INDONESIA COUNTRY REPORT

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1.0 INTRODUCTION

The development impact of remittances on recipient households in developing countries are, potentially, greatly enhanced by channeling funds through formal financial institutions, particularly microfinance institutions (MFIs). Leveraging of remittances by MFIs enables them to support business development services, social support programs for returnees and other community development activities which generate high social and economic rates of return.

In Indonesia, there currently exists an extensive network of Microfinance Institutions (MFIs) particularly in the rural and regional areas. With an increasing number of Indonesian migrant workers and the subsequent flow of remittances to the regions, it is envisaged that this extensive network of MFIs has the potential to leverage remittances as a source of development finance for the benefit of the MFIs as well as their clients. Hence, this country report on Indonesia aims to investigate the potential for MFIs to leverage overseas migrant remittances.

The report is divided into five sections. Section One provides an overview of the flow of migrants from Indonesia and the resulting flow of remittances. The policy and regulatory environment for remittances is explained in Section Two. Sections Three and Four outline the results and findings from the survey research, and key policy recommendations are presented in Section Five.

1.1 Overview of migration

With a population of 226 million and a per capita GDP of $1,280 in 2005, Indonesia is South-East Asia's largest country and one of the poorer countries in the region. Since 2004 a series of major natural disasters, Including the tsunami of December 2004 and more recently, earthquakes in Nias and Yogjakarta and another tsunami in West Java, have imposed enormous social and economic challenges, but economic recovery has been strong, with GDP growth rates above 5 per cent in 2005 and 2006, and projected in 2007 (World Bank 2006*a*). Unemployment remains high, at 10.4 per cent in 2006, with underemployment estimated at 20 per cent (Hugo 2007). As recent growth is concentrated in non-labour intensive sectors, prospects for future employment growth are limited, the World Bank noting that the level and sources of growth are failing to keep pace with the growing labour force, and that Indonesian workers are becoming more pessimistic about their job prospects (World Bank 2006*a*). In response to the lack of economic opportunities at home, increasing numbers of Indonesian workers are looking abroad.

Official data sources indicate that the numbers of migrant workers and levels of remittances to Indonesia are low in comparison with other Asian labour exporting countries, in absolute terms, and as a percentage of GDP and relative to other sources of foreign exchange. However, reliable official data on migration and remittances is lacking, and commentators agree that official statistics significantly underestimate both migration and remittances. One probable cause for the l underestimation of migrant numbers is a failure by regional authorities to report overseas worker registrations, due to problems with some functions and coordination with the assumption of new responsibilities by decentralised regional governments since 2000 (Hugo, 2002). Another factor is the significant flow of undocumented migration, particularly to Malaysia, indicated by anecdotal evidence but not captured by official statistics in either the source or destination countries.

In 2006, the number of officially registered Indonesian migrant workers overseas was reported by the Minister for Labour to be 2.7 million, or 2.8 per cent of the Indonesian workforce (Suparno, 2006). The Indonesian Department of Labour records that close to 400,000 documented Indonesians were working in the Middle East in 2004, although for the reasons noted below, these are likely to underestimate the total. According to host country estimates, which are more reliable than Indonesian official sources for information on documented migration, around 1.2 million legal Indonesian migrants were working in South-east and East Asia in 2004, with about 1 million in Malaysia alone (ADB 2005).

Since the 1970s two major systems of migration have evolved: the official system, which includes the OECD countries, the Malay peninsular countries and the Middle East, and the undocumented system, focused on Malaysia and Singapore. Most Middle East migrants are women working as domestic servants. Migrants to Singapore are both men and women working in services and construction, while most migrants to Malaysia are male construction and plantation labourers in low-status, poorly paid jobs which are avoided by Malaysians (APMRN 2003). Traffic between Indonesia and Malaysia is considered to be the world's second largest undocumented migration flow after the Mexico-US corridor (Hugo 2007).

In August 2005 the Indonesian director-general of Labor Placement Overseas estimated that more than a million Indonesians were abroad illegally, including an estimated 400,000 in Malaysia, 400,000 in Saudi Arabia (illegally overstaying three-month pilgrimage visas), 20,000 in South Korea and 8,000 in Japan, while in late 2006 the Malaysian home minister estimated that there were 600,000 undocumented foreign workers in Malaysia, most of them Indonesian (Hugo 2007).

