lead role in Brazilian society. E-Governance, nationwide expansion of social policies in the domains of education and healthcare, more monitoring institutions, expansion of education budget: these entire act as catalysts for change, and indicate a process of profound transformation in governance. Further, the Workers' Party is striving to take hegemony over national politics, mainly – but not solely – due to the Bolsa Família. This constitutes a noteworthy transformation, since traditional land-based elites gathered around right-wing parties are now facing powerful political competition, and there has been at least a variation in last names and family lineages in the government representative positions and, to some extent, in state's policies.

### **Weight of the Past**

Though change is undeniable, past social, political and economic practices showcase strong resilience. The programme has been criticized for maintaining conventional patronage relations in local politics, particularly in the Northeast and in far-flung municipalities. Clientelism has translated into favouring non-eligible families that electorally support prevailing political elites, while municipal governments controlled by the latter do not monitor for the education and health conditionalities. Local supervision through citizen councils have been sparsely created and, for those that exist, oversight is often weak and ineffective. By maintaining the support of local impoverished families, local elites are likely to perpetuate in their power positions and the empowerment element of the rights-based rationale in the programme shall remain relegated. While federal authorities are succeeding in bypassing states' governors, these elites have been sharp enough in stirring towards the Workers' Party as allies and even as coalition partners. Therefore, though institutions are going through changes, elected officials and their influence is enduring.

In the midst of a changing environment, political and social structures persist. Reforming of Brazil's unequal societal structural is still in a tentative stage. Frei Betto, a renowned priest and social activist, argues: "What is the point of redistributing income to those who aspire redistribution of land? Government, in fact, fights extreme poverty, but not social inequalities, because that demands tweaking the country's archaic structures and displease those who get rich thanks to the structural injustice." (Toledo 2008)

### **Pull of the future**

Bolsa Família introduces a huge analytical challenge because it can be seen through two antagonistic perspectives: CTT are a distributive right, or CTT are mere handouts. The first notion views the programme through the lens of social rights provision in

post-1988, which attaches to the status of citizenship to a universal right to monetary assistance (Fenwick 2009, 110). The government, its supporters, and international observers tend to agree with this perception. The World Bank explicitly argues that it constitutes a break from clientelism and has been heralded as an alternative to more traditional, paternalistic approaches to social assistance. (Hall 2006, 692). Also within this understanding lies the notion of wealth redistribution that requires complementarity between social and economic policies and a central state responsibility. (da Silva e Silva 2007) Further, the viewpoint realizes the long-term inter-generational potentialities embroiled in conditionalities, and advocates for a broader impact on eliminating poverty. The compelling image here is utopic.

On the other hand, the CCT, viewed through a conservative and neoliberal lens, focuses on the short-term effect of poverty alleviation. This approach believes that government intervention through cash transference leads to an “idleness effect”, where beneficiaries end up lazy, apathetic and uninterested in being employed. Recipients would tend to use the money in basic household consumption instead of activities that boost household income-earning capacity, assets or savings (Hall 2008, 812). The hypothesis is that Bolsa Família creates a disincentive to labour, enticing people into a welfare trap (Soares and Sátyro 2009, 28). Hence, in this mind-set, the long-term goals are not accomplishable. With regards to its compelling image, this perception involves dystopia and disbelief.

This is the fundamental question regarding Bolsa Família and, though data cannot yet confirm nor deny either perception, support to the policy remains a matter of political ideology or faith in the federal government’s abilities.

### **Conclusion**

Bolsa Família is a significant cash transfer programme that has impacted Brazilian society in multiple positive and some negative ways. such aThough a doubtful scenario, the use of the Backcasting technique is extremely handy. The method provided spectrum broadening and useful orientation to policy-makers concerning adequate complementary policies to Bolsa Família for the realization of the fundamental goal of ending the programme in a generation’s time.

Backcasting from “Bolsa Família Ends” allowed for the identification of six main drivers and 26 policy recommendations, which are fundamentally based on the interrelationship between the CCT and other essential complementary policies. For ending poverty, policies have to be directed towards boosting sustainable livelihoods, social security, access to quality services, lowering the inequality gap, promoting political empowerment, and expanding information technology tools. The Brazilian government has to emphasize and prioritize these in its policy agenda.

The political scene, social relations and economic growth have all been affected to some extent by the programme’s increased money supply and lifting of families out of the poverty threshold. However, after almost 10 years of massive nation-wide implementation of the Bolsa Família and gradually reaching the 100 percent adherence of eligible families, the programme’s prospective impacts are uncertain. In the critical analysis section, the elements of past, present and future showcase the discontinuities

regarding structural resilience, change drivers and conceptual utopias and dystopias over the futures of the programme.

The question of whether the programme will assist the poor is escaping poverty, or is simply a welfare trapping handout remains unanswered due both lack of reliable data and scarce futures-driven research. As empirical analysis remains unattainable, the government should focus on devoting political will, governance strategies and resources to the complementary actions to Bolsa Família, while constantly checking for changes in the five key trend clusters discussed.

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## GOVERNANCE AND DEVELOPMENT: INDONESIA'S TRADABLE AND NON-TRADABLE INDUSTRIES

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*Jose Ma. Luis P. Montesclaros*<sup>72</sup>

*In order to “raise all boats,” or achieve higher levels of economic growth across countries (especially the less developed countries, or LDCs), economic theory states that each country needs to shift labour to industries that have higher labour productivity. The state plays an important role in this. While scholars have argued about “how much” or “how little” government intervention there should be, Peter Evans (1995) posits that it is rather the kind of intervention that matters. This paper employs Evans’ framework of embedded autonomy in order to determine governance pre-requisites needed for sustained improvements in growing tradable and non-tradable sectors, leading to a “virtuous cycle” of complementary development. It is applied to Indonesia in its process of industrialization, with the hope that the next wave of countries may learn from its experiences, and that the current “dominant economic system” can indeed “raise all boats.”*

### **Introduction**

#### *Strategic industries for the least developed*

The United Nations Conference on Trade and Development (UNCTAD) says that least developed countries (LDCs) with higher levels of population density have the potential to develop a virtuous cycle of growth. This begins with raising productive capacities, which leads to growth in income of the populace that allows them to buy more products. This income then feeds back into the economy in the form of demand for goods and services. In fact, consumption has the highest contribution to gross domestic product growth in the LDCs (UNCTAD, 2006).

With this perspective, one path to development is to develop non-tradable industries which take advantage of the large demand base for LDCs.<sup>73</sup> On the

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other hand, development economists like Rodrik (2007) have stressed that countries should diversify into more sophisticated, technically-demanding activities that support higher rates of economic growth, and developing internationally tradable industries, and acquire competitive advantage in these sectors.<sup>74</sup> Both domestic and international demands are therefore important. Earlier, manufacturing was thought to be the ideal industry for growth, being prioritized in export-oriented Asian countries, which achieved high levels of economic development in the 1980s and 1990s, in particularly the Four Asian Tigers. These economies implemented currency devaluation and export subsidies to boost their exports, and the focus on manufacturing was generally referred to as “industrialization” (Kuchiki, 2007).

Table 1: LDCs classified according to the contribution of demand components to GDP growth

Contribution of demand to GDP growth, highest and second highest, respectively	1993–2003	1993–1998	1998–2003
C, I	Bangladesh Burkina Faso Madagascar Rwanda Mauritania Togo	Bangladesh Burkina Faso Madagascar Rwanda Mauritania	Bangladesh Benin Burkina Faso Madagascar Mauritania
I, C	Benin	Benin	Gambia
I, X	Mozambique Zambia	Mozambique	Zambia
X, I	Senegal	Zambia	Cambodia Mozambique Togo
X, C	Cambodia	Gambia Senegal	
C, X	Gambia Malawi	Cambodia Malawi Togo	
C, G	Ethiopia United Rep. of Tanzania	Ethiopia United Rep. of Tanzania	Rwanda
G, C			Malawi
G, I			Senegal
G, X			Ethiopia United Rep. of Tanzania

Source: UNCTAD secretariat estimates based on table 1.

Notes: Countries have been grouped according to their first and second highest GDP components.

C is private consumption, I is investment, G is government consumption expenditure and X is exports.

Source: UNCTAD 2006, 266

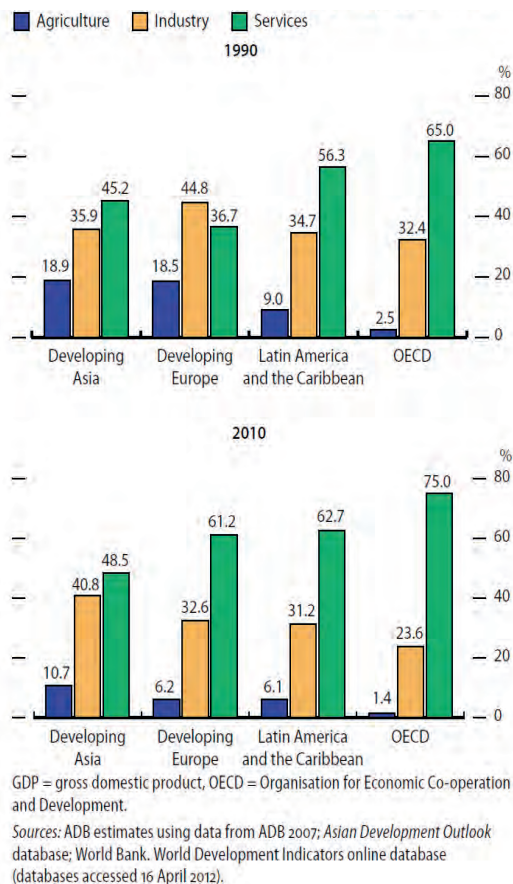
<sup>73</sup> Osmani finds that the growth of agriculture has provided great stimulus to growth of non-tradables (which by definition are those which are more likely to be consumed domestically), such as include services, construction, and small scale industries in Bangladesh. S.R. Osmani, et al. *The Macroeconomics of Poverty Reduction: The Case Study of Bangladesh*. (United Nations Development Program: 2006), vi-viii.

<sup>74</sup> Interestingly, Rodrik notes the findings of his student, Jason Hwang, that convergence is inevitable at the level of products: “when a country starts to produce a particular good, the productivity with which that good is produced— measured by either labour productivity or unit prices (an indicator of product quality)—converges to the frontier for that good unconditionally, regardless of any of the characteristics of the country in question.”

### Importance of services

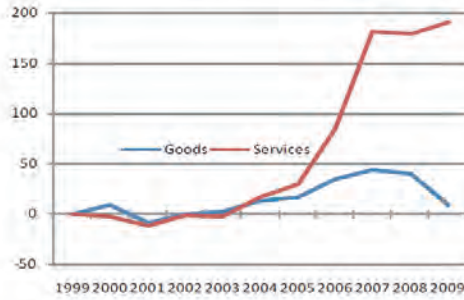
In the 2012 Asian Development Bank (ADB) Report, Park showed that services, or the tertiary sector, usually seen as non-tradable, have had growing demand and growing contributions to GDP. This has been attributed to rising levels of income, which lead to greater consumption at the domestic level. At the international level, the transportation costs on goods have decreased, leading to greater fragmentation in the production of goods and greater ease in trading previously non-tradable goods. Because of these, trade in services is even growing faster than trade in goods, internationally, as can be seen in Figure 2.

Figure 1: Sector Shares of GDP by Country Group, 1990 and 2010



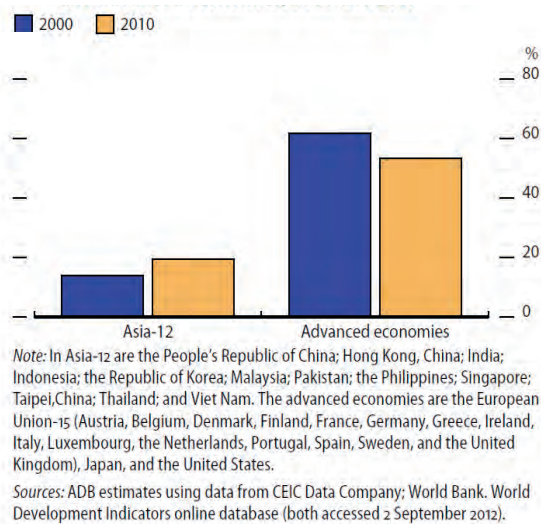
Source: Park, 2012, 34

Figure 2: Cross Border Services and Goods Exports



Source: Yi, 2011

Figure 3: Shares of Global Services Trade held by Asia-12 and Advanced Economies, 2000 and 2010



Source: Park, 2012, 37

Growth in local and global demand for services has led to the “post-industrialization” of economies where there is a shift in focus from industries to services. Figure 3 shows that services trade in Asia has grown from 2000 to 2010; the challenge therefore is to penetrate these markets in order to maintain competitiveness and sustain growth in the new globalized age.

Figure 4: Correlation of Productivity in Services and Industry, Late 2005 (2000 constant \$'000)

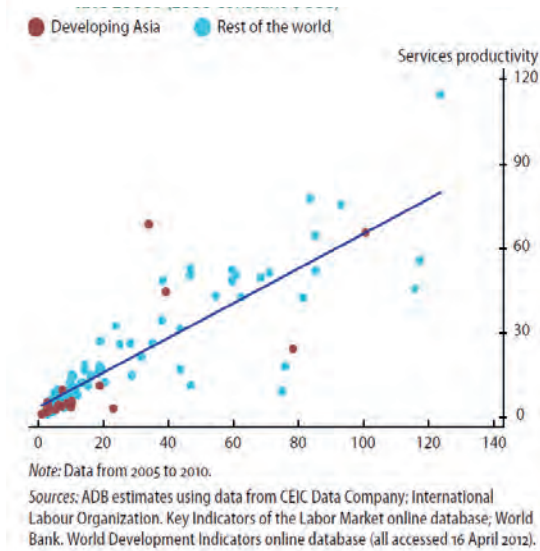
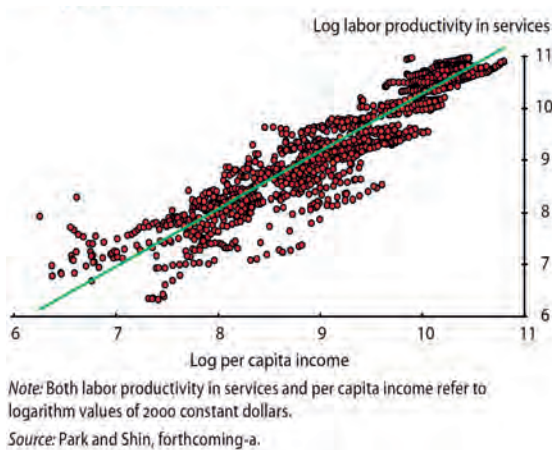


Figure 5: Log of Labour Productivity in Services against Log of per Capital income



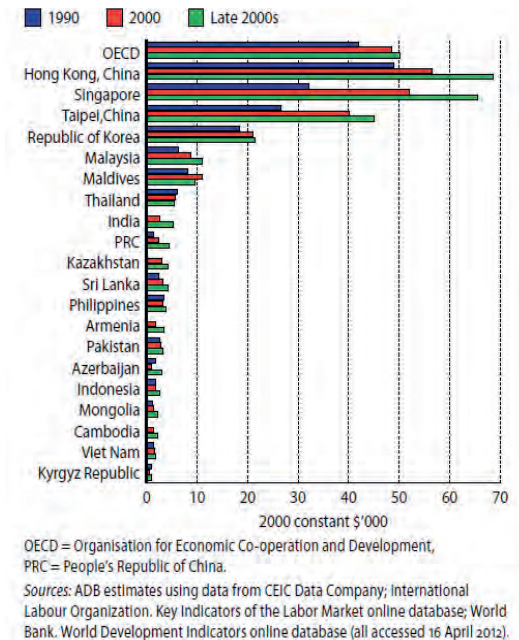
Source: Park, 2012

Productivity in services has also been shown to complement that of manufacturing, as shown in the positive correlation that between labor-productivity and per-capita income above.

### Difficulties in developing services

The 2012 ADB report below shows the gap in labour productivity between the Asian Tigers and the rest of the Asian countries in labour productivity.

Figure 6: Labour Productivity in Services, 1990, 2000 and Late 2000s



Source: Park, 2012

From the human capital perspective, lack of education is a key cause, as it inhibits productive employment in strategic industries. Infrastructure, in the form of transportation, telecommunications and electricity industries, is likewise a prerequisite. Once these barriers to non-tradable industrial improvements are overcome, tradable industries, such as information technology (IT) and IT services will follow suit. Non-tradable services feeding into tradable goods and services is therefore another justification for seeing services as an important sector for growth.

This study therefore seeks to uncover how developing countries can overcome such barriers by using the case of Indonesia, considered to be among the industrializing economies that are following the Four Asian Tigers in development. With a population of 237 million, which makes it the world's fourth most populated country, a majority of Indonesia's labour force is in services. Over the past 18 years the population has increased by 50 million people, causing problems of unemployment and underemployment in the country. However, amid these factors, its service industry has grown. From the

political perspective, Indonesia can be seen as a spectrum of good and bad points across decades of presidential terms, therefore providing a useful case for demonstrating important contrasts on the role of state characteristics in industrial development.

Understanding what made this process work for Indonesia would be valuable for developing countries with similar issues. The next part of this paper therefore references the theoretical framework, which is also a discussion of the roles of states in development, and of how this can be attained, through the concept of embedded autonomy. The third part discusses the concept within the larger context of political economy theories about development, as well as applications and critiques of the concept. The fourth part presents the findings and analysis.

### **Theoretical framework**

#### *Roles in development of industries*

In order to adapt to the changing globalized environment, there is a need for both the states and the private sector to play the appropriate roles in the said industries. However, Evans (1995) notes it is not always the case that the private sector enters it or is able to perform well because of risks entailed. The state therefore has an important role to play in coordinating the development of important sectors.

Roles of the state have been categorized by Evans (1995) as “custodian, demiurge, mid-wifery and husbandry” (13). As custodian (78), the state regulates, polices and promotes a certain industry through interventions such as guaranteeing property rights. This role is critical when local capital is willing and able and the state is willing to participate but does not have enough capabilities. In such cases, international capital needs to be tapped.

As demiurge (Evans, 1995, 79), states produce the goods through organizational structure such as state-owned enterprises. This is best exhibited when the state is willing and able but local and international capital are both unwilling (though may be capable) to contribute and invest in the initiative.

Mid-wifery (Evans, 1995, 80) states motivate and enable local firms to enter certain industries through the provision of capital as well as other forms of support to firms. They may likewise help in negotiating with transnational capital to help develop local firms. Lastly, husband (Evans, 1995, 81) states expand on the mid-wifery role by boosting the competitiveness of local firms through incentives for research and infrastructure towards innovation (leading to lower production costs, or more differentiated goods, which make the goods more competitive internationally). They may likewise help in negotiating with

transnational capital to work with local firms that are trying to develop competitiveness through knowledge and technology sharing.

Sector characteristics, which include technological variations (techniques of production, forms of industrial organization), and appropriate modes of governance (Evans, 1995, 93), change, and so do capacities and interests of the actors (the state, the private sector, and the international community). Therefore, the role of the state must also evolve, sometimes requiring combinations of these roles. Knowing the role of the state is one thing, but having the state play that role is another. For instance, the government has been primarily responsible for direct provision in certain industries, such as telecommunications and education. If this kind of mind-set is locked-in, it is unlikely that a more efficient solution will emerge. The likelihood that the right actors will play the right roles is therefore influenced by government.

*Embedded autonomy for proper role identification and application*

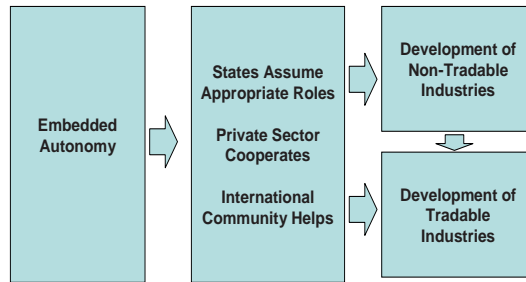
Evans posits that the ability of the state to achieve the right balance is hampered by two problems. First, states are not able to shift to the appropriate role, and to be effective in implementing it (Evans, 1995, 95) because they are influenced by interests of elites, which are traditionally seen as oligarchs and clans who influence politics. For instance, communication, transportation, power and utilities have been traditionally provided by the state (Evans, 1995, 79), and it will be difficult to override this tradition unless heads of the agency concerned are convinced to give up some powers. This leads to the need for autonomy of the state from elite interests. The second is that a lack of cohesion between the state and the private and international sector may lead to a lack of knowledge on the appropriate policies and access to the resources needed; hence, there is a need for embeddedness (Evans, 1995, 59). Embedded autonomy (EA) is therefore the ideal set-up for states to implement industrialization in order to achieve the best levels of sector development.<sup>75</sup>

The diagram below summarizes the concept of embedded autonomy leading to the appropriate roles of state and the cooperation of the needed local and international capital. This addresses issues in service barriers, leading to the development of the non-tradable and tradable industries.

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<sup>75</sup> Further elaborations on embeddedness and autonomy are in the appendix to this report.

## Political Economy of Development



### Review of related literature

The importance of government in development has been the topic of discussion for economists and political economists. Max Weber (1978) has theorized that the possibility of capitalist development, or of any economic activity, is dependent on a certain degree of calculability / predictability in law and administrative policies. He therefore sees economic institutions being grounded in social and political foundations, which are carried by bureaucracies.<sup>76</sup> Moreover, in studies on economic backwardness/underdevelopment, Gershenkron (1962) noted that economic change depends on the ability or inability of bureaucracies to generate this change.<sup>77</sup>

In relation to these, Evans' concept of embedded autonomy makes an important contribution from a comparative institutional perspective.<sup>78</sup> The concept was

<sup>76</sup> Max Weber has theorized that "the patrimonial state lacks the political and procedural predictability, indispensable for capitalist development, which is provided by the rational rules of modern bureaucratic administration." Max Weber. *Economy and Society: An Outline of Interpretative Sociology*. Roth, G. and Wittich, C. (eds.). (Los Angeles: University of California Press, Berkeley and London, England: University of California, 1978).

<sup>77</sup> Gershenkron notes that "no industrialization seemed possible for as long as formidable institutional obstacles (such as the serfdom of the peasantry or the far-reaching absence of political unification) remained." Alexander Gershenkron. *Economic Backwardness in Historical Perspective*. (Belknap: Cambridge, 1962), 8.

<sup>78</sup> In 1989, Evans noted that the differences in the performance of states as a whole that came as a result of differences in state structure, by using Zaire as an example of a state with a poor structure, Taiwan and Korea as examples of an ideal developmental state, and Brazil as an intermediate case, and validated the link. Peter Evans. "Predatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State". *Sociological Forum*, Vol. 4, No. 4, Special Issue: Comparative National Development: Theory and Facts for the 1990s. (Springer, 1989), pp. 561-587. Accessed thru [http://links.jstor.org/sici?sici=0884-8971 percent28198912 percent294 percent3A4 percent3C561 percent3APDAOAA percent3E2.0.CO percent3B2-F](http://links.jstor.org/sici?sici=0884-8971%20percent28198912%20percent294%20percent3A4%20percent3C561%20percent3APDAOAA%20percent3E2.0.CO%20percent3B2-F)



crystallised in Evans' seminal book on the topic entitled *Embedded Autonomy: States and Industrialization Transformation*, wherein he describes the development of the Information Technology industry in Brazil, India and Korea. He first gave a background of the embeddedness and autonomy of the states, and based on this, contrasted developments in applying the correct role and getting the cooperation of the needed private and international capital. He showed that Korea, which had EA, "was able to build on a base of firms with a broad range of related industrial prowess, fostered by prior midwifery (which) shifted easily to the combination of prodding and supporting (called) husbandry" (Evans 1995, 14). On the other hand, Brazil and India, which had moderate versions of EA, made use of approaches which were not applicable to the sector: demiurge and custodian so that they "got bogged down in restrictive rule-making, and invested heavily in direct production of information technology goods by state-owned enterprises" (Evans 1995 14) and failed in shifting to programs of husbandry.