1.2 Remittances

Official remittances were recorded at $3 billion in 2005, just over 1 per cent of GDP. This figure probably represents less than half of the total due to the poor quality of official data. Bank Indonesia receives information on the numbers of migrant workers and these numbers are then multiplied by the standard wage for each country. These figures are matched with the value of 'all residual balance of payment' transfers once the figures from other BoP categories are extracted to estimate the value of remittances (ADB, 2005). This method is used because there is no direct information on remittance transfers. For transfers under US$10,000 there is no requirement that the purpose of the transfer be recorded. As well, a large proportion of remittances go unrecorded as they are unofficial transfers through unregistered operators and cash and gifts brought by hand[1]

As migration in Indonesia tends to occur in pockets remittances have more significance at the regional than national level. In East Flores and Eastern Java, remittance inflows far exceed regional government budgets (Hugo 2007), and in 2004, for example, the contribution of remittances to Gross Regional Domestic Product in the East Javanese regions of Madang, Tulungagung and Blitar was 42 per cent, 23 per cent and 13 per cent respectively. In the key migrant-sending districts of Kalimantan, West Sumatra, West Java, East Java and Lombok, remittance inflows are more significant than in other areas. The more concentrated financial impact of remittances within specific areas can be seen in the province of East Java, in which the present study is focused.

2.0 THE POLICY AND REGULATORY ENVIRONMENT

2.1 Foreign exchange licencing rules and regulations

Interest in Indonesia in remittances as a source of foreign exchange and development financing has grown in recent years, in step with the growing global awareness of the significance of remittances. Indeed, the need to expand numbers of migrant workers has actually been written into the IMF Post program monitoring agreement as a way to increase foreign exchange earnings. The Minister of Labour and Transmigration has set a target of Rp 186 Trillion in remittances annually by 2009 (Susilo, 2006).

However, despite this interest, remittance related priorities - such as promoting the availability of cheap and good quality transfer services - are not at the forefront of Government and Central Bank policy making in shaping and regulating the financial sector. A decade on from the Asian financial crisis, its devastating effect is still being felt. As part of a long term effort to build up an economy and banking sector that was virtually destroyed, Government and Bank Indonesia (BI) financial sector policy is still very much preoccupied with fundamental issues such as monetary stability, controlling inflation and ensuring the health of the banking sector through prudential controls (Charitonenko, 2003; Bank Indonesia, 2005). The orientation is thus toward limiting and controlling participation in the financial system rather than throwing open the playing field.

This can be seen in regulations regarding the payments system. Only fully fledged commercial banks are able to handle money transfers, NBFIs such as MFIs are not permitted. In Indonesia banks are divided into commercial banks, literally known as "public banks" *Bank Umum* (BU) and rural banks, or "people's credit banks" *Bank Percreditan Rakyat* (BPR). Commercial banks have a full range of functions and are able to participate in the payments system (Banking Act 7, 1992). BPR have limited functions in savings and credit and do not participate in the payments system. BU is permitted to deal in foreign exchange but BPR are not. Banks that deal in foreign exchange are described as *Bank Devisa* (Foreign Exchange Banks) and they must obtain a license from BI to carry out banking functions involving foreign exchange (BI Reg. 6/15/PBI/2004).

The only cross over by an MFI into the money transfer market is Bank Rakyat Indonesia (BRI) which is a state owned commercial bank with a specific mandate for microfinance, fulfilled by its network of Unit offices at sub-district level throughout the country (Charitonenko, 2003). It is the only bank to have a presence in the rural areas beyond district towns.[1] Money Transfer Operators are permitted to operate in Indonesia but only with a Bank as an agent. There are also special provisions for post offices to provide international money transfer services (ADB, 2005).

BPRs and other companies, under certain conditions, are permitted to become Foreign Exchange Traders (PVA) (BI Regulation 5/2/PBI/2003, 3/10/2003) with limited powers to handle foreign exchange. Foreign exchange traders may buy travelers cheques and trade foreign currency bills but they are not permitted to make payments based on instructions from overseas, send or receive international money transfers or sell foreign currency travelers cheques.

In addition to limiting who can handle foreign exchange, BI also puts controls on the handling of the Rupiah in the international financial markets. In order to combat the problem of the currency instability which has plagued Indonesia since the Crisis, BI has a policy to prevent speculation on the Rupiah and thus the Rupiah cannot be traded or used for international transfers (BI reg. 3/3/PBI/2001). The only trade in Rupiah that is permitted is some trade in derivatives to a limit of US$3 million. Moreover, Indonesian Banks are not permitted to provide credit to foreigners or foreign institutions.