Wai (1998) also showed how EA, which varies across government organization within states, can determine the ability of the state to set a clear role which was appropriate for the sector/industry. He changes his approach by describing institutions within states, adding greatly to the theory which previously theorized one state.

In a later study, parts of the concept of autonomy were used in a survey by Evans and Rauch (1999) to compare key economic bureaucracies across 35 countries, which measured (1) meritocratic recruitment, and (2) rewarding predictable career ladders, in the 1970-1990 period. They found "a strong and significant correlation between (autonomy) score on the (questionnaire) and total growth of real GDP per capita during the 1970-1990 period" (Evans and Rauch 1999, 75) even after controlling for pre-existing levels of human capital.

There are criticisms of embedded autonomy, however. Schwartz (1996) opines that states cannot by themselves evolve because of their "path-dependent" nature" (289) wherein structures and social actors determined in the past can influence the present. Should embedded autonomy take this into account? The focus of embedded autonomy can be seen as describing dynamics of states and industrial development. It does not claim to describe organizational dynamics, which may include concepts such as sociological and social anthropology. Nevertheless, Schwartz justly advises that Evans' advice be taken with a "measured dose of history" (292). It may therefore be said that the framework describes how the right balance can be achieved at a particular point in time, although there may be previous dynamics to determining the embeddedness and autonomy at that particular time.

## Research methodology

This study seeks to contribute to the further studies on embedded autonomy by adding the perspective of the need to improve complementary industries, which are seen as either tradable or non-tradable. The country focus will be Indonesia, and the industry foci will be education and telecommunications as non-tradables, the development of which lead to information technology (IT) a tradable sector.

The unit of analysis will be the Indonesian government, focusing on its performance in developing said industries during the Suharto regime (1967-98) as well as the regime after it. These will be measured on the basis of autonomy, which is determined by the ability to be free from corruption and influences by elite interests, usually accompanied by meritocratic recruitment, promotion and wages. This is measured in this study through qualitative analysis by authors, as well as through findings from a survey implemented by World Bank on corruption in Indonesia.<sup>79</sup> The survey shows views of survey respondents and public, private, and NGO sector experts (Kaufman et al, 2010). Embeddedness, on the other hand, will be measured by joint project between the private and the public sector.

The dependent variable is divided into two. The first is the ability of the state to undertake the appropriate roles in the sector of interest. The roles will be classified as demiurge, custodian, mid-wifery and husbandry, as earlier defined. As a result of this, the second independent variable is the performance of the state, in terms of relevant policies implemented and their impacts, in the non-tradable and tradable sectors.

Main sources for industrial statistics will be the Indonesian Government's database, as well as the World Bank. This will be supported by qualitative secondary data, through reviews and interviews by other scholars, and their descriptions of the Indonesian state and industries; these help determine the type of state, the role played, and the effectiveness of this role.

## Findings and analysis: embedded autonomy in tradable and non-tradable

*Indonesian bureaucracy: reduction of corruption from Suharto regime to post-Suharto Regime*

To apply the framework to the bureaucracy of Indonesia, this paper first differentiates levels of autonomy between Suharto period and before it (1) and

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<sup>79</sup> Control on Corruption is defined as "capturing perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests." (Evans and Rauch, 4).

the period after Suharto (2). Prasajo, Kurniawan and Holidin have noted that the bureaucracy faces historical legacies from the previous experience as a colonial government. They describe the problematic patron-client relationship among friends and family, which has become rooted in the Indonesian culture. At the organizational level, they talk about low remuneration and low competence of bureaucracy, as well as patronage-based recruitment. These lead to individual behaviours such as being opportunistic, opening up the possibilities for corruption, collusion and nepotism, popularly known in Indonesia as “KKN” (Prasajo et al 2004, 9-17).

During the new order of Suharto, government is described by Datta et al. (2011) as having the executive as extremely dominant, and top-down with orders flowing from the president (advised by his advisers trained at Berkeley and Harvard in the US). Civil service salaries at this time were severely limited given competition for the budget across industries, and this led to high levels of bureaucratic corruption. Moreover, research seemed to serve a legitimating function, as political interests played a more important part.

After Suharto’s rule, President Habibie made amendments to the constitution to address being too executive-focused, as well as leaving parts, like term in office, ambiguous. Several laws were likewise passed in his term, which seek to improve freedom of assembly and to create unions, conduct free and fair elections, freedom of speech and press, separation of state from the national army, and transparency (Prasajo et al, 2004).<sup>80</sup>

The impact of these laws has been seen to be a big improvement in comparison with the Suharto regime, although there are some who find that the colonial legacies are strong, leaving traces of the KKN culture. The data on control of corruption from 1998 (Suharto’s rule) to the most recent time, 2011, shows improvements in this aspect. The Worldwide Governance Indicators (WGI) findings on Control on Corruption are below. The impact of the policies can be seen as improving control of corruption.

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<sup>80</sup> These are translated into Laws on Structure of People’s Constituent Assembly, Law on Political Parties and Law on General Elections, Law on Press, and Creation of Supreme Auditing Body, respectively. Eko Prasajo, Teguh Kurniawan, and Defny Holidin Analysis of Government Systems in Indonesia.

Figure 7: Control of Corruption Actual Score

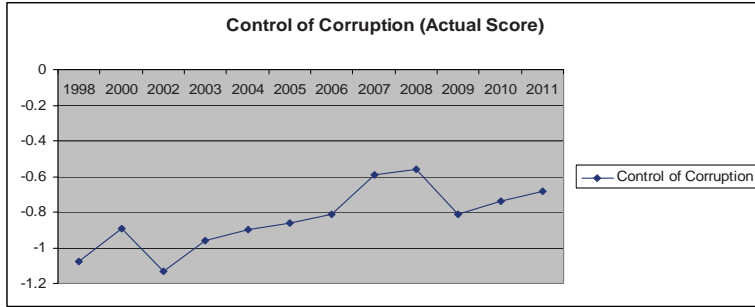
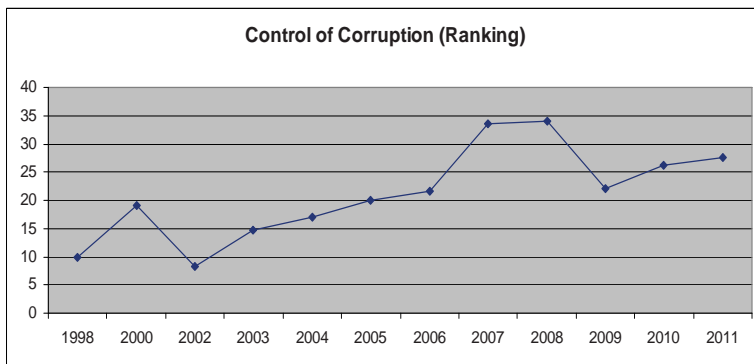


Figure 8: Control of Corruption Rankings



Note: Figures based on WGI, 1998-2011

The impact of external factors on governance has also been recounted by Prasojo, Kurniawan and Holidin. First, the International Monetary Fund (IMF) has been making strong demands on Indonesia, and these have been strong given the debt position of Indonesia with the said institution. Moreover, since corruption is a systemic trait, accountability and freedom of press can influence the legitimacy of the new government after the Suharto regime, therefore supplementing civil service reforms.

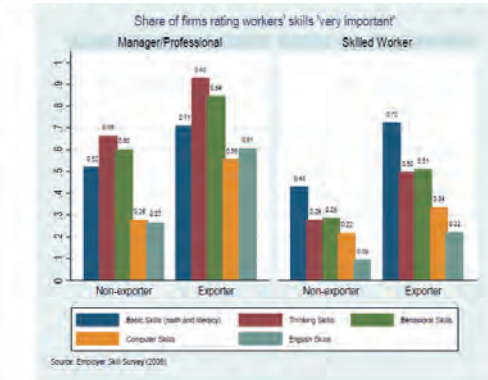
#### *Non-tradable industries: roles and outcomes*

The impact of improved autonomy of the state, as shown above, affects the roles played by the state from the perspective of appropriateness of roles, as shown in this section.

**Education**

In a report published by the World Bank in 2010, it was noted that “there are indications that the skills profile of the Indonesian workforce has not evolved along with the demands of the labor market” (Di Gropello 2010, vi). The tables below show demand for skills based on a survey in 2008. Moreover, the demand for skills is expected to grow as the export orientation is predicted to increase from 20 percent of GDP in 2009 to 30 percent in 2014, according to the IMF (2009).

Figure 9: Importance of Skills in the Export and Non-Export Sector



Source: Di Gropello, 2010, vi

With the growing demand for technology, there is growing need for workers to learn skills needed to make use of said technology, which include “creativity and critical thinking, and command of ICT skills, but also pro-activity and curiosity, and broad-based understanding of company operations and industry knowledge” (Di Gropello 2010).

Figure 10: Difficulties in Filling Vacancies by Sector

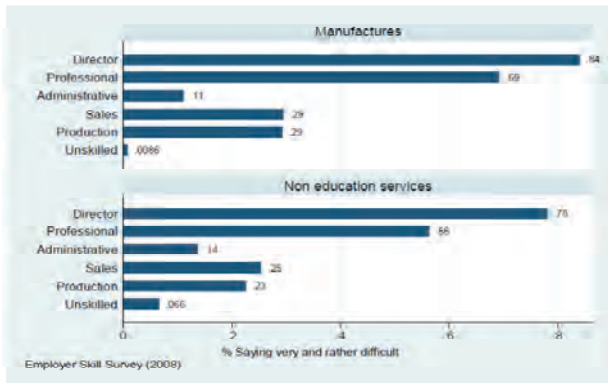
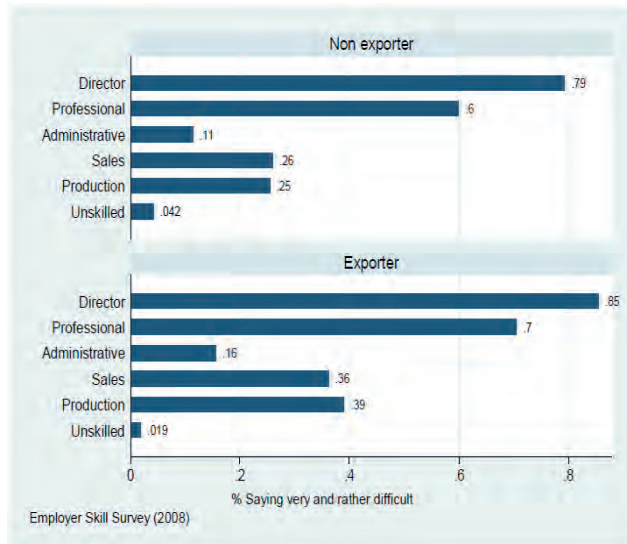


Figure 11: Difficulties in Filling Vacancies by Export Orientation



Source: Di Gropello, 2010

According to an employer skill survey (Figures 10 and 11), Di Gropello (2010) notes that “(t)he widest gaps across professional profiles are for English and computer skills followed by thinking and behavioral skills” (14) while “theoretical and practical knowledge of the job are also considered to be weak” (15). Moreover, “(t)here are important gaps in creativity, computing and some technical skills for young workers. English remains the largest gap.” (15)

Figure 12: Gaps in Core Generic and Subject Skills

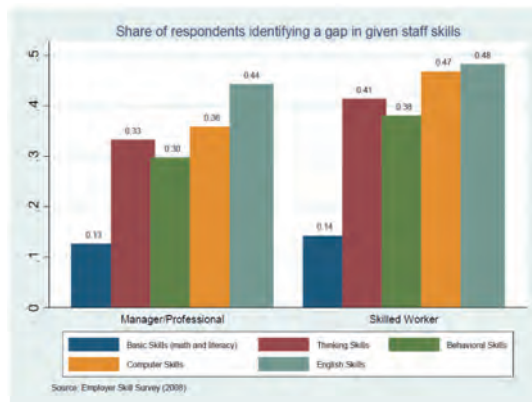
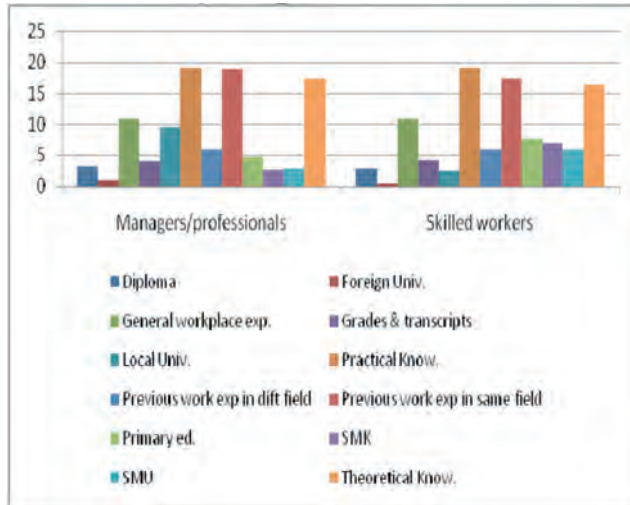


Figure 13: Gaps in Job-Specific (and Sources of Job-Specific) Skills



Source: Di Gropello, 2010

Most of the empirical evidence from the World Bank study “confirms the existence of issues with the relevance and quality of education and training more than quantity, as captured for instance by educational attainment.” (Di Gropello, 2010) This is indeed relevant to education.

There is “a need for a supply push to increase relevance of secondary and tertiary education to the needs of the manufacturing sector (as also indicated by high education premiums in that sector), while maintaining relevance to the growing service sector.” (Di Gropello 2010).

*Role of government as demiurge is not sufficient; need for private sector*

The government’s provision of education, indicating a demiurge role, has therefore led to the current state of mismatch between the skills needed by the industry and the skills provided by education. Government by itself would be focused too much on fundamental measures such as participation rate and completion rate at all levels of education. However, in order to allow the education system to adapt to the needs of labour, it is important to get the perspective of firms, or to link up with international organizations.

With the need to improve supply have come private sector firms, which have organically implemented workforce improvement programs (Di Gropello 2010). In this case, government did not need to provide education, because firms themselves needed to adapt to the situation.

*Needed role of government: demiurge and custodian*

While the government has been the largest provider of education (demiurge), it has started taking on the role of custodian. Given the presence of private institutions in the government, improving competitiveness has required aligning the skills development to the needs of the market. Since government itself would not be able to do this, it also partnered with a foreign investor, BP Indonesia, as well as the International Labour Organization (ILO) to align skills, development programs with market demand (ILO, 2012) showing effective regulation of industry.

The said partnership became possible because the Indonesian government designed an "Indonesia Decent Work Agenda" launched in 1999 by the Manpower Ministry (MM), another indication of the role of custodian. Data sources for monitoring the said initiative (labour productivity, employment-to-population ratio, and employment), which are essential for international partnerships, have been provided by both the statistical government body, BPS Statistics Indonesia through the National Labour Force Survey, as well as the MM which contributes qualitative data from stakeholder consultations as well as administrative data (UNESCAP,2012).

In Indonesia's 2001 Five-Year Action Plan for the Development and Implementation of Information and Communication Technologies (ICT) under Presidential Act No.6/2001, the government created an Indonesian Telematics Coordinating Team (TKTI) to coordinate within the bureaucracy as well as with the private sector for how the ICT industry could be improved. From a human capital perspective, collaborations with the ICT industry as well as ICT educational institutions for training and R&D would also be involved to aid in achieving an ICT Human Resource Development Plan in Indonesia. For infrastructure related to education as well as other private actors, which include telecommunication and internet operators, schools, universities and hospitals, the government has also aimed at funding support schemes to improve internet access in their respective institutions. For instance, one of the initiatives under this is "innovative public access initiatives, including new technologies and telecenters" (IKTI, 2001).

Moreover, despite a change in administration from Megawati Sukarnoputri to the current president, Susilo Bambang Yudhoyono, the initiatives have continued. In 2008, the National Information Communication Technology Human Resources Development (NICT-HRD), in cooperation with KOICA (Korea International Cooperation Agency) was established in the Syarif Hidayatullah Islamic State University and the Jababeka Industry Complex, with the soft loan funded by Korean Government. This led to a joint study and research with Korean Information Society Development Institute (KISDI) which



involved a study visit to Seoul, Korea. The Ministry of Communication and information Technology has also facilitated the ICT establishment of training centers for the district government officials that are centred in four locations, Makasar, Banjarmasin, Padang and Semarang (Risadi, 2008).

Competency standards have likewise been created through ICT Curriculum Composing for ICT Training Centre for roles relevant to boosting education's relevance to emerging industries such as Information Technology. These included curricula for computer operators, programmers, technical support, network and system administration, multimedia service providers, and telecommunication satellite technicians (Risadi, 2008).

The joint projects above are indications of embeddedness of government. Through effective networking with the international community as well as with the private sector, the government has therefore been able to make progress in bridging the gaps between education and employment in newly emerging industries.

*Telecommunications services and infrastructure government's role: development of industry with shift from demiurge to mid-wifery and custodian*

During the Suharto regime, state institutions monopolized telecommunications in Indonesia: Telkom for domestic, and Indosat for international (Winata, n.d.). In the figures below, one can find that the Suharto Regime, which lasted from 1967 to 1998, led to low levels of improvement in telephone lines, while the next regimes were able to increase these substantively.

Figure 14: Number of Telephone Lines

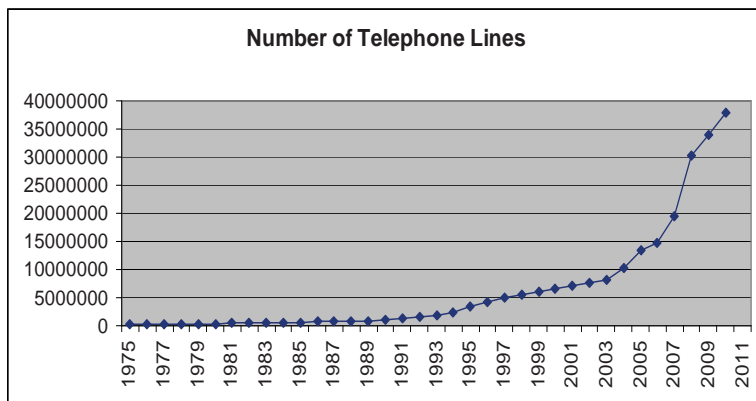
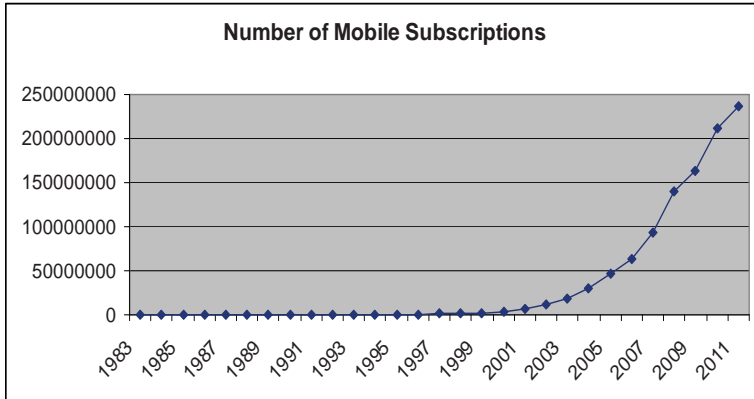


Figure 15: Number of Mobile Subscriptions



Note: Figures created based on WGI 1998-2011

In spite of population growth, the number of telephone lines and mobile subscriptions for every 100 people has likewise been on a steady increase, as shown below. What led to these improvements? In the post-Suharto regime, ownership of these firms was slowly given to the private sector (Winata, n.d., 3). As a result of this, the reach of said services has expanded. This is because in a profit-driven field, attracting a large number of Indonesians forces players to increase in capacity if they are to maximize profits. This has been helped by innovation coming from assistance from foreign partners who are large service providers in their own countries such as Korean Telecom Freetel (KTF) and Asia Link (in the Philippines).

Figure 16: Number of Telephone Lines per 100 People

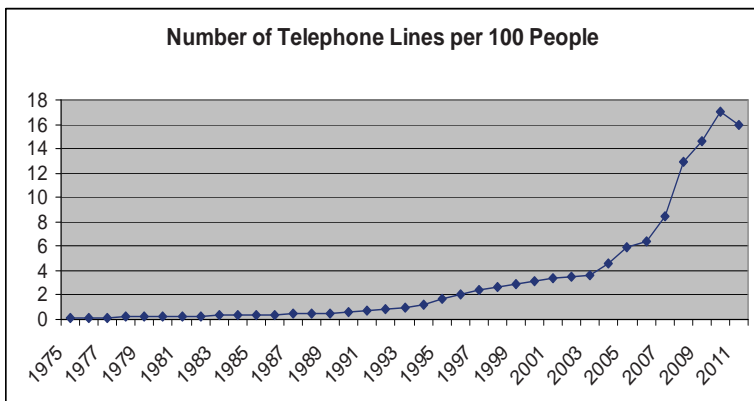
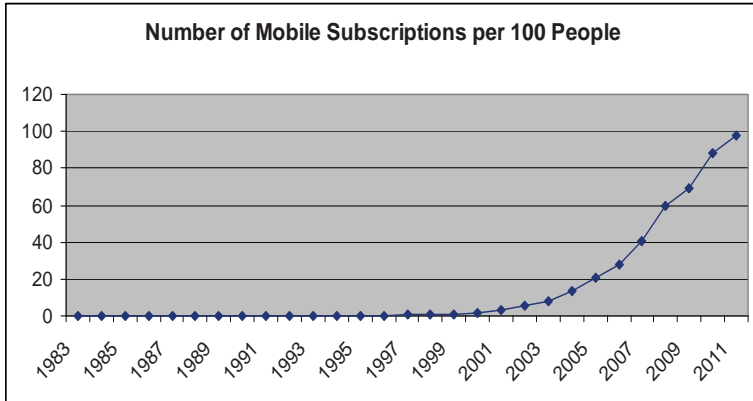


Figure 17: Number of Mobile Subscriptions per 100 People



Note: Figures created based on WGI 1998-2011

The key reforms that have driven the changes have been the abolishment of exclusive rights of fixed line services, local call, and domestic long-distance in 2001, 2002 and 2003, respectively (Winata, n.d.), as well as opening up the industry to foreign direct investments (Zita, n.d.).

*Shifting from demiurge to mid-wifery and custodian: failure and success*

The liberalisation of the telecommunications industry was gradual, and happened within a period of 10-15 years. Zita (n.d.) describes the history of telecommunications liberalization in Indonesia. It began with a law in 1989 allowing nine local companies to enter into build-transfer agreements with Telkom. However, because of the insufficiency of capital, direct-equity investments were allowed in 1993, and a more proactive effort by the government in 1994 created joint-operating schemes to invite foreign companies to bid for regional build-operate-transfer arrangements with Telkom. This led to the entry of firms such as Cable & Wireless, France Telecom, NTT, Singapore Telecom, US West and Telstra, as they were allowed to hold 95 percent of capital and 70 percent of revenues. However, this initiative failed at first, because of several factors: resistance by Telkom, political instability with fast changes in government, the Asian financial crisis in 1997 which led to financial instability, and allegations of corruption. The first efforts at reform failed because the state was not able to remove itself from the picture effectively, and this can be linked to the corruption that generally encompassed the Suharto regime. With interests by the state in Telkom, resistance has therefore been felt by investors, leading them to exit the country in no time at all.

The second phase of liberalisation happened after the collapse of the initiatives, as the International Monetary Fund (IMF) urged the government to undertake

fiscal reform in line with commitments to the World Trade Organization (WTO), as Zita (n.d.) indicates. This led to the Telecommunications Blueprint of 1999, which came with Law 36 in 2002, which lifted monopoly in the two industries. Cross-ownership between the two was likewise removed, and ownership by state went down further from 64 percent to 51 percent with the entry of foreign firms. As networks entered, firms from Malaysia (Telekom Malaysia and Maxis), Thailand (Chareon Pokphand) and Korea (Korea Telecom) eventually bought shares of the new telecommunications providers, Excelcomindo, Lippo Telecom, PT Cyber Access Communications, and Mobile 8.

The government therefore endeavoured to shift its role from demiurge to mid-wifery in the beginning, by allowing local providers to enter the market. However, as local capital was insufficient to bridge infrastructure gaps, the government then turned to make use of signalling mechanisms such as opening up direct-equity investments for drawing international capital to enter. With the failure to remain autonomous, however, this initiative has failed.

The next shift happened as a result of embeddedness within the international community, which influenced the state to apply more stringent policies for liberalization. Under the eye of institutions such as the IMF and the World Bank, the state sustained its initiatives through laws for this purpose. The state eventually shifted its role to mid-wife-regulator from player to regulator, with the entry of local and foreign firms in the market and falling shares in state telecommunications firms, leading to the creation of the Indonesian Telecommunications Regulatory Agency (BRTI) created in 2003 to regulate the industry.

*Dynamic implications: innovation and rise of higher technology*

With the state's success in stepping out of the picture in direct provision, it has therefore given incentive to private firms to innovate, with great help from their foreign partners. This had dynamic implications, as it has led to the infrastructure, which would be needed for the emerging information technology industry. For instance, it was only in 1999 when fixed broadband internet subscription was made available to the people.

The impact of the development of the telecommunications industry on the ability of government to generate new industries will be shown in the next sector.

Figure 19: Number of Fixed Broadband Internet Subscribers

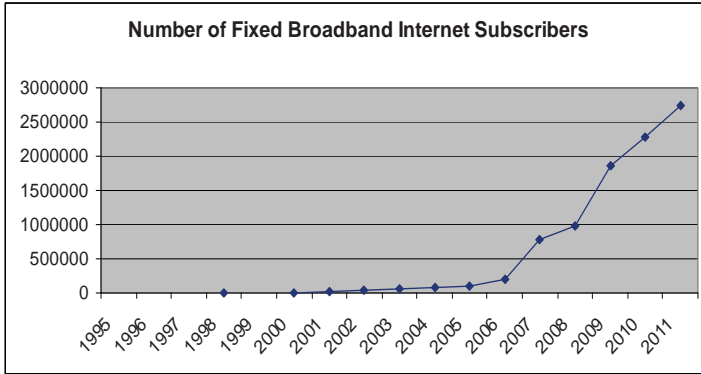
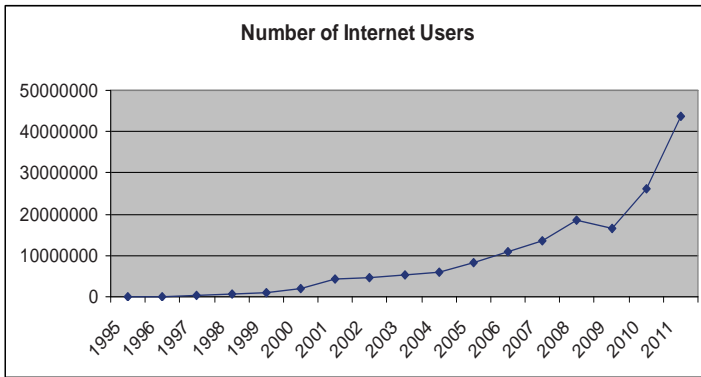


Figure 20: Number of Internet Users



Source: WGI 1998-2011

*Tradable: information technology*

Before the rise of information technology, Indonesians had shown capability in making use of more traditional technologies (Sandee and Rietveld 2001), as can be seen in their competitiveness of its textiles and other goods (Indonesian Textile Association 2001). A trait of this is that it requires a great deal of creativity as well as local initiative. Small and medium enterprises have run this aspect of Indonesia's industry. These traits are very important in the current age of information technology, as can be seen in multimedia services (creativity) and electronics (skills with technology). Therefore, Indonesia's large population may already have had a comparative institutional advantage in developing this due to the creativity displayed by the people in textiles.

The indication of these is the idea that Indonesians can also be competitive in Information Technology. The difficulty with this sector, however, is that it

requires substantive investments in complementary infrastructure and human capital. The previous section on telecommunications and education are therefore critical to explaining the rise of the information technology sector in Indonesia.

The rise in global demand for Information Technology has made it more attractive to both the government and the private sector. This has led to policies to take advantage of this, with the aid of international investors who have sought cheaper production areas.

*Government's role: custodian, mid-wifery, husbandry*

There was no previous attention to information technology in the Indonesian government until the rise in technologies globally. The role that government eventually took in this aspect has therefore been custodian and mid-wifery.

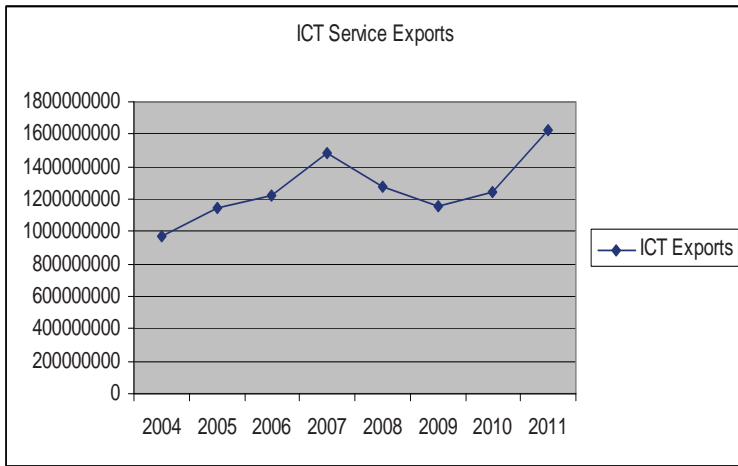
The custodian role began with the 2001 Five-Year Action Plan for the Development and Implementation of Information and Communication Technologies (ICT) in Indonesia, where the government created an Indonesian Telematics Coordinating Team (TKTI) to coordinate within the bureaucracy as well as with the private sector for how the ICT industry could be improved. Non-tradable initiatives stated here included the telecommunications and education regulatory reform mentioned earlier. On the other hand, the role played by government in allowing for his nascent industry to develop began with “prepar(ing) regulation accommodating ICT local industry access to the government procurement” (IKTI 2001, 3) as well as eliminating barriers to investment through the Ministry of Finance. Charges and taxes for sales of goods related to this would have to be kept low.

The Ministry of Communications, on the other hand, had to take charge of removing barriers to innovative communications technologies and so, the private sector was tapped in achieving objectives such as “(e)nhanc(ing) the development of information content and application industries including the use of open source software” and “build(ing) government online platform based on competitive bids” (IKTI 2001, 3). Within the decentralized context of Indonesia, it was also important to tap the spatially spread out private sector, and the international sector which had the expertise, in developing regional IT centres of excellence such as the Bali Camp, Bandung High Tech Valley (and the) APEC Centre for Entrepreneurship (IKTI 2001, 4).

To maximize use of the domestic commercial networks of both the public and the private sector, the government has implemented projects such as “comprehensive e-government, e-business, and e-public infrastructure services as national pilot project (G2G, G2B, G2C) e.g, Batam Intelligent island, Kemayoran Cyber City” as well as telecommunications kiosks (IKTI 2001, 8).

To further develop competitiveness of the private sector, expertise was targeted. The Ministry of Industry and Trade, Ministry of Finance, Ministry of Cooperatives and the private sector was then tasked to provide trade facility, information, assistance centre for development of SME (small and medium enterprises), which would include technical assistance as well as a training funding support scheme for SMEs capacity improvement, including matching grant scheme as well as assistance in marketing and logistics. Finally, the Ministry of Industry and Trade and the private sector would facilitate and assist ICT application to market research marketing and trade for Indonesia industry and targeted market groups. The result of IT-related initiatives can be seen in the ICT service exports below, wherein government began exporting in 2004 (IKTI 2001, 8-9).

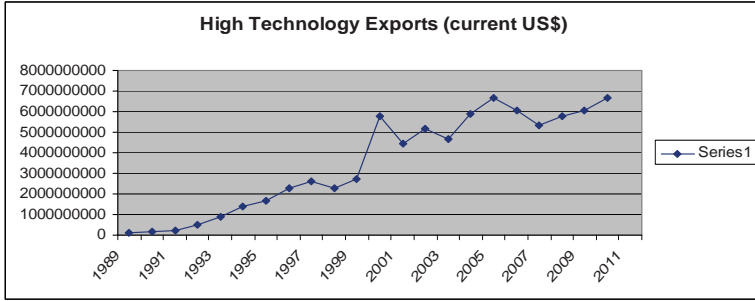
Figure 21: ICT Service Exports



Note: Figures created based on WGI 1998-2011

Furthermore, high technology exports, which include “products with high R&D intensity, such as in aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery” (UN Comtrade, n.d.) have also increased, as shown in the graph below. While IT service exports began in 2004, high technology exports had been started earlier.

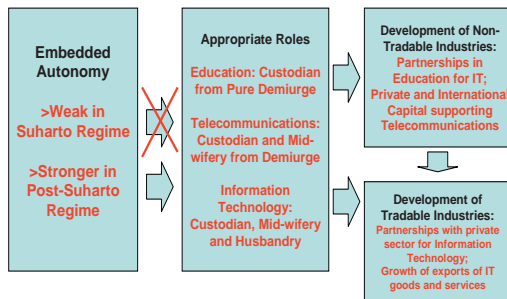
Figure 22: High Technology Exports (current US \$)



Note: Figures created based on WGI 1998-2011

In addition, the IT market has likewise grown. Given the large demand base of Indonesia, IT spending has likewise increased, and it is in fact the largest IT spender in Southeast Asia, with US\$11.5B spent, making it the 19<sup>th</sup> top IT spender in the world. “Hardware spending in Indonesia reached US\$11.5 billion last year and is expected to rise to US\$17.8 billion by 2016. Meanwhile, spending on IT software and services stood at US\$22 million and US\$759 million respectively in 2011.” (Graziella 2012, 1). The findings for embedded autonomy in the three sectors are summarized in the table below, and are further summarized in the conclusion that follows.

### Political Economy of Development



### Conclusion

Traditionally, education, telecommunications have been seen as public goods, and which are best provided by the public sector. However, because of globalization, these non-tradable sectors have become critical sectors for state competitiveness. With the raised profitability in these sectors through linkages with the IT sector, the private sector and the state have therefore been increasingly interested in developing these.



Analysis of the ability of Indonesia to allow for increasing the responsiveness of education to the needs of firms, the breadth of telecommunications services, and for growing the IT sector has shown that indeed, there are appropriate roles in each sector: adding custodianship functions to the demiurge role in education was important in giving direction to education; mid-wifery and custodianship meant the deregulation of the telecommunications industry, allowing for private firms to enter; and for new sectors such as IT, the role the state needed to play was mid-wifery, husbandry and custodian at the same time, to the point that it required the TKTI for coordinating across government in getting these roles done.

It was clear that these roles would not have emerged under the Suharto regime, and failed attempts were indeed shown in telecommunications, while responsiveness of the private sector was not seen to have emerged for education and IT, given the lack of embedded autonomy (in particular, corruption in the bureaucracy) in the sector. On the other hand, embeddedness was shown in the joint projects with the states, and these allowed the state to make the needed shifts in roles across the non-tradable industries, and to create for itself the needed roles in IT.

LDCs can therefore learn from the example of Indonesia's best practices in developing IT as an example of higher value-added services, and education and telecommunications as enablers for this. Findings in this paper can therefore serve as a supplement to the 2012 ADB Report on barriers to developing services, given the facts mentioned in the case studies.

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## Appendix

### A. Autonomy

Autonomy is achieved through implementation of meritocratic recruitment and promotion (meaning, these are based on actual, objective standards rather than personalistic ties) which eventually lead to a stronger sense of solidarity and cohesion within the state bureaucracy (Evans, 1995, 49). Based on a study of Wai (1998), autonomy is measured by corporate coherence, which can be seen in 1) meritocratic recruitment, which “ensures the quality and neutrality of policies because intelligence is derived from well-defined criteria for the selection of employees, policy formulation, and implementation” (35), 2) informal network, which can be internal and external, and which, “like corporate culture (and) close working relationship among civil servants within the bureaucracy leads to coherence and creates corporate identity to overcome other parochial interest”(35), and 3) external network, which “facilitates the participation of society in the formal organizational structure of the state binding the behavior of incumbents towards collective goods instead of piecemeal private interest” (36). In a later work, Evans and Rauch (1999) made use of Weber’s characteristics of a bureaucracy to compare key economic bureaucracies across 35 countries, which measured 1) meritocratic recruitment and 2) rewarding predictable career ladders, in the 1970-1990 period. On the “Weberianness Scale,” the Philippines scored a grade of 6.0 while Korea scored 13.0, as rated by over 126 experts spread across the 35 countries answering a fixed-response questionnaire. Research on meritocratic recruitment is based on the policies as well as secondary literature on the effectiveness of the recruitment policies. Informal networks that are internal to the bureaucracy are measured by accounts in secondary literature which talk about the corporate culture. Last, external networks are measured by the presence of an ombudsman, anti-corruption bodies, and channels of communication with society.

### B. Embedded

Embedded, on the other hand, is achieved through giving sufficient windows for the private sector and the international community to contribute to the strategy’s development (Evans, 1995, 59). Doing so allows states to get their cooperation in implementing the initiatives for development of industries that will boost national competitiveness. It has been measured by practicing a “joint-project of transformation” (59). This entails “society provides nonbureaucratic source of intelligence (to the state) (Wai 1998, 36)” thereby “solv(ing) the problem of a lack of bureaucratic capability by incorporating those who possess most up-dated and relevant information crucial for policy formulation” (36). Therefore, research involves documents on concrete projects and government policies, as well as interviews and secondary literature.

### C. Embedded Autonomy

The presence of EA leads to successful state intervention, as in the identification of the industries which are needed by the market or which the market can develop, as well as the assumption of the appropriate method of interaction in the said industries (Evans, 1995, 50). States possessing EA are considered as “developmental states” (67). The opposite of these states are the “predatory states” (45), which have no autonomy (they are vulnerable and susceptible to influences by private interests) and no embeddedness (the sectors have no ways of feeding states information needed for tapping market opportunities for innovation and economic development initiatives).

## MICROFINANCE AND COMMUNITY CURRENCY: THE CASE OF BANCO PALMAS, BRAZIL

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Rafael Barreto Souza<sup>81</sup> & Lorryayne Porciuncula<sup>82</sup>

*Microfinance has been widely adopted throughout the developing world but it has often suffered criticism for not effectively reducing poverty or bringing substantial social change. In Northeastern Brazil, Banco Palmas launched a system of individual money lending to local residents in a community currency used for intra-neighbourhood trade. This MFI puts forward community credit, professional training, and incentives for neighbourhood businesses investment, all through participatory decision-making processes. This paper analyses how after a decade in place, this microfinance typology coupled with educational and politically engaging undertakings, has shown encouraging results in poverty reduction, neighbourhood-based economic growth and community bonds strengthening. Also, an organization has been created for replicating the local currency microfinance policy; various other community banks are slowly emerging elsewhere in Brazil. International development academia and practitioners have much to learn from this experience and possibly implement similar microfinance schemes in Asian and African contexts.*

### Introduction

Microfinance is under attack for its supposed inability to reduce poverty and to create sustainable productive activities (Bateman 2010). Nevertheless, new forms of microfinance institutions (MFIs) have been arising. This paper aims to

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understand the novelty behind the experience of Brazilian community bank *Banco Palmas*, which was the first structured community bank in Brazil to use a *community currency*, and the lessons that could be disseminated to overall microfinance. That being so, this paper aims at answering two main questions: (1) Can a community-based microfinance institution act as a catalyst to reduce poverty? and (2) Can a community currency assist in creating and strengthening productive activities?

In order to illustrate the findings, the paper is divided in three sections. The first section briefly introduces the Brazilian context: its financial system, exclusion pattern and microfinance panorama. In the second section, the case of *Banco Palmas* is analysed through its history and current framework. The third section investigates the outcomes of *Banco Palmas'* model and tries to answer the two research questions.

### **Brazilian context**

The financial system in Brazil, when compared to that of other countries, has a number of sound characteristics. It has solid and competitive institutions, which possess high liquidity levels. Also, its banking system is known for the quality and sophistication of its services. Nevertheless, those qualities are overshadowed by the high concentration of services and liquidity in the richest areas of Brazil, which leaves a great parcel of demand underserved (Menezes et al 2007). An additional problem worthy of mention when analysing finances in Brazil is the price of credit – the elevated interest rates make credit extremely expensive.

Accordingly to recent research, almost 40 percent of Brazilians do not have a bank account (IPEA 2011). This amounts to almost 50 million people without access to basic banking services of transactions, deposit, credit and other services and products. The financial exclusion for many Brazilians is unfortunately a reality, and the causes are rooted in deep poverty in which many live. A large number of people are excluded from financial services because of their incapacity to pay for the costs of account maintenance, lack of collateral, absence of minimal financial literacy, or simply unawareness of how banking institutions work. With only 46.3 percent of credit operations in relation to GDP (November 2010), available credit is well below Brazilian economic needs, which severely limits its growth (Sebrae/ABCRED 2012).

Amidst such scarce access to resources, the solution proposed by some advocates is that microfinance might help in financial inclusion (Singer 2007). While in other countries with sizable poverty and exclusion microfinance has quickly spread, this has not been the case in Brazil. Theories abound but there is no consensus over this “Brazilian Mystery” (Schomberg 2000). The convincing

arguments (Goldmark et al. 2000, 8) are numerous. Brazilian macroeconomic environment with its high interest rates makes accessing credit too costly. The presence of subsidized credit by governmental institutions crowds out private MFI. The legal structure is not welcoming for MFIs – laws against usury have forbidden for a long time any non-financial institution to charge more than one percent interest rate per month and, only recently, reforms have been made in the legal framework to allow for relative freedom of manoeuvre of MFIs. Finally, the existent retailers' credit for low-income consumers has been responsible for absorbing MFIs' potential clients (in Brazil the credit in stores<sup>83</sup> and *post-dated checks*<sup>84</sup> are common especially among low income sectors).

As in other countries in Latin America, NGOs first introduced microfinance schemes in Brazil. Since the first microfinance initiative, 1975's *Projeto Uno* in Recife, MFIs have increased considerably after 1994 (Goldmark et al. 2000, 12). Out of all of them, the biggest microcredit portfolio is the one of *CrediAmigo* created in 1999 by the largest regional development bank in the country – *Banco do Nordeste*. The National Program of Productive Microcredit created by the central government in 2004 is also noteworthy. Today, there are 139 registered active MFIs regulated as special non-governmental bodies (Sebrae 2011).

Since MFIs are not well developed in Brazil, there has been a sizable interest regarding its unexplored potential. Within Brazilian microcredit scenario, one trend involving community currencies is emerging and it tends to follow the Banco Palma's leading practice.

### **Banco Palmas**

#### *Background*

The case of *Banco Palmas* is invariably connected to the community of Conjunto Palmeiras in Fortaleza, Brazil. Conjunto Palmeiras is located in Fortaleza, the seventh largest Brazilian city situated in the Northeastern region of the country. The community was designed to be a public housing project in a peripheral urban area. However, in its early days, it was a swampy mosquito-infested plot (Neto II 2009b).

The reason for establishing this area for social housing is closely related to land speculation in Fortaleza. In 1973, the local authorities introduced a redevelopment plan for the city's coastal area, introducing a seaside avenue, high-rise hotels and other tourism-related initiatives. The cost for these

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<sup>83</sup> Brazilian stores often advertise products expressed in terms of how much each parcel will cost, instead of the whole price, and those parcels can be divided up to 36 months.

<sup>84</sup> The phenomenon of *post-dated checks* is commonly used in Brazil to buy any kind of merchandise – from clothes to house appliances.



endeavours was the eviction of traditional fishing communities of those beach areas. Neto II (2009b, 45) argues that Fortaleza's municipal government found that, in 1973, families were "misplaced" in downtown coastal areas and had them resettled in an area as far from the high-valued central areas as possible: this new area came to be called *Conjunto Palmeiras*.

The name *conjunto* turned out to be quite misleading in the eyes of the evicted. Traditionally *conjuntos habitacionais* in Brazil are state-owned brickwork houses or apartments with reasonable access to basic services. Thus, their arrival at this deserted swampy area was alarming, since people did not find the ideal houses they expected. Soon afterwards, improvised wood and clay structures were to become their new dwellings.

Northeastern Brazil is characterized by a semi-arid countryside seasonally struck with long-term dry periods. During the 1970-80s the region faced numerous severe droughts that drove thousands of families out of their lands and promoted migration to the coastal capital cities, particularly to Fortaleza. Therefore, throughout the years, original coastal fishermen had their hinterland counterparts gradually joined them and the community grew.

Lacking public services, overlooked by government authorities, suffering from high disease-related mortality, unemployment and generalized poverty, dwellers decided to create a community association called *Associação de Moradores do Conjunto Palmeiras (ASMOCONP)* to look after their collective interests.

Initially the main problem for the community was water-related. People suffered from thirst as well as from seasonal flooding (Neto II 2009b, 79). Access to water came from public wells, which served undrinkable water, or from water trucks, which sold it at prohibitive prices. The inhabitants, after innumerable promises of connecting the houses to the water distribution network, decided to take matters in their own hands. They occupied a newly-built housing project for retired military personnel and later threatened to explode the main pipeline that provided water to downtown Fortaleza. These actions accompanied by frequent demonstrations led to starting the installation of sewage works in the late 1980s using local workforce.

Next on the priority list were sanitation and drainage, as seasonal flooding remained a major problem. Understanding the pluvial drainage dynamics and undertaking the necessary digging and constructing activities would turn out to be quite complex and demanding. At this moment, the German cooperation agency GTZ (Gesellschaft für Internationale Zusammenarbeit) stepped in and proposed a development project for the community to be elaborated through

community direct involvement and oversight. This project had a budget amounting to R\$ 2million (almost US\$1.2 million) that was run entirely by ASMOCONP. Having the responsibility over such a large amount of funds was an essential feature of the project that gave the community association know-how and practical experience in accounting and project management, which would later be indispensable for managing *Banco Palmas*.

Once Conjunto Palmeiras had running water, pluvial drainage, sewers and masonry housing, the community seemed to have changed its status from a slum (or *favela*) into a neighbourhood. This was a common perception among the residents and it was a sign of social inclusion in the formal city. The area had then access to water, sanitation, decent structural housing, reasonable demographic concentration and relative tenure security due to the state's ownership of the land.

Evidently, the community was better off. However, a new and more complex issue soon surfaced. The old inhabitants began to sell their property and move to other – and cheaper – neighbourhoods or slums, where there were not as many services available, or utility bills to pay, and where housing was more affordable. Shortly after the Conjunto improved, property prices rose along with living costs. The same did not happen to dwellers' incomes. Infrastructure upgrading had limited effects in the face of extreme poverty.

Low income was not solely determinant, but the condition of vulnerability of the community's inhabitants. Small changes in people's lives led to destabilization of personal and familial balance. Whether it was remunerating a lawyer for a son in prison or paying unexpected healthcare bills, poor residents often needed urgent resources. Joaquim de Melo Neto Segundo, community leader and founder of *Banco Palmas* (2009b, 179) contented such events pushed residents to informal property selling, which provided easy money due to low transaction costs and readily available demand.

The neighbourhood had around 30,000 inhabitants; hence, the efforts undertaken to improve people's lives were under serious threat of benefiting other better-off people who would simply move to this now urbanized area. Urgent action was needed in order to tackle this obstacle in improving the welfare of existing community members.

The inspiration came from South Asia. The Bangladeshi microcredit experience served as a starting point for creating a community bank that could lend money to those excluded from the traditional banking system, and that could bring development to the Conjunto. Thereby, in regards to such goals, ASMOCONP managed to raise the scanty sum of R\$ 2,000 (approximately US\$ 1,250) with a

local NGO and provided in January 1998 the Bank's first loans (Neto II 2009b, 191-208). Later on, international aid stakeholders came on board funding the bank's expansion; Oxfam and GTZ put forward R\$ 30,000 (app. US\$ 18,750) more.

### **Bank's framework**

The idea began as creating an institution that would offer microloans to local businesses and consumers, thus catalysing neighbourhood economy, and ultimately reducing endemic poverty. *Banco Palmas* was founded. It was named after the community, since *palmas* is short for *palmeiras* – typical palm trees originally found in the area.