2.2 The impact of sender vs recipient regulatory environments

The Indonesian regulatory environment for transfer services is quite restrictive. In considering how this impacts on the services that are available for Indonesian migrants and remittance recipients it is important to note that much of the costs of transfers are incurred in the sender country. There are three components to the fees charged for a money transfer including:

a) the fee charged by the sending institution

[1] Bank Danamon now also has a strategy to open Units at sub-district level as part of a shift into the microfinance market (Asian Banker, interview with Sebastian Parades, president director, Bank Danamon, 21/2/06)

b) the foreign exchange spread in which the transfer provider charges higher than market interest ranges and
c) fees charged by the recipient agency. In many cases the recipient institution acts as an agent of the sender institution and so the majority of the fees are incurred in the sender country (Martinez, 2005).

The fact that Rupiah cannot be traded may have some impact on the interaction between sender and recipient agents in sharing fees on foreign exchange spreads. However, generally the regulatory framework in the sender country may have a greater impact on the cost of transfers than the regulatory framework in the recipient country. Despite the advantage of a closed market in Indonesia, most banks do not charge the receiver to collect the transfer. On the other hand, the ADB Southeast Asia Workers' Remittances Study has shown the level of money transfer operator regulation in the sender country to be a statistically significant indicator of cost along with the volume of transfers and level of informality (Table 1).

Table 1: Migration levels and remittance costs in Southeast Asia

Host Country	Total no. of migrants from sending country		Average income (USD)	Average remittance (USD) + annual no of transactions	Average cost of transfer per USD 1000 (per cent)
Japan	Indonesia	22,000	22,000	830/5	6.3
	Philippines	180,000	19,000	567/11	9.4
Malaysia	Indonesia	1,000,000 (400,000 undocumented)	4,000	151/6	8.4
	Philippines	140,000 (100,000 undocumented)	2,500	132/10	7.4
Hong Kong	Indonesia	108,000	4,800	268/11	2.8
	Philippines	142,000	5,000	322/15	2.3
Singapore	Indonesia	60,000	2,000	284/3	4.3
	Philippines	90,000	9,000	294/14	3.3

Source: ADB 2005

Studies have shown that migrant corridors in which there is an active policy dialogue between sending and recipient country governments tend to have lower fees. For example, the US Governments and Mexico have signed agreements to allow funds to be transferred through the US Federal Reserve Bank's ACH (Martinez, 2005). The US and Philippines Governments are also discussing ways to improve the connectivity of payment systems to facilitate low cost transfers between the two countries (ADB, 2004). There have been discussions between corporations and banks in Indonesia and in destination countries for Indonesian workers[2] . Indonesia is not yet at a stage of exploring integration of payments systems with other nations, it is only just developing its own electronic payments facilities. Remittances are touched on in bilateral policy discussions and international fora such as APEC and ASEAN in practice, but there is no formal program for coordination along specific corridors (ADB, 2005).

In Indonesia, remittances can only be collected from banks (ADB, 2005). Currently, rural residents do not have to travel as far as they once did to get to a bank. A series of banking reforms, known as PAKTO, which began in 1988, allowed commercial banks to extend their network throughout Indonesia and they are now present in district towns (*Ibu Kota Kabupaten*) throughout the archipelago, this apart from the Bank Rakyat Indonesia (BRI) which has a wide network of units at sub-district level (Charitonenko, 2003). There are also indications that although the number of banks is not increasing, the number of branch offices of banks is continuing to multiply. For example, in East Java the number of Bank branch offices was 1,612 in 1997 but had increased to 2,174 in 2005 (Soebagyo, 2006).[3] This does not necessarily mean that banks are getting closer to rural communities, just that more branches are clustering in district towns.

2.3 Rules relating to mobilisation of deposits by non-bank financial institutions

Despite the large number of micro-enterprises and their substantial contribution to GDP, microfinance lending is still not a big market for the commercial banks in Indonesia. There are a number of reasons for this, including effects of the financial crisis. Most banks are not present in the rural areas and many do not have micro-enterprise products, or they are not promoted in the way that is attractive to the consumer. Micro-savings accounts are more common than micro-credit among the banks. It is notable that the majority of migrant workers remit to banks accounts with commercial banks, however but there is no correlation with loans being taken out at the same institutions (Didik et al 2006).