Neto II (2009a, 2), in explaining the bank's structure and modus operandi, establishes three main axis of work: (i) integrated system of local development, which promotes credit, production, commercialization and training; (ii) local currency (*Palmas* currency); and (iii) management responsibilities being borne by the community. This threefold approach is also used in this paper to analyse and assess Banco Palmas.

### **First axis: local social development**

Taking on poverty reduction as a driving force, the bank acts on various fronts. Concerning its microcredit policies, there are two kinds of loans: productive microcredit and consumption microcredit. Nonetheless, bearing in mind the multidimensionality of poverty, the bank also carries out solidary trade and training for community members in order to address the community's enrooted exclusion problems.

The bank provides two categories of microloans, one for production, that is, for local businesses, and another for consumption, targeted at individuals who live in the community. The former is provided in Brazilian regular currency – the *real* – and the latter in the community's local currency – the *palmas* (Martins 2009, 10).

The productive microcredit is destined to small enterprises in the neighbourhood. Martins (2009, 10) also clarifies that to be eligible, an owner must reside in the neighbourhood, be a member of the community association, and be "trustworthy" – the latter is a criterion subject to collective scrutiny. This loan typology has an interest rate that scales from 1.5 to 3 percent, usually repayable in six months. The amount is lent in Brazilian currency (the *real*, or reais) and ranges from R\$ 300-10,000 R\$ (US\$ 187-6,250). Though not large by some standards, these funds help shop owners who wish to expand their business, e.g. a grocery store that needs an extra freezer (Neto II 2009b, 252).

Consumption credit is also explored. Clients are individuals living in Conjunto Palmeiras who are submitted to a neighbour survey in order to ensure her/his reliability as a debtor. Loans are provided in palms and not in reais: this stimulates local trade schemes as opposed to out-of-community purchasing. Loans range from R\$ 20 to R\$ 300 (US\$ 12 to US\$ 187) and repayments are due in two months, and can be made in instalments. There are no interests charged. In short, the step-by-step process for getting microloans is as follows. The interested party goes to the bank's headquarters in the morning, where she/he is informed of loan conditions and methodology. In the afternoon, the credit agent visits her/his residence, talks to the neighbours, fills out the request form and preliminarily analyses the credit demand. During the next days, the credit approval committee – composed of the bank's coordinator and executive director – decides on the proposal's feasibility and whether the proponent is in accordance with the principles of solidarity economy<sup>85</sup>. The process takes 15 days on average. Reasons for asking the loan are seriously taken into account in the decision-making process.

For an overview of the bank's portfolio, it is necessary to look into global transactions in 2009. In that year, microcredit for productive purposes amounted to R\$ 700,000 (app. US\$ 437,500) for 490 shopkeepers, and microcredit for consumption took up R\$ 36,000 (app. 22,500) for 340 individual residents (Banco Palmas 2010). One can easily note that productive credit overpasses the consumption one, thus indicating a focus on local trade expansion and local poverty alleviation.

#### *Banco Palmas 2010*

Furthermore, the Bank equally dedicates itself to capacity-building projects for job creation and dissemination of community bank methodology. It also engages the community in local trade fairs.

*Bairro Escola de Trabalho* is a training centre founded in 2005 for people 16-24 years old who attend courses on business, accounting and basic management. Alongside this centre devoted to community's youngsters, the *Incubadora Feminina* (Female Incubator) acts as an empowerment tool for women in vulnerable conditions. Coursework involves insertion in a productive activity usually related to retail or tourism. *PalmaTech* was also created in 2002 for

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<sup>85</sup> Solidarity economy is an innovative form of income and work generation in favour of social inclusion. It is based on the principles of cooperation, self-management, productive economic engagement, and solidarity among all the actors. The economic thinking aims to create a sustainable economy for income and work generation and carried out by diverse economic and social practices through cooperatives, associations, self-managed companies, and cooperation networks that provide goods and services (MTE, online).

training NGO professionals, students, shopkeepers, housewives etc. in the domain of solidarity economy, while using pedagogical tools for disseminating *Banco Palmas'* experience (Martins 2009, 15-16).

Table 1: Global Transactions for Microcredit for Productive Purposes

Actions	2005	2006	2007	2008	2009
Credit Portfolio in reais	50,000	120,000	250,000	530,000	700,000
Credit Portfolio in Palmas	3,000	10,000	20,000	25,000	36,000
Default in the credit portfolio (in palmas and reais)	1.0 percent	1.8 percent	2.0 percent	1.3 percent	2.5 percent
Number of people served with productive credit (in reais)	70	97	170	310	490
Number of people served with consumption credit (in palmas)	70	97	170	310	340
Number of operations realized by bank correspondents	40,000	80,000	95,000	110,000	130,000
Number of enterprises that accept palmas	90	99	130	180	240
Jobs created (formal and informal)	40	69	110	180	160
Young people who received job training	90	340	420	860	560
Women at risk served by <i>Incubadora Feminina</i>	40	40	20	0	25
Community fairs (25 producers on average)	26	22	28	17	14
Annual revenue from the solidarity shop – (in reais)	Does not apply	25,000	53,000	76,000	55,000

Currently there are two main businesses developed by the bank: *PalmaLimpe* and *PalmaFashion*. The former concerns a store of cleaning products that trades recycled materials. The latter is a sewing atelier that produces jeans and school uniforms while integrating community members in the seamstress craft.

### Second axis: community currency

*"[O]ne realized that the situation of poverty of that community was not the result of absence of money, but rather the resource flight out of the neighbourhood."* (Neto II 2008). *Banco Palmas'* innovation, though, does not result from its microcredit loans *per se*. The ground-breaking achievement of the institution was the establishment of the *palmas*. This currency is printed in paper money, watermarked, barcoded and engraved with serial numbers, and it is the innovative *modus operandi* element for which Banco Palmas is praised.

After Joaquim de Melo Neto II recognized capital flight from the neighbourhood, the bank introduced the first alternative currency in contemporary Brazilian history. The theory that shopping in the other areas of the city instead of in neighbourhood shops impoverished the community as a

whole was creative, fresh and new, and it did not take long to accumulate numerous followers.

Initially, the bank issued a community credit card called *Palmacard*, which was a cardboard rectangular sheet of paper whereby consumers could go to local shops to buy goods. Shopkeepers would then write down how much was spent in the card itself, determining hence for the bank how much was owed. *Banco Palmas* guaranteed the credit transaction, limited to a pre-determined small amount. By a certain date the following month, payment was due by community members. Two years later, due to connection with an Argentinian experience during the 2001 economic crisis in creating alternative currencies for dealing with inflation, the current banknote-based community currency was finally adopted in Conjunto Palmeiras.

Community currencies are not a recent phenomenon. De Meulenaere (2006, 230) explains that, in reaction to economic crisis, alternative currencies were put into place in England in the beginning of the 18<sup>th</sup> century, as well as in post-First World War Germany and in the United States during the Great Depression. Thus, community currency systems were not adopted in modern history by strong counter-hegemonic ideological foundations; they were, on the other hand, mostly a by-product of coping with economic hardship in times of recession, post-conflict scenarios, or extreme structural poverty.

Blanc (2006, 6-8) distinguishes four generations in the history of community currencies. The first one was characterized by the involvement of big national networks in 1980s and early 1990s in establishing mutual credit systems where there was no convertibility between community currencies and formal national currencies; this scheme had weak partnerships with formal economic activities, as well as with local governments. Within the second generation, also in the 1980s, these currencies were based on pure time exchange schemes, where the exchange unit was the man-hour. Concerning the third generation, late 1990s, alternative currency was implemented with an economic purpose, while constituting "complementary currency" schemes; having a territorial ambition, they were truly "local currencies" as well. NGOs, local cooperatives or community banks generally implemented these. Fixed rates linked the complementary currency to the national one, and convertibility rules were set up. Lastly, the fourth and most recent generation is differentiated by setting out multiplex projects where focus was primarily on environmental issues and where local governments play a major role. The goal was to incentivize sustainable behaviours through the distribution of a complementary currency in relation with those behaviours: local or organic product consumption, fair trade, waste recycling, and others.

*Banco Palmas* is clearly situated in the third generation typology. The concern with the local aspect was decisive in the bank's implementation, since the currency, from its beginning, had a direct correspondence with the Brazilian official currency. The idea was that "the *real* is the strong arm gathering wealth outside of the neighbourhood and the *palmas* is the currency that redistributes within it" (Neto II 2009b, 226-230).

Many researchers and microfinance experts argue that community currencies play an irrefutably positive role in reorganizing community economy and trade relations. In a different article, Jérôme Blanc (2006, 31-32) points out that there are three types of complementary currencies: currencies based on a political rationale (e.g. typical national currencies), currencies based on a profit-making rationale (e.g. inter-company compensation systems) and currencies based on a citizenship rationale (e.g. Palmas currency).

The citizenship rationale is designated by three main characteristics: trade places being within the community's territory; dynamisation of trade inside these places; and transformation of local trade. Firstly, territorialisation appears as a critical element of these alternative currencies; community currency is circumscribed to a territorially based community. Secondly, local trade is dynamised through promoting access to credit and organizing goods and services exchange in a way that people expend their income quickly, in its totality and locally.

Thirdly, the local exchange practices are deeply reformulated. The concept of "*prosumator*" (Garcia 2010, 15) comprising the figures of producer, consumer and actor in the same individual refers to the great web of social and trade relations undergone on a local sphere. Traditional individualism and opportunist practices common to regular trade schemes are also broken down due to a finer linkage in the communal social tissue. Harmonizing at a local level trade and – likely – social relations engender a finance of proximity that encourages a redefinition of criteria even for price-setting, that may lead to a monetary exchange system thought of and understood as not purely an abstract currency, but as exchange in itself.

*Palmas* is a token of the theoretical framework ensemble of community currencies in a citizenship rationale. It bridges the common bond between local consumption and production, through its lending to Conjunto Palmeiras' residents. Still, it is the implicit social pact upon which the community agrees to give it value that allows it proper. The complex social tissue in which the *palmas* is linked is the fuel that propels its expansion.

From launching the currency, shopkeepers had to be persuaded to accept it as payment and community members were given discount for purchases using *palmas* instead of reais. Yet, a study carried out 10 years after the bank's foundation shows that only 22 percent of the subjects surveyed considered the discount the "main motivation" for using the *palmas* as currency, as opposed to 44 percent who declared using it because it "helps to develop the neighbourhood's trade" (LIEGS 2008, 47).

### **Third axis: participatory decision-making process**

What makes *Banco Palmas* a unique case study is not the fact that it is a microcredit institution, nor because it promotes capacity-building related to productive activities, nor because it has a social currency. *Banco Palmas* is special because of how it combines all these factors and functions through community-centred participation. These elements brought together boost the sense community belonging, improve social capital and strengthen the social tissue's harmony.

This political aspect permeates the bank's activities since its conception. The foundation of community resident association ASMOCONP is rooted in a deep sense of community, open debate and participation. The history of collective struggle for accessing basic public services has been source of the institution's participative decision-making praxis, now institutionalized by the *Fórum Econômico Local* (Fecol). Fecol oversees and directs the bank's activities through periodical meetings and ample community participation.

### **Outcomes from Banco Palmas model**

In order to understand how a methodology of microcredit that rests on the mentioned three axes – local development, social currency and participation – could generate a positive impact in a given community, it is necessary to understand first the impact of *Banco Palmas* in the context of Conjunto Palmeiras. For that, this paper builds general conclusions on a recent study on the Conjunto. After careful observation, and due to the singularity of it, this paper uses data acquired from this study, called "Impact and Image Evaluation: Banco Palmas – 10 years" (LIEGS 2008).

### **Impact and image evaluation study**

First, it is important to contextualize this above-mentioned source. This 2008 impact evaluation was commissioned by the *National Secretariat of Solidary Economy – Ministry of Work and Employment* – and was the first, and till today only, of its kind. The executer institution was the *Interdisciplinary Laboratory of Social Management Studies* (LIEGS, in the Portuguese acronym) – *Federal University of Ceará/ Cariri Campus*. Here, it should be mentioned the specificities



of this institution. Despite the fact that *Campus Cariri* is part of the Federal University of Ceará, it is relatively distant geographically and socially from its headquarters in Fortaleza. Nonetheless, they are both still inscribed in the state of Ceará and it is safe to assume that researchers are familiarized with the reality of their state's capital.

The fact that the object of the study and those conducting the research are neither too close nor too distant suggests a positive aspect on credibility and neutrality. In enquiring on a possible bias, the multiplicity of backgrounds of the people involved on the research is also quite important: eight researchers have coordinated their specialties on sociology, psychology, philosophy and management. This interdisciplinary approach is also present in their methodology, which was a hybrid between qualitative (participatory observation, interviews and focus groups) and quantitative methods (survey). The quantitative parcel of the research confirmed many of the impressions acquired qualitatively. For the survey, the researchers elaborated a questionnaire with closed answers and applied them to a random sample (248 individuals) out of 2.649 clients of *Banco Palmas* (i.e. borrowers, users of the social currency, entrepreneurs that accept the social currency, youngsters from Bairro Escola, entrepreneurs that employ youngsters from Bairro Escola, and clients of the banking correspondent).

The data gathered is illustrative of Conjunto Palmeiras's population and indicates the general impact *Banco Palmas* has had. Among the sample of users of *Banco Palmas'* services, it is found that: the average client age is 34 years, there is a balance between men and women (56 percent are women), the average number of people in a household is 4.7, 38.7 percent have concluded high school, 86.9 percent have more than 11 years of residence at the Conjunto, and most strikingly, 75 percent of people live with as little as two salaries on the minimum wage and 23.32 percent are unemployed (a number extremely high to the national parameters that floated between 9 and 10 percent in 2007 (IBGE 2007).

When questioned on the impact of *Banco Palmas* on the community and on their own lives, responses were preponderantly positive: 98 percent answered that the Bank had helped in the local development and 90 percent said that it had contributed to the improvement in their quality of life – on reasoning how the Bank had acted on that role, 25.5 percent said their incomes had risen, 20.2 percent said it was because they had acquired a job, 23.3 percent due to meeting other people, 12.12 percent because it brought other projects.

As for the quality of their services, 53 percent of the sample had acquired a loan, 67 percent of those had taken one more than once and 91 percent

evaluated the Bank's performance as 'good' or 'great'. Also, only 2 percent of those with loans in other banks have resorted to them after taking a loan in *Banco Palmas* (in absolute numbers this amounts to 4 people who have not justified their answer), which can indicate that indebtedness is not an issue that results from the bank's activities.

From the qualitative observations, the often-mentioned impacts are: the visibility *Banco Palmas* has brought to the community (regional, national and international), which was responsible for raising the self-esteem of the people who inhabit it; and collective gains from its efforts toward education, culture and youth capacitation. However from these non-quantitative enquiries, other effects of *Banco Palmas'* performance were unveiled.

A few people mentioned that *Banco Palmas* has outgrown ASMOCONP, which has reduced the influence of what used to be the primary source of social mobilization in the community. Many feel that the Association should retake its role and affirms its ownership of *Banco Palmas*, since it is indeed a product of that institution.

One should also be aware that assessing impact in a context of informality is a very difficult task. Informal entrepreneurs do not have regular monthly incomes. Their periodic income – and any change in it – can only be roughly assessed. Due to the uncertainty relying on such quantifying effort, LIEGS researchers chose to adopt the relatively open-ended question of "how did your life improve through *Banco Palmas*?" in order to estimate the broad effects of *Banco Palmas* in the community's welfare. This was taken into account in this paper's analysis and the conclusions are not distant from the evaluation consulted.

From the computed data, the impact of *Banco Palmas'* activities in Conjunto Palmeiras and in its inhabitant's lives is largely positive. In its goals of job and income generation, *Banco Palmas* achievements were commendable – 21 percent and 19 percent of *all* respondents answered they had either been employed or raised their incomes due to Banco Palmas. This leads to the following questions: (1) Can a community-based microfinance institution act as development catalyst and reduce poverty? (2) How can a community currency assist in creating and strengthening productive activities?

It is well said that the experience of *Banco Palmas* is *sui generis*, thus it is so because it was able to implement a unique methodology. As Blanc (2011) states, new generations of microfinance institutions come about because of their innovation. The *Banco Palmas* model is a hybridization of other models and it has created a methodology that goes beyond microfinance. Nevertheless, it is

possible to speak of its model theoretically and ponder on its effects on poverty reduction and on the creation of productive activities.

### Poverty reduction

Despite the proportion of people who raised their incomes due to the *Banco Palmas*' activities, poverty is still a wide-spread problem in Conjunto Palmeiras. The data on the profile of users of the Bank (e.g. 75 percent living with less than two minimum wages) shows that the standard of living on this community is far from ideal.

It should also be noted that the penetration of *Banco Palmas* is not yet sufficient to answer for the need of the whole of Conjunto Palmas. The number of clients of the Bank amounts to less than 10 percent of the entire population of the Conjunto. Additionally, people on the focus groups of the 2008 study criticized the fact that the Bank had not yet helped (or aimed) the people in the more distant blocks of the neighbourhood – noticeably those in *Conjunto Palmeiras II*. However, the fact that the bank could have done more is not a good argument to gauge whether its activities have been positive. The only thing that can be measured is what it did with the resources it had. Such contestation is relevant though, since it is important to keep in mind that there is no “magic bullet” that will solve all the problems. Yet, the positive effects are noticeable.

The fact that the methodology of *Banco Palmas* stands on the central idea of being community-based should be highlighted. This is justified by the extent that the community engagement is the cornerstone of *Banco Palmas* and indispensable for poverty reduction – especially when causes for their impoverishment go beyond mere lack of access to resources.

As collected from the survey, *Banco Palmas* not only was responsible for raising incomes but also bringing other projects and making people meet each other (LIEGS 2008). Overall, *Banco Palmas* has helped strengthen the social fabric of Conjunto Palmeiras. Also, it brought visibility to the community that might not only have reinforced the self-conceit of the inhabitants and their sense of belonging, but also empowered them *vis-à-vis* public authorities. At the very least, *Banco Palmas* magnified their social capital, raising individual gains through “the solidarity that makes them possible” (Bourdieu 1985, 249).

One critique on MFIs is that it forces voluntarism into an artificial grouping that becomes mechanized and depoliticized, practicing within it a single-minded focus on credit disbursement and repayment and forgetting their fundamental strength in social and political claims (Parthasarathy 2012). Well, if an MFI aims to reduce poverty, it should not alienate its participants from fundamental causes of their poverty and vulnerability. In Northeastern Brazil, those causes

are related historically with the neglect of government and the invisibility forced upon those people who are moved off to isolated peripheries. The shareholders of *Banco Palmas*, ASMOCONP in this case, should always keep this in mind.

If we consider poverty as multidimensional, the political and social aspect from the fight against it cannot be forgotten. A methodology of microfinance based on the demand of the community and on its sense of ownership and organization has the potential to expand the individual *capacities* (Sen 2000). Instead of being sold as a ready-to-buy product, the outputs of MFIs should be not only tailored to the communities but owned by them. If that is so, the reduction of poverty could be accomplished.

### **Creation and strengthening of productive activities**

Social capital is also central for the role of the methodology used by *Banco Palmas* in aiding the creation and strengthening of productive activities. Here, the instrument used was the “community currency” and it served as the tactile solidarity between the inhabitants of Conjunto Palmeiras.

Since the survey available did not weigh the specific effects of *Banco Palmas* in the businesses of those clients who were entrepreneurs, it cannot be assessed the direct impact of the Bank’s activities on the ventures of the neighbourhood. It was not specified how many of those in the productive credit portfolio had been able to increase their incomes; the data (19 percent which stated having an improvement in their income) encompasses the clients of many other services of the bank. Despite that, the model created by *Banco Palmas* offers general insights that enable the acknowledgement that it has had a positive impact in local productive activities.

From the start, the goal of *Banco Palmas* was to create a market for those producers who would get a loan from *Banco Palmas*. From an economic point of view, this thinking makes sense – it is not possible to raise production when there is not enough demand. What *Banco Palmas* did was to induce more local demand, both by the currency *per se* and by the credit for consumption that allowed for demand to flourish where it was limited. In territorializing the spending of the community, the model of *Banco Palmas* boosted the dynamics of the Conjunto’s local economy. And it did so by strengthening the links between local producers and local consumers – this methodology brought, again, the deepening of the social fabric.

In theory, this model offers an intelligent alternative to the issue of creating and strengthening productive activities locally. Notwithstanding, reliable data endorsing such theoretical precepts is not available or has not yet been

produced. What can be observed is that the bank accomplished the creation of a successfully executed complex strategy of enhancing the local economy network and communal solidarity.

### Conclusion

Conjunto Palmeiras has an extraordinary history of community mobilization and organization, both of which – aligned with a peculiar local political ambiance – provided for successful implementation for public services by the authorities and, later on, a financial revolution on the local sphere. The greatest achievement was to mobilize funds, start up and administrate a community bank on the principles of democratic participation and by making use of their own currency – the *palmas*. The bank's three-axis methodology is indeed the foundation for its success and any attempt of replication should take these into account, otherwise any such endeavour is doomed to fall into the threshold of regular MFIs, therefore being subject to their typical shortcomings.

The study undertaken by LIEGS 10 years after the bank's creation displayed positive results in terms of community perception concerning local development, job creation, income amelioration, and standard of living. With the support from the Brazilian federal government, *Banco Palmas* has provided technical assistance and methodological consultation and helped to start up over 54 other community banks Brazil wide, always ascertaining the three-fold framework of local development, community currency and participation. Nevertheless, this experience is quite recent and long-term impact assessment is still unattainable. A main omitted variable in the whole *Banco Palmas'* equation is that since its creation the Brazilian macroeconomic and social policy scenario has shaped admirable outcomes in terms of GDP per capita increase and extreme poverty reduction.

Further investigation is still required in order for clear causality relations to be distinguished in terms a community bank *modus operandi's* direct effect on overall quality of life heightening. One aspect is certain, though. Inciting community mobilization, reinforcing social capital through tightening the communal tissue in a locality has produced profound impacts in how Conjunto Palmeiras residents perceive their surroundings, neighbours, finances, political empowerment, and vision for the future.

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 EXTENDING HEALTHCARE TO THE INFORMAL SECTOR IN LAOS<sup>86</sup>


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*Beñat Oñatibia Camara and Zhang Yingxin Louisa<sup>87</sup>*

In early January 2000, the Minister of Health of Laos was grappling with a seemingly insurmountable healthcare problem in the country. Laos had just implemented a social health insurance scheme for the formal private sector to complement the existing civil servants insurance scheme. However, this left a huge vacuum in healthcare for the remaining 80 percent of the population in the informal sector<sup>88</sup>. The Minister was scheduled to meet with the Cabinet to discuss a strategy to tackle this inequitable problem at the end of the month.

The informal sector largely comprised of the rural population engaged in subsistence agriculture (an activity which contributed more than 50 percent of the country's GDP) and the self-employed. Many of this group were living below the national poverty line<sup>89</sup>. A substantial proportion lived in remote, far-flung regions and had to travel long distances to access public health facilities where they incurred high user fees and drug costs. This deterred them from seeking healthcare services and the Minister had witnessed the decline of healthcare access to the informal sector in the past few years.

The Minister was no stranger to implementing radical health reforms. Since his appointment as head of the Ministry of Health (MoH) in 1996, he had pursued a series of public healthcare reforms such as the introduction of user fees and the

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<sup>86</sup> This case won the first prize in the Case Writing Competition 2012. This case has been written under the guidance of Associate Professor Phua Kai Hong and Visiting Professor Tikki Pangestu, Lee Kuan Yew School of Public Policy (LKY School), National University of Singapore and has been funded by the LKY School. The case does not reflect the views of the sponsoring organization nor is it intended to suggest correct or incorrect handling of the situation depicted. The case is not intended to serve as a primary source of data and is meant solely for class discussion. This case is based largely on interviews, publicly available sources and actual events, but some characters and events have been altered for the purposes of this case study. Copyright © 2013 by the Lee Kuan Yew School of Public Policy at the National University of Singapore. All rights reserved. This publication can only be used for teaching purposes.

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<sup>88</sup> International Labour Organisation. Lao PDR: Social security. *ILO Paper Series on Social Security Extension Initiative in East Asia*. ILO Subregional Office for East Asia, 2006. p.3.

<sup>89</sup> The national poverty line in Laos is based on nutrition; a person is poor if he consumes less than an amount that buys 2,100 Kcal/day (plus a 30 percent allowance for non-food items).



Revolving Drug Funds (RDFs), a mechanism used to finance medicines in which drug supplies were replenished with monies collected from the sales of drugs after an initial capital investment<sup>90</sup>. Although these reforms had lessened budgetary stress on the government, they also exacerbated the inequity of the healthcare system.

Convinced that there was some way he could alleviate the problems of providing basic healthcare to the informal sector, he called upon Phoumi Vorasai<sup>91</sup>, the recently appointed Deputy Director-General of the Planning and Finance Department. The Minister wanted Vorasai to analyse the various health systems financing options to improve health coverage for Laos' informal sector so that he could recommend the best approach to the Cabinet.

Vorasai understood that this was a difficult task, as procuring additional funding from the government was a tenuous affair since tax revenues in Laos were low. The alternative of harnessing more financial aid from external donors would not be simple either, and was unsustainable in the long-term. In short, he had to address the issues of financing the system as well as effectively extending healthcare to the informal sector. There was a need to balance the trade-offs of efficiency versus equity, expediency versus sustainability and quantity in terms of coverage versus quality. There was also the issue of whether he could get support from other ministries which were closely linked to his strategies. He identified three approaches, all of which had their own challenges and drawbacks.

The first approach was to increase funding to provide subsidies of essential medicines through the RDFs such that healthcare would be affordable for the targeted group. This could be financed through an integrated approach from external donors and an increase in government funding.

The second option was to initiate Community Based Health Insurance (CBHI), a voluntary scheme where the participants would prepay a small premium which would be topped up by funding from external donors and the government, in return for pre-determined set of health services. External donors could provide assistance on a district or provincial level, the funding of which would be much more feasible.

The last approach was to create a mandatory national health insurance scheme. Premiums would be collected from the non-poor self-employed, and premiums

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<sup>90</sup> The initial source of funds for the RDFs came from the government, foreign assistance, and donations from several other sources.

<sup>91</sup> Character's real name has been changed for privacy reasons.

for the poor would be subsidised by government and external donor funds. Social security contributions towards health would also have to be increased. By enlisting the informal sector into the insurance system in a gradual approach, the premiums from them would be pooled with the existing social security health fund. Such a scheme would enable cross-subsidisation from the formal to the informal population, and would involve working closely with the Social Security Office within the Ministry of Labour and Social Welfare.

### **Background on Laos**

Laos was one of the least-developed countries in South-East Asia with a GDP per capita of US\$330 in 1999, and much of its population was impoverished. The single-party country had been running on strict socialist lines since 1975, but in 1987 the government had introduced the “New Economic Mechanism” which had triggered a process of trade liberalisation and encouraged private investment. Although this had led to economic growth of as much as six percent annually during the 1990s, the benefits of economic growth were concentrated in the urban areas especially in the Vientiane province, leaving behind a large proportion of its population mostly in the informal sector living on less than US\$2 a day. Still, poverty incidence had dramatically dropped from 46 percent in 1992 to 39 percent in 1997 to slightly above 33 percent in 1999<sup>92</sup>. Laos had no fewer than 4.2 million (80 percent) of its 5.2 million population working in the informal sector primarily in subsistence agriculture<sup>93</sup>.

Health-wise, the country had one of the highest fertility, lowest life expectancy and highest infant and maternal mortality rates in the region (see Exhibit 1). Malaria, pneumonia, influenza, diarrhoea, and dengue were the most common causes of morbidity, and of death (with the exception of influenza).

### **Reforms in the health sector**

The public health sector largely operated on three main levels –the central level governed by MoH, the provincial level and the district level (see Exhibit 2). Besides the vertical health programmes run by the ministry that ran through to the lower levels<sup>94</sup>, the provinces and the districts had much autonomy in running their own health programmes. Since the opening up of the economy, the ministry had been heavily assisted by international donors and NGOs.

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<sup>92</sup> Lao Statistics Bureau Yearbook, 2000. Vientiane: Ministry of Planning and Investment, 2000.

<sup>93</sup> *Ibid.*

<sup>94</sup> Laos had 16 provinces and one special security zone, 142 districts and approximately 12,000 villages in 2000.

There had been several key health reforms in Laos during the last few years. From 1975 to the mid-1990s, public health services were free but these services were extremely basic and had a limited reach for the population. Salaries of health workers were low, there were frequent and severe shortages of essential drugs and health infrastructure was in a dismal state under the free public healthcare regime. More tragically, the provision of these free services was financially unsustainable. To prevent the implosion of the healthcare system, user fees for public health services had been introduced under the Prime Ministerial Decree 52 in 1996.

The Revolving Drug Fund (RDF) had been expanded under the Prime Ministerial Decree 230 in 1997 to provide a steady supply of essential medicines from the central level all the way down to the village level through cost-recovery. Prices of drugs were to be sold at a mark-up over the purchasing price to cover administrative and logistical costs. Concurrently with the RDF, the Laos Government permitted the flourishing of private pharmacies to improve drug availability to the population.

In 1999, the Ministry of Labour and Social Welfare had established a social security scheme that covered the healthcare of employees in the formal private sector under the Prime Ministerial Decree 207. Managed by the Social Security Office (SSO) in the Ministry of Labour and Social Welfare, the social security contributions consisted of 9.5 percent of the salary with employers contributing 5 percent and employees contributing 4.5 percent; 2.2 percent was channelled to healthcare<sup>95</sup>.

Social security for the public sector had already been in existence since 1993. It was funded by the civil servants' contribution of 6 percent of salary and topped up by the government treasury as and when it was needed<sup>96</sup>. Beneficiaries of both the public and private sector schemes could receive ambulatory and in-patient care without the need for any co-payment. The healthcare providers were paid by the capitation method (received a fixed amount per insured person and dependents annually).

This now meant that both the public and private formal sector were covered for healthcare under the two social security scheme, while those in the informal sector, who were the most vulnerable of the population, were left to fend for themselves.

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<sup>95</sup> MOH Technical Working Group and JICA Study Team. *Lao Health Master Planning Study – Final Report Vol. 4*. Vientiane. November 2002. p9-11.

<sup>96</sup> *Ibid.*

## Health system financing in Laos

Vorasai was acutely aware of the problems of financing Laos' weak healthcare system. The country's average annual healthcare spending of US\$11.50 per person was on the low side when compared to other low-income countries in the region<sup>97</sup>. The level of health spending in Laos was patently insufficient to provide for the country's health needs and to support the existing network. It could not even cover a minimum package of basic services for the whole population which would cost US\$15 per person, and was nowhere near the US\$34 per person required to establish a close-to-client healthcare system as estimated by the World Health Organisation (WHO)<sup>98</sup>.

The heavy reliance on foreign and external sources was equally troubling: 35 percent of total health expenditure was financed externally by international and bilateral development agencies and banks. Out-of-pocket household expenditure on healthcare was sky high and comprised 55 percent, while government spending<sup>99</sup> was a paltry 10 percent of total health spending (see Exhibit 3).

The average household expenditure on health was US\$6.70 per person, and although the amount spent on health was lower in rural areas, it was higher as a percentage of total household expenditure at 4.6 percent (compared to 2.3 percent for those living in urban areas)<sup>100</sup>. A third of this was spent in public facilities and the rest spent in private pharmacies or informal drugstores. The money went largely to medicine (92 percent), with the remainder going to the payment of service fees.

Having personally conducted the study on "Hospital Expenditure Findings" with the WHO a few months before, Vorasai had identified why the facilities charged so much for user fees and drugs. Half of government funding was primarily used for staff salaries, and a substantial chunk was spent on investment in new buildings (see Exhibit 4). Already underfunded, the hospitals had no choice but to charge high service fees and drug prices to finance their operating costs. He had found it shocking that for example, drug

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<sup>97</sup> In comparison, Cambodia and Vietnam's health expenditure per capita were US\$19 and US\$23 respectively in 2000.

<sup>98</sup> Commission on Macroeconomics and Health. *Investing in Health for Economic Development*. World Health Organization. Geneva, 2001.

<sup>99</sup> Government health expenditure is defined as budget expenditure from MoH, other ministries (Defence, Interior and Labour), and provincial governments on health.

<sup>100</sup> As a percentage of total household spending these figures are high especially when compared with the proportion of food expenditure out of total expenditure (25 percent for the rural population and 41 percent for the urban population).

sales comprised 77 percent of revenues in central and provincial hospitals while this figure jumped to 90 percent in district hospitals. It was clear that the informal sector was the group most disadvantaged by this cost-recovery system, as the level of household out-of-pocket expenses was surely beyond their means.

### **Decentralisation of the health sector**

Decentralisation throughout the 1990s had decreased MoH's allocated share of government health expenditure from two-thirds in the 1980s to 28 percent in 1999<sup>101</sup>. 63 percent of government health expenditure was allocated to the provinces and 9 percent to the Ministries of Interior and National Security which provided healthcare to the police and the military.

With an "upward revenue sharing" fiscal system<sup>102</sup>, Laos' health sector's functions were similarly devolved to provincial and district levels. The framework of decentralisation had been expanded just months ago and gave provinces wider fiscal autonomy in collecting and allocating revenues within envelopes set by the government, subject to MoF's approval<sup>103</sup>. Budget allocations depended mostly on negotiations between provincial governors and the central government. The province and district offices were responsible for running their respective hospitals and in their vicinities, but many lacked the recurrent budgets allocated from district chief offices to run the health services properly.

Another problem of decentralisation was that even though the purchasing of the drugs for the RDFs was done by the MoH, the procurement was done at the provincial level. Drug procurement committees in more rural provinces did not have the specialised knowledge to carry this out, and the health centres often had shortages of key drugs.

The MoH managed vertical health programmes supported by external donors, and was not supposed to distribute funds to the provincial and district levels. This posed a problem as this led to different goals, objectives and strategies amongst the various levels of governance, as the ministry effectively lacked the power to impose health policies at the localised levels.

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<sup>101</sup> MOH Technical Working Group and JICA Study Team. *Lao Health Master Planning Study – Final Report Vol. 4*. Vientiane. November 2002. p9-5.

<sup>102</sup> In this system, revenues are collected at the provincial level, and surplus revenues collected by richer provinces are to be transferred to the central level to fund both central government expenditures and transfers for the provinces in deficit.

<sup>103</sup> Subnational administrations raised around three-fifths of total revenues and spent almost half of total expenditure.

## Healthcare in Laos

Healthcare in Laos, mainly provided by public healthcare facilities, was plagued by myriad problems. In 2000, the country had eight central hospitals, all in the Vientiane Municipality, five regional hospitals, 13 provincial hospitals, 121 district hospitals and 533 sub-district health centres<sup>104</sup>. While more than 300 private clinics were in operation<sup>105</sup> (mostly in Vientiane), there were no private hospitals operating in Laos even though the government had permitted the opening of private hospitals in 1992.

There were 11,382 public sector health workers under the central and sub-national levels (see Exhibit 5). For every thousand Laotians, there were about two doctors and six health assistants. Considering the fact that the network of health centres was much more extensive than the network of central, provincial and district hospitals, the health centres received disproportionately less health workers and financial resources and were staffed predominantly by less qualified health workers. There was also a group of health workers employed by the Ministry of National Security and the Ministry of National Defence to cater to the healthcare needs of the police and military.

Anecdotal evidence suggested that the workers at the health centres were alarmingly inefficient, provided poor service and did not show up regularly. Not surprisingly, the health centre workers typically received low salaries, little training and there was a dearth of career development opportunities. In each health centre, there were on average only two health professionals and these centres were inadequately maintained and equipped with drugs and provided low quality service. Many health workers preferred to work in urban areas over the rural areas and there were problems of conflict of interest as many of the senior health workers were involved in private health practice outside of their official working hours.

Even in urban areas, health services were sub-standard, though they were of much better quality in comparison to the rural health centres. After allocating the majority of the government funding towards the salaries and capital, what was left for operations and maintenance of the facilities was inadequately little, leading to rapid deterioration of the health facilities and an abysmally low quality of healthcare. This led to the population's high mistrust of the public health facilities, with only 28 percent of those who fell ill seeking health services

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<sup>104</sup> Department of Statistics, Ministry of Planning and Investment, Lao PDR

<sup>105</sup> State-employed doctors with at least 7 years of practical experience in the public sector were permitted by the government to run private clinics after working hours if they were still working in public health facilities or on a 24-hour basis for doctors who had retired or had been properly discharged.

at public health facilities<sup>106</sup>. The biased distribution of human and financial resources in favour of the central institutions and provincial levels meant that the district and village levels, where most of the poor were concentrated, were the most severely underfunded.

All these explained why a country like Laos had public healthcare facilities that were so underutilised. Naturally, this translated into a substantial wastage of government resources. Bed occupancy rates were absurdly low at 44 percent in provincial hospitals, 3 percent in central and district hospitals and 10 percent in health centres, while ambulatory activities were rarely used in most health facilities<sup>107</sup>.

### Healthcare for the informal sector

The MoH did have service fee exemptions in public health facilities for the poor and other groups in society such as monks, students and civil servants according to Decree 52 which was established in 1995. But in reality, exemptions granted were few and far between. According to a technical officer from the WHO, the discretion ascribed to each health facility to decide whether or not to grant the fee exemption led to wide variations in this practice throughout the country<sup>108</sup>. Lack of standards on identifying the poor and the poor not knowing that exemption policies existed made the situation worse. Moreover, it was illogical that civil servants, who were already eligible for health expenditure reimbursement from their social security scheme, were within the exemption.

Although it was true that service fees were low, users still had to pay for the medicine which was exorbitant considering the little that the informal population earned, and the RDFs only served to worsen the problem. "The RDF was more lip-service to primary healthcare than anything else," observed a technical officer from the WHO who was then working on a project with the MoH, "because they (RDFs) often charged higher prices than private pharmacies, and some RDFs even bought their drugs from private pharmacies nearby."<sup>109</sup> The RDFs were neither well-regulated nor well-controlled, leading to exploitation of this revenue source by health service providers.

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<sup>106</sup> State Planning Committee and NSC. Lao PDR Lao National Health Survey, Vientiane. 2000.

<sup>107</sup> MoH Technical Working Group and Japan International Cooperation Agency Study Team. *Lao Health Master Planning Study. Volume 2*. Vientiane. November 2002. p9.7.

<sup>108</sup> From interview with authors.

<sup>109</sup> From interview with authors.

Vorasai was also keenly aware that the negative impact of the Asian Financial Crisis in the late 1990s on government revenues had only served to compound the exploitation of RDFs. Since the RDFs were the only non-tax earmarked revenue for the public health facilities, the decrease in earmarked funding had led to hospitals over-prescribing and even charging as much as 40 percent over drug costs to raise revenue. This was in clear violation of MoH's regulated prices of a maximum of 25 percent over purchasing price at central and provincial hospitals (lower mark-up of 15 and 10 percent for district hospitals and health centres respectively)<sup>110</sup>. But, he also knew that the stipulated level of mark-up was usually not enough to cover the administrative and logistical costs of providing the drugs.

As such, the informal population largely avoided visiting such health centres, except in dire circumstances. When ill, they most commonly resorted to self-medication or visiting one of the multitudes of private pharmacies or informal drug sellers which were much cheaper options, albeit not the most effective in curing illnesses. "The drugs dispensed by the private and informal drug sellers were usually of low quality and were often wrongly prescribed,"<sup>111</sup> observed the deputy chief in the Medical Administrative Division of MoH at that time.

In extreme or life-threatening circumstances, in order to access the public healthcare facilities, they would have to sell possessions like animals, stored rice or even land to pay for the services, borrow from relatives and friends or forego the healthcare. The medical expenses could be so massive compared to their meagre earnings that it could push the individual or family into poverty, often forcing them to postpone or delay getting healthcare services. As the deputy chief recalled, "It was only when working at the hospital as a physician that I understood the high risk of catastrophic health spending, as many low-income people had to leave the hospital before the due course of treatment was over as they did not have enough money to pay the medical bill."<sup>112</sup>

Physical access to these health centres was also a major deterrent. As each district spanned large distances, some villagers who lived in the more rural parts of the province would have to walk for hours through forests and crossing rivers to reach these district health centres and this would mean losing at least a day's pay from not working on the farm. It was reported that it took 108 minutes for the rural population to get to a health facility in stark comparison to 19 minutes for the urban population, and 3 hours for those living in the remote

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<sup>110</sup> MOH Technical Working Group and JICA Study Team. *Lao Health Master Planning Study – Final Report Vol. 4*. Vientiane. November 2002. p98.

<sup>111</sup> From interview with authors.

<sup>112</sup> From interview with authors.



highlands which lacked infrastructure compared to 48 minutes for those in the lowlands.<sup>113</sup>

### **Health insurance for the informal sector**

From Vorasai's standpoint, he was inclined towards starting a health insurance for the informal sector. While drug subsidies could help them to a certain extent, health insurance would help to risk-pool and avoid catastrophic expenses. Health insurance at the community level for informal populations had already been employed in several countries and had seen wide-ranging results. Mandatory national health insurance was one step closer to achieving universal health coverage, but it had been less successfully implemented in low-income countries due to its heavy strain on financial resources.

He knew that the minister would favour the option that would minimise such a strain on government coffers. If indeed the MoH undertook the strategy he recommended and the scheme proved successful, Vorasai would have the chance to rise to the highest position within his Department.

### **Financing prospects**

Vorasai knew better than anyone else the difficulty in increasing funding from the government. Although the government health budget had been gradually increasing in terms of raw figures since 1999 (see Exhibit 6), taken as a percentage of total government expenditure, it had plummeted in the last few years. As a proportion of GDP, government health expenditure had always been low, but after the Asian Financial Crisis, it had plunged from slightly below 1 percent to 0.3 percent. Although the country's economy was starting to pick up after the recent Asian Financial Crisis, its recovery would be a slow and lengthy process. In this light, would the government be able to provide additional health financing for this endeavour? With poor administrative capacity and the small formal sector, taxes collected by the government were meagre. "The truth of the matter," pointed out one of the MoH staff in the Planning and Finance department, "is that health policy always follows the money."<sup>114</sup> In a poor country like Laos, it was inevitable that no matter how much one sliced the economic cake, the slice allocated to health would be paltry until economic growth accelerated.

New resources from budgetary and non-budgetary sources had to be mobilised, but from where? The most ideal situation would be an earmarked sin tax that

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<sup>113</sup> Department of Statistics, Ministry of Planning and Investment, Lao PDR, Lao Expenditure and Consumption Survey 2002/2003 (LECS III), Version 1.1 (June 2010).

<sup>114</sup> From interview with authors.

could help to justify it being used for health financing. The Minister could try to negotiate for such an arrangement with the MoF, but the likelihood of them agreeing to this was low. The reality was that such taxes would probably be allocated to more powerful ministries instead of to the MoH.

Since the 1990s, international development banks such as the World Bank and the ADB, as well as a wide array of bilateral donor agencies like the Australian Agency for International Development, the Swiss Red Cross and the Japan International Cooperation Agency, had implemented projects in Laos' health sector. In 1998, total donor assistance was US\$13.7 million. However, these were mostly vertical programmes with a narrow focus and were usually limited to several districts, a province or spanned a few provinces. Amongst the external donors, agencies and NGOs, and between MoH and the donors, there was little coordination, leading to huge variations in scope, activities and methods of the projects.

Vorasai recognised that the potential of pooling together the financial aid from external donors for an integrated approach towards healthcare would surely improve the healthcare coverage of the informal sector. But, did the MoH have the administrative capacity to coordinate such an approach? More importantly, such funds would not be indefinitely sustainable; and if mainstreamed into recurrent expenditure for regular services, it would be hard to wean off dependency from this source of financing in the future.

The MoH had the highest chances of receiving financial assistance for such an extensive programme from the multilateral agencies like the World Bank and the Asian Development Bank (ADB), but with the development banks' strong emphasis on transparency, would they be amenable to providing financial assistance for this purpose? One of the staff in the Asian Development Bank observed that the ADB and external donor agencies generally did not have a high level of trust in the Laotian government due to the lack of transparency, accountability and monitoring mechanisms.

### **Vorasai's policy options**

It was up to Vorasai to choose the best option to recommend to the minister in order to improve health coverage for the informal population. His first option to provide subsidies of essential medicines to them through the RDFs was to be financed through a combination of government revenues and an integrated external donor funding approach. Vorasai knew that this would be a steep uphill task. Even if the medicines were subsidised during distribution to the RDFs in the provinces, he could not be sure that the provinces and districts would not try to sell them at higher prices. The difficulties of monitoring such a programme in Laos' decentralised health system would be immense.

The financing of this scheme posed a huge challenge too. Vorasai was doubtful that the government would have the financial capacity for such large recurring costs. The external donors and agencies were presently financing area-focused vertical programmes in individual provinces or regions; would they be amenable to such a large, integrated, country-wide project? Especially since the external donors were not fully convinced of the MoH's accountability procedures, this would be an additional barrier to overcome. The trade-off between expediency and sustainability would be a key consideration in determining the extent to which external donors should be financing such a scheme.

Or, should he initiate a CBHI scheme? This could be piloted in several districts and expanded over the years, initially subsidised by external donors. The donors could find this option more acceptable as it would mean financing CBHIs only in certain provinces or districts which was much more financially manageable. Gradually, the government could take over subsidising the premiums. However, smaller risk pools within the community would also result in lower average contributions and consequently less healthcare benefits.

While CBHI was a popular option used in many countries with a large informal population and could potentially be more financially sustainable, there was no guarantee that the uptake would be significant due to its voluntary nature. There was a high risk of adverse selection which would heavily strain the fund, and the population would not be very trusting of the district-level health schemes. Even if the premiums were set at a minimal level of US\$1 to US\$2 per person annually, this amount was equivalent to a few days of food and was no small sum for the informal population. The remaining payment to providers would have to be covered by the government and external donors yet again. He was also unsure if the provinces and districts had the administrative capacity to collect these premiums. Enforcement of the collection premiums would be a large problem, and the administration costs of this could outweigh the revenues from the collection itself. The poorest and most in need of health insurance would be the least likely to enrol in such a programme, while the non-poor ones could opt out.

The final option of starting a compulsory national health insurance would mean partial or even full subsidisation of premiums for a substantial proportion of the informal sector, although many self-employed professionals would be able to pay the full premiums. Subsidisation of the poor could be financed by the government, integrated assistance from external donors, and increased social security contributions from the formal sector. Enrollment would be a major issue and it would be tough to identify which informal workers should be subsidised. Vorasai thought of going through cooperatives, village groups,

occupational groups and community-based organisations for help in enlisting the informal sector. While this option was a much more comprehensive approach that would cover more of the population than the others, the trade-off was that the benefits from such an insurance scheme could not be very high if the funds were spread out so thinly.

Also, even though this would need a huge financial commitment from the government and from external donors, the assistance required would gradually decrease as Laos' economy grew, and as more people joined the formal sector. Raising the contribution rates from the formal sector would require working closely with the Ministry of Labour and Welfare's Social Security Office, but this department would be extremely wary of collaborating with the MoH on this scheme. Any attempt at cross-subsidisation from the formal to the informal population could severely deplete the Social Security Office's coffers since the social security scheme only reached a very small part of the population at that time.