Much of the lending done by the banks to the poor is through lines of credit channeled by BI for lending to specific target groups. These credit programs, known as KLBI, are no longer managed by BI. The Act 23/99 which removed the function of credit provision from BI restricted its role to monetary policy and financial sector regulation and supervision. However, other institutions were designated to manage credit programs on BI's behalf. BI regulation 5/20/PBI/2003 on Liquidity Credit channels funds to the state owned enterprises: Bank Rakyat Indonesia, Bank Tabungan Negara and PNM. The funds include special programs for particular groups such as farmers, cooperatives, sugar producers and housing credit for low income earners, MSMEs, MFIs and migrant workers. Some of the funds are channeled directly to community groups through

[2] For example, on 23rd November 2006 Singpost and Post Indonesia announced an agreement to work together on a number of initiatives including remittances.
[3] The number of Shariah banks is also increasing, For example, in East Java in 1997 there were five Shariah Bank branches and in 2005 there were 36.

programs and others are channeled through commercial banks. There is also a linkage program between commercial banks and BPRs. The programs offer funds at subsidised rates. When commercial banks are involved in the programs they tend not to continue with the lending practices after the program is finished (Didik et. al. 2006).

As for MFIs, while they are large in number, their potential for growth and expansion on commercial terms is hampered by a difficult legislative and regulatory environment and crowding out by subsidised credit programs. BPRs are generally commercial but the very high minimum capitalisation requirements, which was raised from Rp 50 million to Rp 500 million or Rp 1- 2 billion for provincial and district levels respectively (with high levels also for branches) has hampered their expansion (Charitonenko, 2003).

Cooperatives are numerous in Indonesia. They provide savings and loan facilities to members and non-members. There is a comprehensive legal framework for cooperatives but supervision is weak. The Department of Cooperatives is aware of the problems but lacks the resources to improve the situation which is also complicated by the fact that supervision and guidance has been devolved to the Provinces. Banks are not inclined to lend to cooperatives as they are seen as high risk and it is presumed that funding for them should be sourced through the Department of Cooperatives (ProFI, 2005).

There are many other types of MFIs in Indonesia including village credit organisations (BKD) and village credit institutions (LDKP), the state owned pawning company (PT Perum Pengadaian) and NGO programs. Apart from the Pawn company which has its own legislation, MFIs in Indonesia operate in a legal limbo. There is no specific MFI legislation, although there has been draft bill in process since 2001 (Charitonenko, 2003). The options for a *badan hukum* (legal body) for MFIs are therefore either to be a bank or a cooperative. Becoming a bank is out of the league of most MFIs due to the high minimum capitalisation requirements and becoming a cooperative does not really integrate them into the financial system. On the other hand, without a *badan hukum,* MFIs can't legally accept savings deposits or obtain commercial finance. Many MFIs thus remain fairly small operations, accepting savings and providing loans, but with an unclear legal basis which makes them unable to pursue aggressive expansion.

The remittance market in Indonesia is not of the scale of those countries where remittance products have really taken off in the banking, the NBFI and MFI sectors. At US$2–3 billion a year (US$1.85 Billion in 2004, US$2.9 Billion in 2005) remittances constitute about 0.7% of GDP (2004) (Ibrahim, 2006). While these figures are likely to be a significant underestimation due to issues with data collection, clearly the remittance market is not of the scale of India, Turkey or Mexico, and does not represent the proportion of GDP of some African and small island states. However, in Indonesia, migration for work and the associated remittance transfers occurs in pockets with the majority of migrants coming from Kalimantan, Lombok and East and West Java (Depnakertrans).

In some areas, the contribution of remittances is much higher as a percentage of Gross Regional Domestic Product (GRDP) than the contribution at national level to GDP. In Ponorogo District in East Java, in 2004, for example, remittances constituted 104% of GRDP. However, with the commercial banking sector more focused on consumer and corporate lending in the cities and with the MFI sector stuck in a rather un-dynamic growth pattern – the financial services sector is not responsive at the local level. That is, financial service providers are not in the habit of developing products and innovations to suit a particular region, such as more convenient transfer services and other financial products specially tailored for migrants in areas of dense migration.