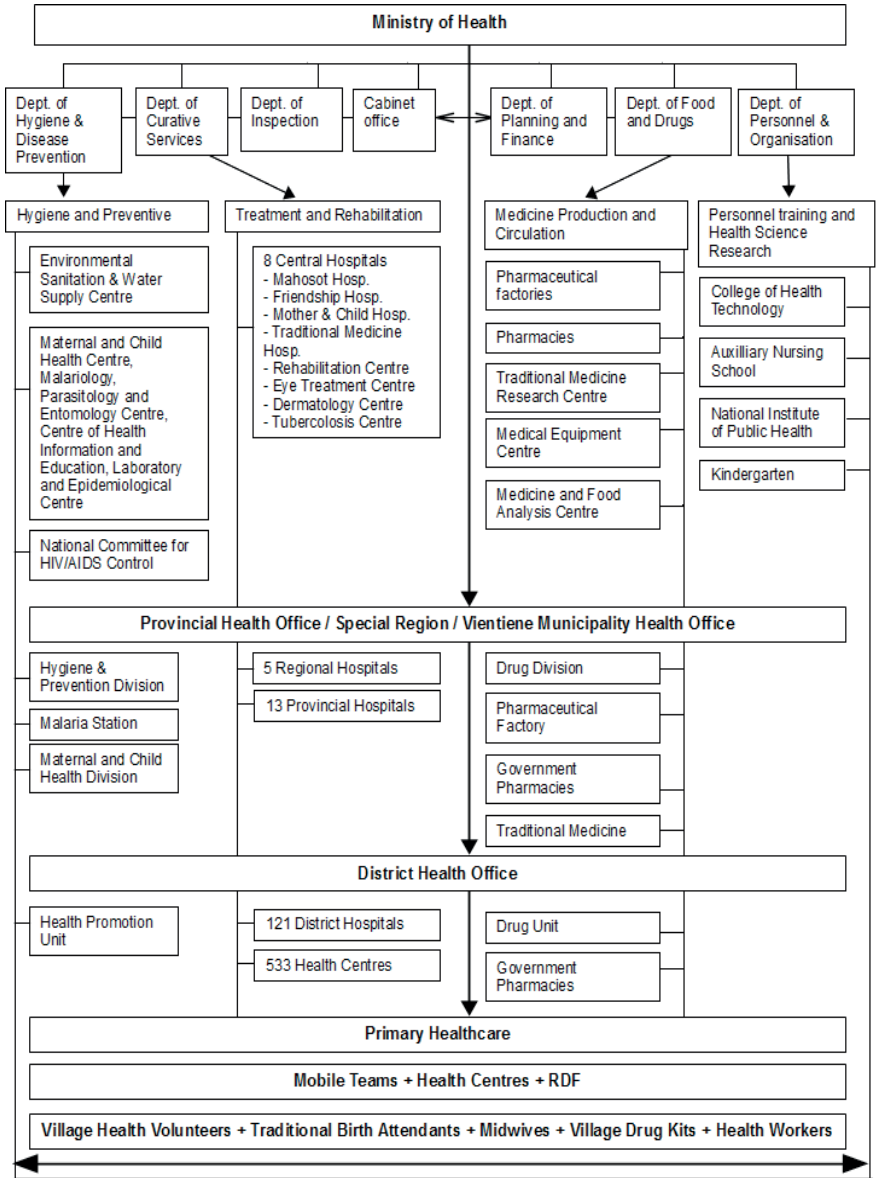
Vorasai needed a credible strategy to address the Minister's concerns. Which option should he take?

Exhibit 1: Health Indicators of Countries in South-East Asia

	<b>Total Fertility Rate (per woman)</b>	<b>Life expectancy (years)</b>	<b>Infant Mortality Rate (per 1,000 live births)</b>	<b>Maternal Mortality Rate (per 100,000 live births)</b>
<b>Year</b>	<b>1995-2000</b>	<b>1995-2000</b>	<b>1999</b>	<b>1980-1999</b>
Lao PDR	5.3	52.5	93	650
Cambodia	5.3	56.5	86	470
Myanmar	3.3	55.8	79	230
Indonesia	2.6	65.1	38	450
Vietnam	2.5	67.2	31	160
Philippines	3.6	68.6	31	170
Thailand	2.1	69.6	26	44
Malaysia	3.3	71.9	8	39
Brunei	2.8	75.5	8	0
Singapore	1.6	77.1	4	6

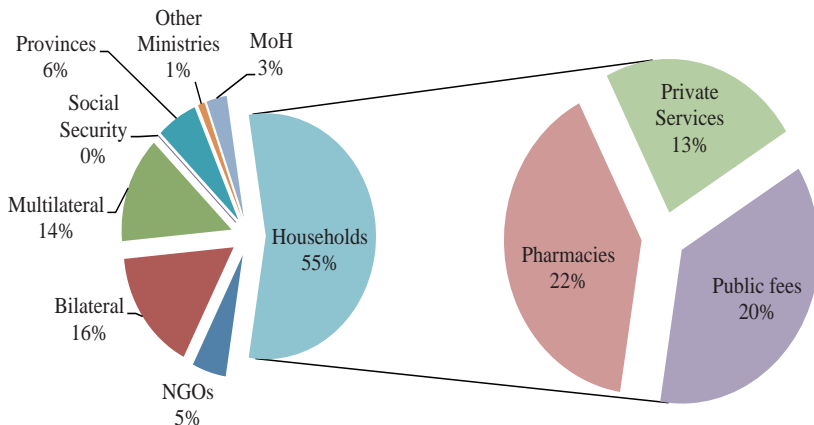
Source: UNDP: Human Development Report HDR. Oxford: Oxford University Press, 2001.

Exhibit 2: Organisational Structure of the Ministry of Health and the Levels of Healthcare



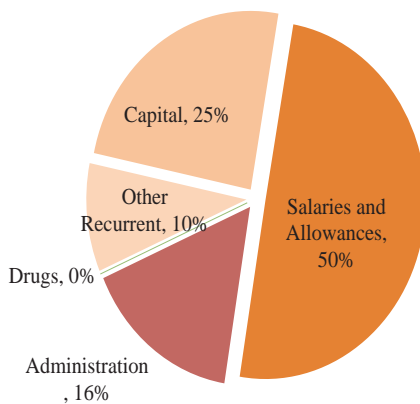
Source: MoH, 2002

Exhibit 3: Composition of Health Expenditure by Source in 1999



Source: MOH Technical Working Group and JICA Study Team. *Lao Health Master Planning Study – Final Report Vol. 4*. Vientiane. November 2002.

Exhibit 4: Composition of Government Health Expenditure by item in 1999 (for MoH and Provinces)



Source: World Bank, 1997; ADB, 1999a, as contained in MOH Technical Working Group and JICA Study Team. *Lao Health Master Planning Study – Final Report Vol. 4*. Vientiane. November 2002.

Exhibit 5: Distribution of Human and Financial Resources in Public Health Facilities in 1999

Facility level	Number of Personnel	Percentage	Recurrent Expenditure (%)
MoH admin & support	612	5.4	10.0
Central hospitals	1,231	10.8	13.0
Provincial health offices	1,533	13.5	16.0
Provincial hospitals	2,328	20.5	20.5
District health offices	2,019	17.7	18.0
District hospitals	2,438	21.4	15.5
Health centres	1,221	10.7	7.0
Total	11,382	100.0	100.0

Source: MoH, 2001

Exhibit 6: Trends in Government Health Expenditure from 1994-1999

Year	1994	1995	1996	1997	1998	1999
GDP current (billion kip)	1419	1,726	2,201	3,745	8,700	3,495
Government budget (billion kip)	294	364	412	847	700	2,778
Gov. health expenditure (million kip)	11,895	4,171	9,662	7,494	1,154	3,843
- Spending by MoH (million kip)	3,720	4,792	8,800	4,893	8,635	12,174
- Spending by Provinces (million kip)	7,974	9,379	10,862	10,922	19,269	27,569
Gov. health expenditure as percent of GDP	0.89	0.82	0.89	0.47	0.36	0.32
Gov. health expenditure as percent of total expenditure	4.05	3.89	4.77	2.07	1.83	1.58

Note: Figures in italics are estimates or planned expenditure, others are implemented expenditure. Exchange rate used: US\$ 1.00 = 10,000 Kip

Source: Government Budget 1999-2000; MoH; ADB II PPTA Feasibility Study; World Bank Public Expenditure Review 1997; Bank of Lao PDR; Annual Report to Committee, as contained in The Study on the Improvement of Health and Medical Services for the Lao People's Democratic Republic - Lao Health Master Planning Study Volume 2, Japan International Cooperation Agency, 2002.

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*Allen Yu-Hung Lai*<sup>116</sup>

At 2.28pm on 12 May 2008, a magnitude 8.0 earthquake swept across three provinces in China – Sichuan, Gansu, and Shanxi. The Wenchuan Earthquake (the Quake hereafter) was one of the greatest natural disasters that China had ever experienced, directly affecting half of the 20 million people living in that area, leaving over 70,000 dead and 400,000 injured or missing. Economic losses also amounted to hundreds of millions of dollars. Many relief agencies dashed to ground zero, some of whom urgently called for external assistance; for example, the China Red Cross (CRC).

Right after the calamity, Jiang Im, the vice chairperson of the CRC, sent a request to Chen CV (CV hereafter in the document), the chairperson of the Taiwan Red Cross (TRC)<sup>117</sup>, for emergency assistance. The TRC was the first organisation that directly expressed its concern to the China Red Cross and demonstrated its willingness to help. Due to its past experience with Chinese Mainland affairs, CV personally felt obliged for the TRC to lead the relief initiative. He, however, left the planning details to TRC's new Secretary General, Chen SK (SK hereafter in the document).

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<sup>115</sup> This case was an honourable mention winner in 2012 Case Writing Competition LKYSPP, NUS. This case study is based on facts and field interviews and has been prepared by Allen Lai under the guidance of Dr. Caroline Brassard, Senior Lecturer at the Lee Kuan Yew School of Public Policy, National University of Singapore. The case is not intended to serve as a primary source of data and is meant solely for class discussion. It draws from a variety of sources, such as organisational newsletters, and the author's interviews in the field. Copyright © 2013 by the Lee Kuan Yew School of Public Policy at the National University of Singapore. All rights reserved. This publication can only be used for teaching purposes.

<sup>116</sup> *Allen Yu-Hung Lai (allen.yuhung@gmail.com) is a PhD candidate in LKY School. His doctoral research focus is to investigate the emergence and development of organisational collaborative capacity through crisis learning, illustrated through case studies of Centres for Disease Control in tackling two major pandemics: SARS in 2003 and H1N1 in 2009. He has published several articles and book chapters regarding infectious disease control, and disaster and emergency management in international peer reviewed journals.*

<sup>117</sup> Its official name is The Red Cross Society of The Republic of China. However given the IFRC charter on national office, every nation has only one national office, in which case China Red Cross Society is the international legitimate identity in IFRC. Therefore, the title of the relief team dispatched from The Republic of China is "Taiwan Red Cross Organization" based on mutual agreement with China Red Cross.

SK had just assumed the post of TRC's Secretary-General just four days before the Quake. Prior to his new posting in the TRC, SK had served across various sectors. He had also been tremendously active in engaging with non-profit organisations when he had served as a board member in the Chinese Association of Relief and Ensuing Services, a major non-profit organisation providing welfare assistance to the Mainland Chinese. New to the TRC, any error in the proposed plan of action in response to the request might undermine SK's credibility in his 30-year long public service career, if not risk TRC's reputation.

SK paced back and forth in his office at the TRC. He looked at his staff through the glass window of his office and saw how busy they were with current routine administrative affairs, such as charity management, local disaster preparedness planning and coordinating training programs.

He was certain the TRC had to take swift action. *"Was the TRC as a whole capable of responding to the calamity 2,000 miles away?"* wondered SK. The answer, in his view, was clearly negative, but the solution was not clear. *"Which organisation should I work with? Who should I talk to?"* he pondered. There was a great deal of uncertainty in terms of the type and the duration of help the TRC could give.

### **Background: Taiwan Red Cross and the Wenchuan earthquake**

The Taiwan Red Cross, initially established in Shanghai China 1904, was relocated to Taipei in 1950. Since its relocation, the TRC had acted as a major and important non-profit civil society organisation to help the poor and the sick in Taiwan. TRC's principal work included providing medical services, catastrophic social assistance, emergency education and training, routine fundraising, charity management, and disaster preparedness at the community level. Through these efforts, the TRC was perceived within the relief community as a leader – at least with respect to its emergency expertise, community preparedness and training activities.

The TRC, among other non-governmental organisations, had a unique legal standing. In the early days, the TRC had enjoyed the discretion of allocating resources and volunteers to assist the Taiwanese government in providing social services, such as healthcare and scholarships, to financially deprived people. It was the only legitimate non-governmental organisation that was mandated to assist the government in public service delivery due to the specific legislation that provided this mandate. Hence, the TRC operated like a public sector organisation. The TRC was held accountable not only to its donors, but also, and most importantly, to its Board and to the central government of Taiwan. Sharing resources and joint decision-making was not commonly practiced in those early days. Till date, the TRC remained the only non-profit

organisation that was able to start a charity campaign without getting permission from the central government on the island. That is, the TRC could more quickly begin fundraising than other charity organisations.

Disaster relief was not included in TRC's scope of operations until Taiwan's 921 Earthquake in 1999. The 921 Earthquake had motivated Taiwan's non-profit organisations to form, for the first time, a National Reconstruction Civil Alliance, an innovative model for resource integration and livelihood rehabilitation. For the TRC, the 921 Earthquake had also been a lesson-drawing experience, because thereafter the TRC actively united its resources, such as stockpiling and stocktaking of relief material at its 26 local branches. The 921 Earthquake had helped the TRC learn of advanced response mechanisms and get recognised in the international relief community.

Since the mid-1980s, there had been frequent, though informal, links and exchanges between the TRC and the CRC in the face of natural disasters and humanitarian assistance across the Taiwan Strait (Table 1). For thirty years, the TRC had played an informal, intermediate role to assist in communication, and lost and found services on both sides of the Taiwan Strait. Moreover, the TRC had also helped to retain or repatriate illegal immigrants from and to the Mainland.

Table 1. Timeline of the Interaction between the China Red Cross Society and the Taiwan Red Cross

Date	Disaster	Location	Disaster Relief Effort
Nov 1986	Earthquake	Hualian, Taiwan	Mainland expresses sympathy and offers to "provide necessary relief supplies and other help," delivers US\$50,000 donation through the Red Cross
June 1988	Flood	Zhejiang, China	Quasi-official Free China Relief Association donates US\$100,000 to the Chinese Red Cross via the League of Red Cross Societies in Geneva, Switzerland, marking the first time China accepts aid from Taiwan
Dec 1988	Earthquake	Yunnan, China	Taiwan's Red Cross donates US\$1 million to the Chinese Red Cross
July-Aug 1991	Flood	Anhui and Jiangsu, China	Taiwan agencies donate US\$210,000 and NT\$1 million worth of supplies to the Chinese Red Cross. \$44 million in assistance from Taiwanese public and private sources are eventually delivered to China. Also, the US Airforce airlifts supplies to Shanghai.

July 1992	Drought & Floods	Eastern China	The Free China Relief Association donates US\$300,000 to the Chinese Red Cross for drought and flood relief in six provinces
July 1993-95	Floods	China	Taiwan public and private organisation deliver millions in aid and supplies to Chinese counterparts for flood relief
Feb 1996	Earthquake	Lijiang, Yunnan	Despite rising cross Strait tensions, Taiwan donates NT\$2.75 million in funds, and NT\$13 million in supplies to China for Lijiang earthquake relief. All together, Taiwan donated US\$3.23 million in disaster relief to China for various disaster relief efforts.
June 1998	Flood	Southern China	The Red Cross Society of the ROC donated NT\$20 million (US\$574,713) worth of goods
Sept 1999	Earthquake	Nantou County, Taiwan	The Red Cross Society of China offered \$100,000 to the Taiwan Red Cross Organisation and \$60,000 worth of relief supplies, though Beijing also refused Russia over flight right for a military rescue team and pressured the UN to seek its permission before sending UN personnel to Taiwan. US military aircraft provide support.
Feb 2003	Earthquake	Xinjiang, China	Taiwan Red Cross provided US\$100,000 in relief aid
12 May 2008	Earthquake	Sichuan, China	Taiwan Red Cross and Taipei City medical teams served in quake-hit Sichuan; Taiwan's government offered China NT\$800 million and Taiwan and China's Red Cross organisations are collaborating on three earthquake recovery projects in Sichuan, Gansu and Shaanxi Provinces, costing NT\$1.375 billion. US military cargo aircraft deliver relief supplies to Chengdu.

Since 2000, the TRC had been led by CV, a renowned Harvard-trained attorney. CV had worked with the TRC for 20 years in a wide range of cross-Strait exchange matters and had been deeply involved as an intermediary for the TRC in the cross-Strait affairs; for instance, bilateral exchange of post service, and small amount remittance services. It was not until the TRC's first overseas mission in response to the 2004 Asian Tsunami that the TRC had clearly understood that the unprecedented scope of relief operations had far surpassed its administrative and operational capacity (Taiwan Red Cross 2005). Because of unfamiliarity with the international relief practice and the local culture and

language in the tsunami-affected countries, the TRC had more or less followed the direction of the International Federation of Red Cross/Red Crescent (IFRC) and had responded to the needs requests indirectly sent from the local governments and other local non-governmental organisations that the TRC had contacted for the very first time. The role of the TRC in the 2004 Tsunami relief effort had been more like a service delivery partner in the joint programme under the leadership of the IFRC. Since this had been the first outbound relief operation where the TRC had dispatched a relief team overseas, the TRC's managers, for the first time, learned about the framework within which foreign relief agencies worked, and through their experience, they realised the importance of collaborating with other specialised agencies of various kinds.

### **Chen SK's arrival in the TRC**

Being aware that the TRC needed a veteran who had experience in social welfare, CV had handpicked SK, then advisor to the Chinese Taipei Olympic Committee, as the Secretary-General on May 8, 2008, four days before the Quake. Prior to his new posting in the TRC, SK had served across various sectors, both public and non-profit, for thirty years. In his mid-fifties, SK was an experienced bureaucratic veteran, having worked at the following public positions: Senior Advisor to the Executive Yuan, Director of Department of Social Welfare and Deputy Secretary General of Taipei City Government, and Director of Overseas Education Centre, Taipei Representative Office in Washington D.C. He was also tremendously active in engaging with non-profit, non-governmental organisations during his term as a board member in Chinese Association of Relief and Ensuing Services, a major non-profit organisation providing welfare assistance to the Mainland Chinese.

SK, as many of his colleagues applauded, was a very flexible and trustworthy person, someone who did not limit himself to the standard operating procedures of the organisation he was working for. *"He is willing to listen to others. If he thinks you are right, he would give you full support. He is problem-oriented and does his best to seek the best solution,"* said SK's colleague, with confidence.

In a press conference on assuming the post of Secretary-General at the TRC, SK had explained his views on humanitarian assistance by saying, "[w]e in the TRC should work closely with other sectors and the government to expand our scope of relief work." He envisioned, upon taking on the new posting, to streamline TRC's internal operations and promised to further strengthen the linkage between external resources through cross-sector collaboration (Taiwan Red Cross 2008a). However, SK's vision had to be in line with the culture of his organisation, a hundred-year-old non-profit response agency.

## TRC's Challenges

The Wenchuan Earthquake was ranked as one of the most severe that China had ever experienced. And to make the rescue effort in the aftermath even more challenging, the disaster area continued to be rocked by aftershocks. According to the official Chinese figures, over 70,000 were killed and 400,000 were listed as either injured or missing as a result of the Quake. In its aftermath, a number of challenges surfaced.

At the time when the Quake took place, all public services and goods provision were immediately shut down. The unprecedented scale of the Quake caused a great deal of social chaos and instability at all levels for the affected communities.

*"Perceptions of inadequate relief efforts resulting from public administrative failures were rampant...the affected communities were looking forward to alternative relief and solutions in the form of collaboration,"* said Daniel, the TRC relief manager who had been working in various kinds of post-disaster missions.

In rural areas like Wenchuan county, the situation was even worse because the local infrastructure, including health posts and water supply system, was insufficient even prior to the disaster.

In his new administration, SK had to propose an action plan in response to the Quake. Subsequently, SK read the needs assessment report to get a clearer picture.

### Unmatched needs assessment

Unlike its response to other previous natural or manmade crisis events, the Chinese government demonstrated unprecedented openness to the public for news reporting and needs requests in the aftermath of the Quake. Plenty of relief needs were expressed from China's grassroots organisations through their Taiwanese counterparts. Within 24 hours of the Quake, the CRC immediately requested for material relief from external resources, including their long-term counterpart – the TRC.

The needs request sent from the CRC to the TRC was mainly focused on funding tangible "hardware" reconstruction; for example, rebuilding numerous collapsed buildings such as schools, health posts, and providing temporary housing for the survivors. The needs assessment report obviously did not match what the TRC was good at.

SK fully understood that the TRC's core service was direct relief provision. Apparently, this was not all that the CRC desired. However, the organisations capable of delivering services requested by the CRC, such as building shelters and anti-quake infrastructures, were not allowed to enter the field. The TRC had to deal with this unprecedented request immediately.

*"A large number of Taiwan's non-profit organisations expressed their desire to help in the field. However those Taiwan's non-profit organisations were not allowed entry into the affected area,"* SK recalled.

The unmatched needs assessment, as it appeared, highlighted another challenge to the TRC – its organisational capacity in post-disaster recovery and its bureaucratic culture.

### **Limited organisational capacity and TRC's bureaucratic culture**

After reading CRC's needs assessment report, SK turned his attention to the TRC itself. The organisation was staffed based on its routine functions. Employees hired on a full time basis were only thirty strong whereas the majority of TRC's regular services relied much on its volunteer network. For the Quake relief, the TRC was undoubtedly understaffed, and recruiting Quake project-based employees was not possible to meet the urgent needs.

SK was also concerned that taking up such a significant humanitarian task far away in the Sichuan province would encounter resistance from the front line desk officers. SK regarded the majority of officials as conservative and reluctant to change in the beginning, without the energy to implement a major relief initiative. He feared that, as a result of the additional administrative burden, he would face tremendous pressure not only from the Quake relief work itself, but from within the organisation. SK was new to the TRC and its organisational culture. Hence, he was not sure to what extent the street-level front desk officers would embrace his ideas.

The TRC staff was virtually all holdovers from the public sector that had worked in the TRC for decades. Thus, their mind-set and behaviour in the organisation was somewhat outmoded and no longer in keeping with the changing times. The staff were kept in the organisation for the sake of continuity.

*"Every non-profit organization that has worked with the TRC all recognise that the TRC is notorious for its hierarchy, bureaucracy and rigidity. It operates like a small government. That is a fact everyone knows except for the TRC itself,"* said the head of another non-profit organisation.

The TRC, for example, implemented a stringent process in budget auditing, similar to government procurement. Every item in the expenditure and disbursement had to be accompanied by an official receipt, and the disbursing procedure took a longer time than most other non-profit organisations.

In terms of decision-making, the TRC seemed to operate more like a top-down hierarchical government bureaucracy. The decision-making was controlled at the top management level. *“Authority rested solely with the top management level, and the way our organisation is running is more of top-down style,”* said Daniel, TRC’s senior manager.

In addition to the bureaucratic culture of the organisation, the TRC also had other limitations in how to support the victims of the Quake. For example, the TRC was limited in its ability to support people with things like long-term housing, livelihood rehabilitation and psychological support because this type of support required skills that were not TRC’s core capability.

The relief initiative required a variety of skills and energies to be mobilised to monitor and evaluate relief projects. Obviously, to execute such a long-distance wide-scale relief project, the TRC alone was not sufficient. It was severely understaffed and incapable of a long-distance mission that would continue for years. Running a cross-border collaborative operation would however, require a special set of skills and capacity to overcome administrative and logistic barriers across political boundaries.

### **The TRC’s “New” initiative – non-profit-led relief collaboration**

*“Some forms of partnership are desperately needed,”* reckoned SK before he further responded, *“and the old school style certainly did not play out.”*

Recognising the importance of collaboration in service delivery and resource allocation, SK needed to provide a new vision and partnership strategy for its implementation and one which would be acceptable to CV, the chairman, as well as generate support and buy-in from other stakeholders to maximise the collective interest.

For SK, being the new leader of an established organisation was a double-edged sword. On the one hand, SK could be bold in implementing a major relief initiative as he wished, before his personal connection with other staff became entrenched and complicated. On the other hand, to carry out his new ideas, SK needed the support of the chairman and his staff at all levels.

SK did not enjoy the luxury of time, and could not make the decision on his own. His thoughts turned to his personal connections in the non-profit



network. Some old friends' faces appeared in his mind. He stopped pacing in his office and made a phone call to his trusted ally, Lucia Lu, the Chief Executive Officer of Begonia Foundation, a non-profit devoted to training and organisational development in the field of social work. SK had worked with Lucia on social service provision in many previous occasions.

As an old acquaintance of SK, Lucia had been active in social voluntary services for three decades. Her organisation, Begonia Foundation, was a Taipei-based intermediate organisation that provided training programs and development skills to social workers all over Taiwan.

*"SK called me at midnight on the same day of the quake. He urged that we form a collaborative working group for the relief operations, just like one of the many (collaborations) we had before."* Lucia recalled.

In the meantime, The TRC dispatched its relief team to ground zero at Mianchu City (one of the worst affected cities in Wenchuan county) to deliver essential life support goods and services to the survivors. Such relief action was made possible due to prior informal mutual agreements between the TRC and the China Red Cross organisations.

The Quake was attracting much attention from the media and from public, private, and non-profit entities, and donations had started to pour in. As a legitimate fund custodian for funds raised, the more donations the TRC accepted from the public, the more accountability would be placed upon the TRC leadership.

SK clearly understood that the relief emphasis should not only be in line with the International Red Cross and Red Crescent Movement, but also present a good combination of voluntarism and professionalism. That is, the TRC had better look for the best hands to do the voluntary job right and build in accountability.

It was SK's belief that the aim of partnership was to support integrated resources in each area, which would break down the barriers between organisational interests, rather than a plethora of isolated projects. In partnership, the commitment of each partnering organisation and their leaders could support their representatives fully. Moreover, he hoped that the TRC could learn resource integration from other non-profit organisations through joint participation.

Both Lucia and SK agreed that, across different jurisdictions, creating an ad hoc organisational structure was the best way to maximise the distributive and

allocative efficiency of organisational resources and charity. The proposed structure, a strategic alliance, had clearly defined and inter-related roles that constituted a formal division of labour. SK initiated the idea of creating the Taiwan Service Alliance (TSA) one week after the Quake (Taiwan Red Cross 2008b).

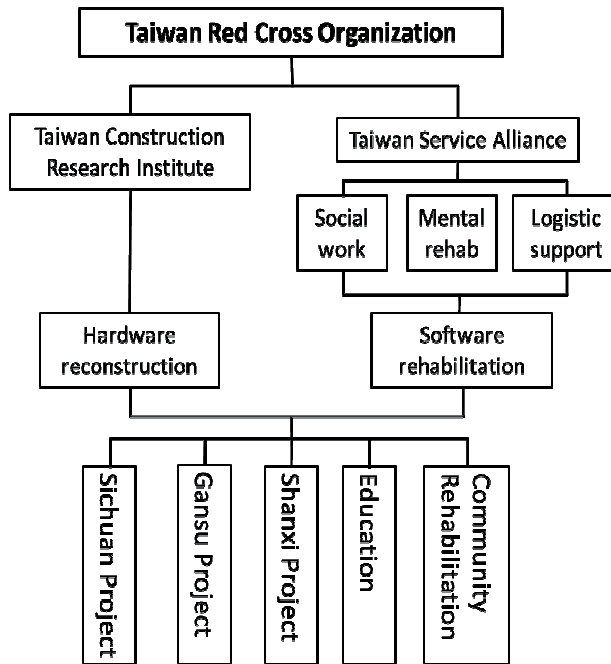
### **Forming a strategic alliance**

Within two weeks of the Quake, the TRC immediately took the lead to convene a joint meeting with domestic major public and non-profit organisations. A specialised relief committee was formed to do more comprehensive planning. In the joint meeting, all like-minded parties shared the same vision that collaboration had to be aligned to the needs of disaster victims.

The relief committee – the Wenchuan Earthquake Taiwan Service Alliance (TSA) – was constituted (governance structure shown in Figure 1). The ad hoc strategic alliance invited non-profit, private and governmental entities as network members for the rebuilding efforts which were categorised into software rehabilitation and hardware reconstruction.

The TSA was meant to enhance TRC's organisational capacity. Among its numerous partners, the Begonia Foundation and the Child Welfare League Foundation had comparative advantage in social work and experience in psychological reconstruction while the Taiwan Construction Research Institute (TCRI) provided technical assistance in anti-quake design and construction.

Figure 1. The Governance Structure of the TSA



The addition of new partnership (or social capital) very often creates coordination problems. The challenge in collaborations lies in coping with the large influx of volunteers at the time of the crisis. Coordination problems in relief operations often create a great deal of competition and tensions among relief agencies – the so called “charity beauty contest phenomenon.” That is, competition among different voluntary agencies can be very strong especially when they try to “show-off” their relief efforts to the world in order to gain recognition for their efforts.

The TSA was a good demonstration of managing conflicts through horizontal coordination with like-minded organisations in a hierarchical framework. For example, on the premise that the proposal was accepted, an organisation needed to become a member in the TSA. As agreed, TSA member organisations enjoyed the resources of TRC – for example, information and communication technology, but they also had to allow other TSA members to use their resources in return (Taiwan Red Cross 2009).

The TSA played a key role in screening the applicants and making recommendations to help align the partner organisations to better propose (or

package) their projects. The TSA also developed relief and funding policies, and later aligned with other professional non-profit organisations based on their track record, strength and expertise.

*“Any officially registered voluntary organisation that desires to help in the Wenchuan earthquake relief must submit their project proposals to us. Based on merit and practicability of the project, we examined and processed in a deliberate procedure based on a set of required documents such as project risks and management of the risks, a complete and concise budget plan,”* said Lucia.

### **Shared decision power**

Within a newly formed collaboration, conflict usually arises due to differences in values, missions, expectations, interests, powers and resources and when new partners join the collaborations. Therefore, to a large extent, managing conflicts across organisations starts with recognising each partner’s organisational values and missions. This was particularly true in disaster collaboration as relief needs changed over time, along with an increasingly diverse representation of private, public, and non-profit interests.

Among the numerous partners, the TSA had a decision-making committee that acted as the lead organisation network that had the resources and legitimacy to coordinate key decisions and funded-projects. To promote consensus building and participation, the TSA invited other major welfare organisations to make informed decisions and take charge of the relief service delivery (Table 2).

Table 2. Working partners with TRC in the 2008 Wenchuan Earthquake

Asian Mental Health Association  
 Begonia Foundation  
 Buddhist Sangha Health Care Foundation  
 China Airlines  
 China Times Corp.  
 Canlove Social Service Association  
 Chishan Foundation  
 Chinese Christian Relief Association  
 Eden Social Welfare Foundation  
 Himalaya Foundation  
 Huahsin Airlines  
 International Medical Science Research Foundation  
 Jieh Huey Social Welfare and Charity Foundation  
 Kungtai Medical Education Foundation  
 Mental Health Association Taiwan  
 National Taiwan University

National Yang Ming University  
 National Chung Kung University Hospital  
 Old Five Old Foundation  
 Outward Bound Taiwan  
 Scientology Church  
 Taiwan NPO Self-Regulation Alliance  
 Taiwan Construction Research Institute  
 Taipei City Fire Department  
 Taiwan International Health Alliance  
 Taipei City Hospital  
 The Child Welfare League Foundation  
 Teacher Chang Foundation  
 Taiwan Fund for Children and Families  
 United Way of Taiwan  
 TVBS  
 Warehouse Taiwan

The TSA had a dispersed leadership structure, including four experienced board members. Besides SK, chief executive officers from two major voluntary welfare organisations – Begonia Foundation and The Child Welfare League Foundation - and an academician specialising in organisational psychology were the other board members. They also shared authority for convening conferences on the design of funding criteria, surveying project evaluation, relief coordination, and monitoring results. That is, a culture of shared leadership was built at the committee for decisions such as selection of funded projects and the amount of funding.

Though power was concentrated at the top, responsibility was shared across the collaboration. That is, each partner was anticipated to take ownership for implementation of the approved project and regularly report its progress. For example, the TRC encouraged partnering non-profit organisations to take ownership in managing the reconstruction programs, and the TRC at best provided technical, financial and logistic assistance for the latter. Partner organisations, at their own discretion, could mobilise their existing networks and dispatch their professionals from adjacent provinces to reach the needy.

### **Using e-governance to enhance accountability**

The TSA also developed a website as a communication platform (see Figure 2), and familiarised its members through training sessions on how to make use of this electronic platform. The primary goal of this multi-level information platform was to mitigate the effects of the disaster by providing accurate relief assessment on the ground, providing on-line training programs for disaster relief teams on a regular basis to optimise relief aid.

Figure 2. E-Relief website for managing results



TSA member partners had to regularly publicise their progress and results on the TSA website; for example, providing relief information, sharing outcomes with other partners and uploading individual relief service progress. The website-based information platform thus provided each partner with timely and valid data on available resources and funding throughout the whole relief work. This made relief information transparent and accessible to all stakeholders. It was also an innovative method for monitoring and evaluating the reconstruction projects online.

Such a platform allowed the TSA to frequently update relief progress and better align relief resources to the needy. Through the website, all members were held accountable by the checking of each other's progress report at the same time.

*"This information platform is an innovative communication tool in the TRC's humanitarian assistance history. It supplements the disaster management from initial responses to long-term reconstruction work. It also provides an effective method for monitoring and evaluating the reconstruction projects, for example uploading video clips for project monitoring, holding teleconferences on the Website,"* said Daniel, the TRC relief manager.

### Memorandum of understanding

The TRC relied heavily on the knowledge and expertise of collaborating partners. The concrete manifestation was the Memorandum of Understanding (MOU) that the TRC signed with its counterparts before the project was implemented. The MOU was a flexible performance agreement between the TRC and partners, which spelled out obligations of each party. In this regard, there were many aspects of the control strategy embedded in the partnership between the TRC and the non-profit organisations.

For example, the TRC signed a MOU with TCRI, an expert in constructing anti-quake quality buildings, to ensure long-term cooperative reconstruction (Taiwan Red Cross 2009). This ensured that each reconstruction project proposal met anti-earthquake requirements. Fully authorised by the TRC, the TCRI was the gatekeeper to set the construction code for anti-quake design and monitor the construction progress for the reconstruction projects.

*“With TCRI’s technical assistance, each reconstruction project proposal needs to fulfil the anti-earthquake requirement. In doing so, the TSA is able to standardise mechanisms for efficient monitoring and evaluation that achieves transparency and accountability,”* revealed Daniel.

In the context of cross-border extreme events, reaching a formal agreement under political constraints took a much longer time than within the same jurisdiction. For example, it took numerous meetings and some six months to forge a formal MOU for reconstruction endorsed by both TRC and its counterpart, the China Red Cross. In the MOU, both sides reached an agreement that continuous training and education would be on a long-term basis to build-up local capacity. The TRC entered into agreements with its counterparts and provided the financial support while allowing the contractors to manage the work. The TRC did not intervene in the process on the understanding that its non-profit partner had the discretion to manage the project in order to meet the goals set forth in the MOU.

### Meeting expectations

The TRC demonstrated collaborative efforts through horizontal integration with like-minded members in the relief network. As a result, the scope of collaboration expanded in terms of participating agents. A total of 31 partners, a majority of which were well-represented by experienced nonprofit organisations, eventually joined the TSA projects. The number of collaborating domestic agents had increased exponentially, from less than 10 in 2004 Asian Tsunami to more than 30 in the 2008 Wenchuan Earthquake. Under TRC’s collaborative framework, the TRCI was able to take the lead in the construction

of 43 schools, 43 health centres, and one rehabilitation centre for the disabled across the three affected provinces.

The TRC had won a wide recognition from the general public, which was shown from the greater amount of public donations it collected. Within two months of the disaster, the TRC had received an unexpectedly high amount of US\$50 million as donation from the general public for the 2008 Quake relief mission. The amount was more than double the donation for the 2004 Asian Tsunami relief, and thirty times more than donations for Cyclone Nargis in Myanmar only one week before the Quake.

For the TRC, it is clear that the new initiative of non-profit relief collaboration had yielded better collaborative outcomes in response to the Wenchuan Earthquake: the increase in numbers of participating relief partners, the amount of public donations (and the trust gained), the use of non-profit networks, the level of professional involvement, the speed of resource mobilisation, and the mastery of information technology all seem more advanced in TRC's relief efforts and demonstrated improved organisational capacity. At the same time, the TRC created public value not only through leading a network of various sectors, but also through meeting diverse and dynamic expectations along the course of disaster recovery.



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## SEXUAL RIGHTS, GENDER BUDGETING AND POLICY-MAKING AGAINST TRAFFICKING: THE CASE OF THE UJJWALA POLICY IN INDIA<sup>118</sup>

*Sudheesh Ramapurath Chemmencheri*<sup>119</sup>

*This paper is an experiment to understand the work that the conceptual frameworks of sexual rights and gender budgeting do when used to analyse a policy designed to deal with trafficking which has been a major global issue in gender and development. The Ujjwala policy from India, implemented by its Ministry of Women and Child Development since 2007 is taken as a case study to understand these implications. Sexual rights have constituted an incomplete discourse ridden with multiple definitions without consensus. The paper explores the spaces available for understanding trafficking as a violation of sexual rights. Meanwhile, gender budgeting has been promoted as a tool to deal with violence against women. The paper brings out the usefulness and boundaries of using sexual rights and gender budgeting as analytical tools. The analysis recommends budgetary flexibility on a topic like trafficking where target setting is problematic, inclusion of communities marginalised in the policy discourse and the revision of the policy directive regarding repatriation of victims. The paper also signals at the possibilities of theoretical revision of the analytical tools themselves.*

### **Sexual rights, migration and trafficking**

The number of women and children in sex work in India is estimated to be 3 million (MWCD 2012). 3517 cases of human trafficking were reported in 2011 (Lok Sabha 2013). These figures warrant a closer examination of the different ways in which migration, trafficking and rights imbricate on each other. The concept of sexual rights provides a useful analytical framework to look at the gender dimensions of migration, particularly in the context of human trafficking, in so far as it relates to the issues of bodily integrity, freedom and

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basic human rights. This brings us to an interesting conversation between three discourses – sexual rights, migration and trafficking – that already have fertile debates happening within their discursive fields drawing from human rights, economics and criminal law respectively. Also, the latter two discourses have already been well-integrated through systematic studies that documented the links between women’s migration, prostitution and human trafficking (c.f Liu 2011, Kotiswaran 2011).

Disparate accounts of the notion of sexual rights have been put forward in the past few decades which, though commendable for the epistemological insights that they have brought out, have still produced only an incomplete theorisation. The earliest engagements with the concept dealt with protecting people from manifest harm or abuse, an account that gradually expanded to include reproductive rights in response to advancements in feminist studies and then the rights surrounding the recognition of LGBT identities drawing insights from the gay rights movement. The World Health Organisation (WHO) suggested a definition in 2002 according to which sexual rights included:

the right of all persons, *free of coercion, discrimination and violence* to: (1) the highest attainable standard of sexual health, including access to sexual and reproductive health care services; (2) seek, receive and impart information related to sexuality; (3) sexuality education; (4) respect for bodily integrity; (5) choose their partner; (6) decide to be sexually active or not; (7) consensual sexual relations; (8) consensual marriage; (9) decide whether or not, and when, to have children; and (10) pursue a satisfying, safe and pleasurable sexual life” (WHO 2002, italics mine).

While the definition doesn’t explicitly touch upon trafficking, it is in its reference to freedom from coercion, violence and consent in relationships that one can find fecund field of enquiry with regard to right against trafficking as a sexual right. While the emphasis on health in the WHO’s definition comes as no surprise, its allusion to the freedom of choice in life opens up new avenues to explore exploitation involved in trafficking as a curtailment of bodily choices and by extrapolation sexual rights.

The concept of sexual rights has since then been used by various forums such as the human rights narrative of Human Rights Watch, the feminist narrative of the International Planned Parenthood Federation (IPPF) or the gay rights narrative of the Yogyakarta Principles on the Application of International Human Rights Law in relation to Sexual Orientation and Gender Identity. Case laws have been interpreted informed by the sexual rights discussion in the European Court of Justice, European Court of Human Rights, Organisation of

American States, and International Criminal Tribunal for the Former Yugoslavia etc. (Miller 2009).

Richardson (2000) surveys the sexual rights discourse(s) that have generated competing accounts of the understanding of sexual citizenship and outlines that they can be broadly classified into three categories – conduct-based, identity-based and relationship-based. The conduct-based discourses argue for rights to have a certain sexual practice such as sexual freedom in relationships. Identity assertions make the essence of the identity-based debates. Meanwhile, demands like same-sex marriage rights, which go a step further to claim rights within the formal institutions, are argued within the relationship-based discourses. Though Richardson fails to explicitly mention freedom from trafficking, she includes freedom from sexual harassment, violence, abuse and coercion as part of the conduct-based sexual rights discourse (2000, 115).

However, what is consistently noticeable in the narratives of the international organisations as well as academic accounts is the thrust on women in the trafficking/sexual rights discourse with a complete omission of other potentially vulnerable groups. The transgender-transsexual community, for instance, is obliterated from the discussions on sexual rights and trafficking. The transgender body, in fact, stands as a critique in itself in so far as it tests the boundaries of the workability of gender as an analytical tool. The emphasis on violence against women has, however continued, transforming, in fact, into the abbreviated analytic paradigm of VAW with the adoption of the Convention on the Elimination of all forms of Discrimination against Women that by the UN General Assembly in 1979 and succeeding events such as the establishment of the Office on VAW of the United States administration in 1993. These events demonstrated that VAW can not only be a discursive tool but also an administrative paradigm. VAW has since then been advocated and adopted by a number of international organisations. For example, the WHO notes that ‘VAW and HIV/AIDS are major *public health problems* that adversely affect sexual and reproductive rights’ (WHO 2013, italics mine).

Translating the concept of sexual rights into workable policies in the wake of such a divided discourse underpinning it is, therefore, particularly challenging. This is especially so because this process of translation would require the revision of a spectrum of already existing laws such as anti-prostitution rules, rape laws, women’s empowerment laws, labour laws and migration laws to make them mutually coherent. To exemplify, an anti-trafficking law could turn out to be a tool for cracking down prostitution wherein the victim may or may not be protected in a scenario in which laws regarding prostitution themselves have not been revised. This is the backdrop in which a new experiment to translate sexual rights into persuasive policy makes its appearance on the

international development stage – gender budgeting for elimination of violence against women.

### **Gender budgeting and elimination of VAW**

The idea of gender budgeting could be said to have had its roots in the feminist studies that brought out gender as an analytical tool (c.f. Boserup 1970). The appeal of gender budgeting lay in its practicability and usefulness in linking the feminist demands with policymaking. Addabbo, Lanzi and Picchio (2010) link the practice of gender budgeting with the Capability Approach and argue that gender budget could serve as a tool to look at women's social reproduction of labour and other inequalities and as an instrument to deal with them through the enhancement of basic capabilities of all women. Gender budgeting thus gained currency as a doable measure to ensure that the governments promoted gender equality. The argument has persuaded major international organisations to incorporate the concept into their narratives. An IMF working paper, for instance, notes that gender budgeting involves the development of tools of analysis to evaluate the impact of gender budgets in reducing gender gap thereby mainstreaming gender (IMF 2003). The World Bank too incorporated gender budgeting within its discourse through the Gender Action Plans that served as the framework to design programmes aimed at gender mainstreaming (World Bank 2006). Bringing out the flip sides of conflating gender budgeting and gender mainstreaming, Mukhopadhyay (2004) argues that it has led to cuts in projects that were solely and directly aimed at women's development and has led to confusion amongst the implementers of policies.

Responding to the demands for increased funding for VAW, the tool of gender budgeting was tied with the idea of tackling VAW, especially by lobbying for the national governments to have 'gender responsive' components in their budgets. Auditing budgets for measures that prevent VAW has now become a common practice (c.f. Budlender and Hewitt 2002, UNIFEM 2006). UN Women, for instance, notes that:

“In UNIFEM-supported initiatives, the use of GRB towards the elimination of VAW has broadly consisted of monitoring budget allocations for prevention of VAW or for physical and psychological care of the victims of gender based violence. Strategies used in this context include: monitoring use of available resources for the elimination of VAW, costing budgetary requirements for the effective implementation of legislation on VAW, evidence-based advocacy to ensure that VAW policies and relevant sector plans are matched with adequate budgets, and advocacy for funding of NGOs that provide services to women victims of violence” (UN Women 2012).

The Ministry of Women and Child Development in India understands Gender Budgeting as the 'dissection of the government budget to establish its gender-differential impacts and to translate gender commitments into budgetary commitments' (MWCD 2012, 75). The Ministry acknowledges that it is not the creation of a separate budget but ensuring that women's needs are addressed within the central budget. Elements of gender-sensitive planning made appearance in the Eleventh Five-Year Plan starting with a focus on the monitoring of schemes for women and has since then been consistently emphasised in successive Five-Year Plans. A Gender Budget Charter was established in 2007, which paved way for the constitution of Gender Budgeting Cells within all ministries of the central government. The gendered component of the central budget increased from 2.79 per cent of the total budget in 2005-06 to 6.22 per cent in 2011-2012, a two-fold increase in six years (MWCD 2012, 77). The constitution of the Gender Budgeting Cells in all ministries is endorsed by the Ministry of Women and Child Development as a step in mainstreaming gender. Das and Mishra (2007) have, however, elsewhere questioned if India's gender budgeting is actually what the name suggests as many policies that were primarily aimed at children or that were brought out for male as well as female beneficiaries were sometimes included in the numbers used to calculate the 'gendered' component of the national budget.

### **Budgeting and policy-making against trafficking: the case of Ujjwala**

India has shown its commitment to tackling human trafficking following Article 23 of its Constitution titled Right against Exploitation, which explicitly prohibits traffic in human beings and forced labour. India is also committed to preventing trafficking as a signatory to the UN Protocol to Prevent, Suppress and Punish Trafficking in Persons especially Women and Children, Convention on the Elimination of All Forms of Discrimination against Women, Convention on the Rights of the Child and SAARC Convention on Preventing and Combating Trafficking of Women and Children in Prostitution, all of which have been ratified by the country. India has also enacted the Immoral Traffic (Prevention) Act in 1956 translating the Constitutional guarantee of right against exploitation to law of the land. The Indian Penal Code details the associated punishments applicable.

The Ujjwala ("illuminant") policy was initiated in 2007 and is run by the Ministry of Women and Child Development which has called the policy 'a comprehensive scheme for prevention of trafficking and rescue, rehabilitation and reintegration of victims of trafficking for commercial sexual exploitation' (MWCD 2007). This policy was the successor of the National Plan of Action to Combat Trafficking and Commercial Sexual Exploitation of Women and Children initiated in 1998. The Ujjwala policy document acknowledges trafficking as a violation of basic human rights and cites poverty, women's

unequal status in the society and lack of protection as reasons for the continuance of trafficking. Apart from the four main objectives noted above, the policy also seeks the 'repatriation of cross-border victims to their country of origin' (MWCD 2007, 2). The policy focuses not only on those women and children who are 'victims', but also on those who are 'vulnerable' to trafficking (MWCD 2007, 3). The central government hopes to implement the policy in collaboration with eligible NGOs who can seek financial assistance from the Ministry. Prevention would be implemented through the constitution of Community Vigilance Groups, *sanghas*/groups of adolescent girls and children, and awareness building. Rescue would involve collaborating with the police, *panchayats*/local bodies, tour operators, hotels etc. and the victims would be rehabilitated in Protective and Rehabilitative Homes. Rehabilitation involves providing legal aid, education and vocational training, and stay in Half-way Homes as part of reintegrating with the mainstream society. Repatriation would include bearing the cost of all paper work and stay in transit homes to mediate the process of return.

Since the most compelling evidence of the efficient use of budget allocation is given by the amount that was actually spent, it would be worthwhile to analyse the actual expenditure under the policy. The data for the budget year 2011-12 (which is the latest, as provided by Union Budget 2013-14, as actual expenditure data is released two years later), suggests that while the budget allocation for Ujjwala was 90 million rupees, the actual expenditure ran to 117 million rupees. An associated policy to construct and run short stay homes to house the 'rescued' women was given 330 million rupees in the same financial year, which saw an expenditure of the entire amount at the end of the year. Also, Awareness Generation Programmes on various gender-related issues spent 20 million rupees brimming over the initial allocation of 18 million rupees (GoI 2011 and GoI 2013).

From a budget utilization perspective, the picture looks rosy. Although one could argue that the effective implementation of the policies need to be surveyed in terms of what achievements were accomplished on the ground, this paper takes a slight moment of pause to reflect on what could be said about gender budgeting itself from a sexual rights angle when one examines the data on utilization of budget. The first striking point is that for a policy like Ujjwala, which makes an attempt to translate the sexual rights discourse into policy-making through gender budgeting, it is a difficult task to judge the allocation in the first place in the absence of any targets, which in themselves are difficult to set on an issue such as trafficking. The dilemma this poses before the policy-maker as well as the gender theorist is this: an attempt to assess *what policy is a good policy* by assessing *how much budgeting is a good budgeting* leads us to a

slippery surface precisely in the wake of a lack of authoritative data on the scale to which trafficking occurs.

Secondly, trafficking cannot be dealt with as an isolated issue and needs to be corroborated with comprehensive measures to prevent violence against women. The data for the year 2011-12 reveal that while 130 million rupees was allocated for the National Mission for Empowerment of Women, only 20.8 million was actually spent. Similarly, although the Protection of Women from Domestic Violence Act was enacted way back in 2006, the amount allocated/spent under the category 'implementation of the Act' was zero. Understanding the links between labour migration and security, the scheme to establish Working Women's Hostels was allocated 89.8 million rupees in 2011-12. However, the actual expenditure was only 4.9 million rupees. As we explored before, sexual rights would include a range of different rights and freedom that often overlap. A gender budget approach to securing rights would then have to make holistic efforts which in the case of prevention of trafficking would mean the strengthening of the associated policies such as the ones indicated above.

The omission of the transgender community, as was noted in the case of the sexual rights discourse, continues in Ujjwala as well. The lack of data on trafficking with respect to transgender has further constrained their inclusion, in spite of the over-emphasised targeting of this section of the society by the government as well as international NGOs as part of HIV/AIDS prevention efforts. It is contradictory that while the sexual *health* rights of this community with regard to access to HIV/AIDS preventive measure have been given attention by the policymakers, their sexual right to bodily integrity and freedom from violence has remained side-lined.

Cross-border trafficking continues to pose another major challenge (c.f. Mukherjee and Ahmed 2009). The SAARC provides a pertinent venue for an informed discussion since trafficking across the subcontinent would have to be dealt with on a regional forum. Although cross-border trafficking was discussed at the Regional Task Force Meeting of SAARC in 2010, the proposed plan for separate uniform toll-free helpline for children and women (SAARC 2009) has yet to be implemented. In addition, the language of *repatriation* of 'rescued' women used in Ujjwala needs to be problematised as it would lead to the returning of the victims to conditions that made them vulnerable in the first place.

### **Recommendations and conclusion**

The above analysis directly leads to the following recommendations: (1) there should be an element of flexibility in gender responsive budgeting with regard to dealing with trafficking as the difficulty in setting targets in this regard



inevitably leads to uncertainty in the extent to which *planned budgeting* could be implemented. The rights framework then provides a useful advocacy tools to facilitate the bargain between policy needs and budget allocation; (2) the policy against trafficking should be coherently supported by efficient utilization of the budgetary allocations for all associated policies to make the budgeting process itself holistic, (3) the policymakers should critically introspect which sections of the society are excluded from the trafficking policy and take comprehensive measures towards their inclusion, (4) cross-border trafficking should be discussed at the appropriate regional forums and a rights-based solution to the question of repatriation of rescued victims should be sought.

As a way of conclusion, it would be a constructive exercise to look back at the analytical framework used to study the Ujjwala policy in India and seek possibilities of new theorisation. The application of the sexual rights discourse in the analysis of Ujjwala showed that while the rights paradigm provided a useful tool to advocate budgetary support to anti-trafficking, an absence of a cogent definition of sexual rights itself has haunted the debate. In light of the above analysis, any agreeable definition of sexual right will have to include trafficking per-se, as well as the legal rights to seek asylum in the wake of rescue from cross-border trafficking. Further, the above analysis raised questions on the extent to which gender can be stretched as an analytical tool with regard to securing of sexual rights and gender budgeting particularly in light of the omission of transgenders from the policy horizon. This critical evaluation thus leads us to new doors to explore how our analytical tools themselves need improvement to improve policy-making.

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## THE JAPANESE FEED-IN TARIFF: HELPING OR HAMPERING RENEWABLE ENERGIES?<sup>120</sup>

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*Since the Fukushima nuclear disaster and the shutdown of almost all Japanese nuclear power plants, Japan struggles to fill the resulting energy gap in an economically and environmentally sustainable way. In July 2012, Japan implemented a feed-in tariff (FIT) to foster renewable energies. This essay asks whether the FIT is going to develop the renewable energy sector or whether design flaws are going to hamper its success. On one hand, the analysis shows that the FIT offers strong financial incentives for investment in renewable energy generation. By obliging the electrical utilities to connect the renewable energy generation facilities to the grid and purchase their electricity, it avoids market discrimination related to the grid monopoly of the vertically integrated utility companies. Distributing the cost equally onto all Japanese electricity consumers helps foster acceptance of the new technology. On the other hand, the law contains a potentially significant loophole: in case grid stability is endangered or grid capacity is reached, the utilities are not obliged to restrict their own energy output on more than 30 days per year and can shut down the renewable energy generator instead. This may create a major source of uncertainty for investors, as they are not reimbursed for the shutdown. Additionally, this legal provision limits the incentives for the utilities to expand their grid to incorporate a rising amount of intermittent renewable energies. This discussion reveals that the Japanese FIT may no longer function when the Japanese grid reaches its capacity. However, as renewable energies start from a very low level in Japan, it is likely to provide strong growth incentives in the renewable energy sector and thus have the added advantage of also creating a more influential interest group for sustainable energies.*

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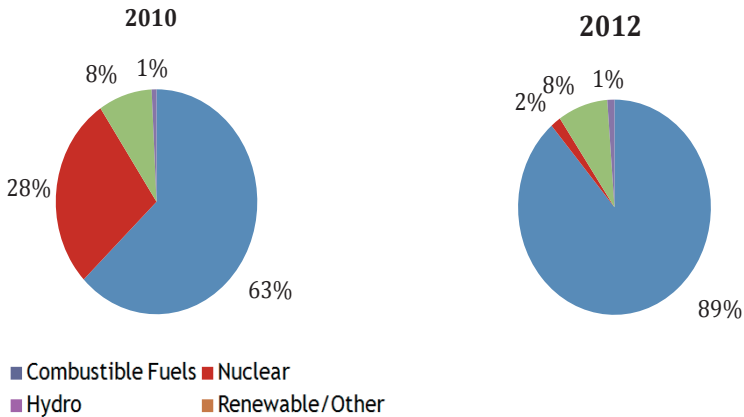
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## Japan's energy challenge after the Fukushima nuclear disaster

It would have been the perfect solution to both Japan's lack of natural fuel resources and its rising CO<sub>2</sub> emissions: before the Fukushima accident, Japan produced more than a quarter of its electricity using nuclear power and was even planning to expand this proportion to about 50 percent until 2050. But when all nuclear reactors were shut down for security checks following the disaster, the country faced a major electricity shortage. The gap that was created is until today almost entirely filled using combustible fossil fuels (cf. Figure 1).

Figure 5: Japan's Electricity Production 2010 and 2012



Note: Own compilation from IEA Monthly Electricity Statistics Archives (2010, 2012). Total electricity production decreased from 1.024.478 GWh in 2010 to 989.665 GWh in 2012.

This method of compensation for the missing nuclear energy is very expensive, as Japan has no fossil fuel resources of its own and has to import all of its supply. It is also endangering Japan's efforts to achieve its CO<sub>2</sub> emission reduction goals. Taken together, this path is highly unsustainable in the long run – financially and ecologically. Although the government is planning to restart the nuclear power plants (Saunders 2013), returning to nuclear power does not seem a viable option in the long run either. As Japan is situated on the tectonically highly volatile Pacific Ring of Fire, similar natural catastrophes are likely to occur again in the future. Additionally, it faces the mounting problem of nuclear waste disposal – an environmental safety issue that no nation anywhere has yet been able to solve. Over the past two years, many Japanese, who ordinarily do not protest in public, have taken this as a reason to demonstrate to demand an end of nuclear power in their country (McCurry 2011; Williamson 2012).

As difficult as the current situation may seem, from the perspective of sustainable development, there is a positive side to the energy gap created by the nuclear shutdown: it represents a unique policy window for a radical reorientation of Japan's energy strategy towards more sustainable, renewable

energy sources. It is fitting that in June 2012, Japan's Diet – then still dominated by the DJP – approved one of the world's most generous feed-in tariffs (FITs) for renewable energies (IEA 2012a, 213), the "Act on Special Measures Concerning the Procurement of Renewable Energy by Operators of Electric Utilities". If Germany's experience is any indication of developing renewable energy sources, the introduction of a FIT could constitute an important impulse for Japan's energy policy. Since the introduction of its FIT (the *Erneuerbare-Energien-Gesetz*, EEG) in 2000, Germany experienced a more than threefold increase in renewables and now boasts a share of 19.9 percent of renewable electricity production (IEA 2012b, 57).

The introduction of a FIT could mark a turning point for Japan's energy portfolio as well, whose share of renewable energies has stagnated at around 10 percent – most of which comes from hydroelectric dams (IEA 2012b, 57). But given the powerful vested interests in the existing power industry that have become apparent in the government's reversal of the nuclear exit, the question remains: is the Japanese FIT really going to help foster sustainable energies or is it going to hamper them because of flaws in its design? The remainder of this essay analyzes this question by critically examining the features of the Japanese FIT and their foreseeable consequences for the energy supply structure in Japan.

### **The Japanese feed-in tariff: Helping investment incentives, but hampering renewables grid integration?**

The "Act on Special Measures Concerning the Procurement of Renewable Energy by Operators of Electric Utilities" was designed and implemented by the DJP government and came into effect on July 1<sup>st</sup>, 2012 (METI 2011). Its basic features are as follows.

First, the electrical utilities are obliged to purchase electricity generated by solar photovoltaic (PV), wind power, hydraulic power (below 30MW), geothermal and biomass facilities (METI 2012, 3). To be able to do so, they are obliged to allow the grid connection and to execute the necessary contracts (METI 2011). Second, the FIT rates and period are specified in the law (cf. Figure 2). They are reviewed regularly by an independent committee organized by the Ministry of Economy, Trade, and Industry (METI) to take into account the anticipated changes in the cost of power generation and facility maintenance (METI 2011). Third, to be eligible to participate in the FIT system, power generators need to be certified by METI. The certification requires that the power generation facility is capable of running stably and efficiently and of measuring produced electricity accurately and transparently (METI 2012, 6). Fourth, the costs for purchasing the electricity from renewable power generators are transferred to

the electricity customers via a surcharge on the regular electricity price. The surcharge is equal across the country; exempt are persons significantly affected by the March 2011 earthquake (until March 2013) and energy-intensive manufacturers (METI 2011).

Figure 6: Purchase Price and Period under the Japanese FIT

Power Source	Purchase Price	Purchase Period
Solar (10kW or more)	40 Yen (0.5 USD)/kWh plus tax	20 years
Solar (less than 10kW)	42 Yen (0.525 USD)/kWh	10 years
Wind (20kW or more)	22 Yen (0.275 USD)/kWh plus tax	20 years
Wind (less than 20kW)	55 Yen (0.6875 USD)/kWh plus tax	20 years
Hydro (1,000kW–3,000kW)	24 Yen (0.3 USD)/kWh plus tax	20 years
Hydro (200kW–1,000kW)	29 Yen (0.3625 USD)/kWh plus tax	20 years
Geothermal (15,000kW or more)	26 Yen (0.325 USD)/kWh plus tax	15 years
Geothermal (less than 15,000kW)	40 Yen (0.5 USD)/kWh plus tax	15 years
Biomass (methane)	39 Yen (0.4875 USD)/kWh plus tax	20 years
Biomass (trees/bamboos)	32 Yen (0.4 USD)/kWh plus tax	20 years
Biomass (wood/crops)	24 Yen (0.3 USD)/kWh plus tax	20 years
Waste Construction Materials	13 Yen (0.1625 USD)/kWh plus tax	20 years
General Waste	17 Yen (0.2125 USD)/kWh plus tax	20 years

1 USD=80 Yen

Source: Umino and Dochi 2012

Looking at the purchase price and period for the renewable energy, it becomes obvious at first glance that the Japanese FIT rates are very high – twice as high as in Germany and more than three times the rates in China (Inoue and Valet 2012). Since power generation costs for renewable energies are still relatively high in Japan, the high FITs are necessary to provide sufficient incentives for investors. In combination with the long duration of the FIT periods, the tariff provides high investment security. This is a crucial factor: investment security has already been identified as a main factor in the continuous and strong growth of renewables in Germany (Jordan-Korte 2011, 127). This feature of the Japanese FIT follows the same logic and is therefore likely to attract investment in the sector.

Another crucial design factor of the policy is the obligation of the electrical utilities not only to purchase the electricity generated from renewable sources, but also to connect the generation facilities to the grid and to enter into appropriate purchase contracts with mutual responsibilities. This is important because it avoids market exclusion through the exertion of the monopoly power by the Japanese utility companies. As they are vertically integrated (i.e. include not only electricity production but also distribution through the transmission

grid and retail to the customers) they would otherwise be able to exclude competitors from feeding electricity into their grid.

A further advantage of the Japanese FIT concerns the political feasibility of the costs incurred by the tariff. The costs for purchasing the renewable energy are distributed as a surcharge on all electricity consumers, regardless of which utility they are connected to. Because renewable energy generation is dependent on certain geographical features (e.g., high wind, solar, or geothermic potential), its distribution across the country is likely to be uneven. By distributing the cost of the FIT to all consumers, the policy avoids a regionally unequal distribution that raises the danger of decreased acceptance by those located close to renewable generation facilities who would otherwise have to shoulder the surcharge burden on their own without enjoying more advantages from it.

The Japanese FIT thus takes into account investors' interests as well as the market failure pitfalls of a vertically integrated electricity industry. However, a this discussion requires a closer examination of the details of FIT – in this case in the fine print of the contract between the utility and the renewable energy generator.

As stated before, the utility is generally obliged to purchase the electricity that is produced by the renewable energy generator, and there is no limit as to which amount has to be purchased? However, there is a significant exemption to this rule. Under certain circumstances specified in the contract, the power generator must restrain its power output without compensation. To avoid unreasonable burden on the utilities, these circumstances include, for instance, interruptions resulting from force majeure. More critically, though, is that this rule also includes situations where grid stability is potentially endangered by additional input from renewable energy sources. While the utility is required to implement certain agreed-upon countermeasures in these situations, including the restraint of its own power output, these restrictions may not be imposed for more than 30 days per year (Umino and Dochi 2012).

This 30-day-limit on interventions on the side of the utilities is a highly critical point for the investment security of the renewable energy generators. The problem can best be illustrated by comparing it to the principle of grid priority in German law (§ 8 EEG), which explicitly states that electricity from renewable sources comes first. If grid capacity is reached, input from conventional power sources has to be restricted first before renewable energy input is reduced. If renewable energy input has to be restricted to ensure grid stability, generators are still reimbursed. The Japanese FIT does not go as far. Therefore, not knowing whether the generator will actually be allowed to run and generate output is a source of high insecurity for investors.

From a practical point of view, there may not be much cause for concern yet, as it may take a while until the Japanese grid reaches the point where it cannot handle the renewable energy input. Renewable energies in Japan start from a very low level and there is still capacity in the grid. However, once renewable energy production exceeds a certain level, and nuclear energy possibly reenters the system, the number of interventions in the grid rises exponentially. For example, in 2011, the German transmission system operators that connected the highest amount of wind energy, TenneT TSO and 50Hertz Transmission, intervened on 306 and 213 days of the year, respectively (RWE Deutschland 2012).

As the Japanese FIT law lacks the component of grid priority for renewable energies, it is highly unlikely that the utilities will implement either restrictions on their own power output beyond the obligatory 30 days or any other measure that might require changes in their operations. Since the utilities do not earn anything with the distribution or sale of electricity from renewable sources but are instead burdened with administration and maintaining the grid stability, they do not have any incentives to prioritize the renewable energy generators. On the contrary, the increased management requirements, because of the intermittent nature of wind and solar PV and the reduced market share because of the renewable competitors, gives them an incentive to restrict the renewable energy input as much as possible.

In the same vein, the Japanese FIT law does not mandate that utility companies take measures to further enhance and expand their grid, as the German EEG does (§ 9 EEG). As grid expansions to integrate renewable energies do not contribute to the utility companies' revenue under the current policy regime – or even reduce the revenue, as the investment benefits their competitors – they are not likely to make these investments. But if Japan aims to generate a significant amount of its power supply from renewable sources, a further grid expansion is inevitable, especially as Japan does not have the opportunity to cooperate with neighboring countries to redirect energy flows through adjacent grids.

Although ways to finance these infrastructural investments are being discussed, such as a “cooperation among the Japanese Government, power utilities, and wind power generators” (Umino and Dochi 2012), it is doubtful that a voluntary solution can easily be reached. It has already become obvious that the utilities are quite unwilling to invest in grid expansions. Making renewable energy generators pay for the grid reduces their profitability and will likely slow down the growth of this sector, countering the policy goal of increasing the percentage of renewable energies in the energy mix. And since consumers already have to pay for the renewables surcharge on their electricity bills, it



may additionally reduce acceptance of the renewable energies if they also have to pay for the expansion of the grid infrastructure.

### **More than economics: The FIT as a boost for change**

When the DJP came into power in 2009, advocates of an alternative energy future for Japan hoped that the DJP government would create an avenue for new and more sustainable ways to supply Japan with the energy the country needs. One month after the election, the new government immediately set in motion a process to create a law to foster renewable energies. It could not be more fitting that the cabinet decided on the bill on the morning of March 11<sup>th</sup>, 2011, just before the Great East Japan Earthquake hit and led to a devastating nuclear disaster (Kojima 2012). The “milestone feed-in tariff policy in late 2011 [...] began to change perceptions of Japan’s renewable energy future” (REN21 2012).

Despite these notable changes in the national mood, a closer look at the actual law reveals the influence of the powerful Japanese energy lobby that is still very visible in the law despite the change in government. Taken together, the utility companies that are producers, transmitters and distributors of electricity at the same time, are hardly asked to make any concessions at all. Instead, their role is reduced to that of an administrator of the purchase of renewable energy, the cost of which is redistributed to the electricity customers. Under the current Japanese FIT scheme, renewable energies are therefore welcome in the grid as long as they do not trespass on the business of the utility companies. Particularly critical is that beyond the 30-day-limit, there are no regulations to avoid that the utilities make use of their monopoly ownership of the grid by simply keeping the renewable energies out of it.

As such, is the Japanese FIT therefore doomed to fail and bust the hopes of the renewable energy advocates? Maybe not. First of all, while the comparison between the German EEG and the Japanese FIT yields valuable insights, their comparability also has its limits. Most crucially, the starting point for the Japanese renewable energy industry is much lower than that of the German renewables. Today, only 2.8 percent of Japanese electricity is produced from renewable sources other than hydropower; the most volatile of them, wind and solar power, constitute only 0.4 and 0.6 percent, respectively (IEA 2012c, 34). Therefore, it may take a while until grid stability really becomes an issue in integrating the renewables.

If the Japanese FIT incentivizes the renewable energy industry to grow, another aspect will change along with it. The producers of renewable energy will gain a louder and stronger voice as more and more of their projects succeed. As contributors to a stable and more environmentally sustainable energy supply in a country still struggling with expensive fuel imports and the management of

dangerous nuclear waste, their voices are much more likely to be heard from a strengthened position. Given the traditionally very strong ties between the policy-making ministries and the energy industry under LDP rule, it can already be counted as a success that the DJP managed to implement this policy at all, taking into account the concessions that it had to make to be able to do so. Therefore, even though there is still much to be done in reforming the energy sector in Japan, the FIT serves as a powerful signal that Japan is slowly but surely steering towards a sustainable energy future.

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## REVIEW OF BILVEER SINGH'S POLITICS AND GOVERNANCE IN SINGAPORE: AN INTRODUCTION

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*Reuben Hintz*<sup>122</sup>

It has become something of a cliché to say that the 2011 Singapore general elections were a “watershed” event in the young nation’s political history. Nevertheless, as an older saying reminds us, “a cliché is a cliché because it’s true.” For his part, Bilveer Singh seems to agree. He devotes the entire fifteenth chapter of his book to the most recent Singapore parliamentary election, and he does not hesitate to open by proclaiming “politically speaking, on 8 May 2011 Singaporeans woke up to a new Singapore.”<sup>123</sup> It seems clear that in an election where the ruling party came away with over 60 percent of the popular vote, something had fundamentally changed in Singapore’s politics. In order to understand how this could be so, we need to look at Singh’s first fourteen chapters.

This is the second edition of *Politics and Governance in Singapore*; the first was published in 2007. Given the obsession that many foreign academics, journalists, and other professionals have with Singapore’s unique situation, there are relatively few serious academic works which try to describe the history and make up of Singapore’s political system. This is one of them. In 256 pages, Singh narrates Singapore’s history, from British colony to Japanese occupation during World War II to independence and the economic success that has become its defining feature. The rise of Lee Kuan Yew and his People’s Action Party (PAP) are also intertwined with discussion of whether Singapore can still be labelled a Westminster parliamentary system and whether an over-reliance on the elite civil service is making Singapore overly bureaucratic.

Possibly the greatest service provided by Singh is his thorough cataloguing of many of the more controversial events in Singapore’s post-colonial history. In the chapter on “Mass Media” he exhaustively narrates repeated tensions between the government and the media outlets that the former is trying to control. He does not hesitate to explain how the government gained ownership over all of the major domestic media outlets and vigorously pressed lawsuits

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<sup>123</sup> Bilveer Singh, *Politics and Governance in Singapore: An Introduction*, McGraw Hill, 2012

against foreign publications which refused to heed the party line but still needed to use Singapore as a regional printing and distribution hub. Similarly, in the “Trade Unionism” chapter, Singh explains how the government effectively gained control over the National Trades Union Congress (NTUC) in order to create a strike free economy, and how this has created the perception that is more of a “rubber stamp” than a true representative of the working class.<sup>124</sup> There are no real revelations in *Politics and Governance*; however it does serve as a useful library reference for anyone who occasionally encounters the need to look up recent events in Singapore’s political history.

Singh manages to cover almost all aspects of Singapore’s political history; however there are several notable omissions. In his chapter on “Nation Building and National Identity,” the author devotes significant space to explaining the diverse racial balance, which has been a defining feature of Singapore throughout its history. Despite this, not much time is spent exploring the issue of foreign residents in Singapore. In recent elections, the issue of foreign immigrants has essentially taken centre stage and become a key rallying cry for most opposition candidates. There is also little discussion of what the opposition parties in Singapore really stand for, or what they have done once they have been able to get into Parliament. These are arguably not very fair criticisms since the book presumably went to press before there was a significant number of opposition MPs in Parliament and the anti-immigration complaints came to reach their crescendo; however, they are important shifts in Singapore politics which are currently very much under-studied.

It is always dangerous to infer too much from a book’s cover, but this author was still struck by the image on the paper copy of *Politics and Governance*. The picture is of the Old Supreme Court Building, built by the British colonial powers in the 1930s. However it is from several years ago, before an on-going reconstruction project covered the neoclassical façade in scaffolding. In the same way, Singapore’s recent political changes have covered the traditional, well known political structures with scaffolding. While we have a good idea of what the Old Supreme Court will look like once it emerges from its metamorphosis, it is much less certain what politics and governance in the city-state will look like once the dust settles. Hopefully, we can look forward to a third edition of *Politics and Governance in Singapore* to reveal some of the answers.

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<sup>124</sup> *Ibid.*, pg. 111.

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## The Pacific Century

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