2.4 Interest rates and prudential regulations affecting non-bank sector growth

To meet the recommendations of the Financial Action Taskforce and the IMF's Know Your Customer (KYC) requirements it is important for banks that adequate information is collected about remittance transfers. Indonesia has introduced regulations for Banks, NBFIs and Non Financial Companies to report on their international transactions and foreign exchange handling (Bank Indonesia reg 1/9/PBI/99, 4/2/PBI/2002 and associated circular letters). NBFIs are described as including insurance companies, pension funds, securities, venture capital funds, payment companies and other bodies that manage community funds. Banks are required to report transfers to and from Indonesia, payments to non-residents and foreign exchange transactions between citizens. For transactions above US$10,000 an explanation must be provided on who is transferring the money, the relationship between the transactors and the purpose of the transaction. Under US$10,000 information on transfers can be combined and categorised according to the currency and type of account. Banks, NBFI and Non Financial Institution Companies must all provide a monthly transaction report and a bi-annual position report to BI.

Commercial and rural banks are required to implement KYC principles through policies and procedures to identify and assess customers, monitor accounts and transactions and manage risk (Act 15/02 on the Crime of Money Laundering, BI reg. 3/23/PBI/2001 on the Implementation of KYC principles and BI reg. 5/23/PBI/2003 on the Implementation of KYC principles for rural banks). These policies and procedures must be submitted to BI. A Centre for Reporting and Analysis of Financial Transactions (PPATK) was established in 2002. All Banks are required to report suspicious transactions to the PPATK (Act. 15/2002, Act 23/2003).

Information and data on remittance transfers is also important for both BoP figures and providing information for potential investors in the remittance market. Statistics on remittance inflows are collected as part of the preparation of BoP figures. BI receives information on the numbers of migrant workers and these numbers are then multiplied by the standard wage for each country. These figures are matched with the value of "all residual balance of payment" transfers once the figures from other BoP categories are extracted to estimate the value of remittances. Because information on the purpose of transactions is not collected on individual transfers under US$10,000 it is impossible to collect information directly on remittance transfers. Official figures are commonly assumed to significantly underestimate the actual numbers so it is likely that remittance figures are also highly underestimated.

2.5 Tax treatment of remittances

There is dearth of information relating to the issue of taxation and remittances in Indonesia. Under the normal income tax regime, remittances may be classified as taxable. Income tax in Indonesia is progressive and ranges from 5% to 30%. Remittances which are transferred as savings from overseas may be exempted.

To avoid incidental double taxation on income earned, Indonesia has signed agreements (tax treaties) with 50 countries. This includes some of the main destinations for overseas Indonesian workers such as Saudi Arabia, Malaysia, Singapore and Taiwan.

2.6 Financial intermediation

In many countries increased financial intermediation for migrants and their families occurs as financial institutions offering transfer services seek to attract migrants to other financial products such as savings, credit and insurance products etc. This is one of the reasons why the involvement of the MFI sector in the transfer market is seen as positive.

In Indonesia, increased financial intermediation for migrants has largely been the product of government programs. For example, the Department of Labour and Transmigration (Depnaker) and some of the banks including Bank Mandiri, BNI, BCA and Bank Danamon, are collaborating to encourage migrant workers to open bank accounts by offering special low fee accounts to migrant workers with a low minimum opening balance (reduced from the usual Rp 100,000 to 10,000) (Didik *et.al,* 2006).

In addition, there are programs in place to help migrant workers finance the down payments on their overseas work contracts. In Indonesia, migration for work, in the mind of the Indonesian public, is synonymous with the exploitation and abuse of migrants, particularly of women who travel overseas to work as domestic servants who form the bulk of the migrant worker population. One well known aspect of this abuse is the charging of illegally high fees (*pungutan liar*) by migration placement agents (PJTKI) who loan the funds to the migrants and then extract repayments through salary cuts.

In 2005 Depnakertrans decreed that all financing of migrants must be carried out with the cooperation of the Banking sector. The logic was that the availability of finance through the banking sector, should remove the need to borrow from the high cost agents. The agents would still facilitate the placements but the banks would finance the migrants and PJTKI would go as guarantor to the loans. KLBI – TKI funds, one of the streams of credit that was devolved from BI (UU 23/99), have been channeled through the banks for this purpose. A number of programs are already being carried out. Depnakertrans is working with the Bank of China Trust, Indonesia, to facilitate credit for TKI going to work in Taiwan and with Bank Mandiri to provide credit to Indonesians travelling to Taiwan and the Middle East (InterBankNews.com, 2007).

The Government is promoting the role of the BPRs in the provision of pre-departure finance for migrants. Under this program, BPR provides lending from their own resources in cooperation with commercial banks, insurance agencies and reputable PJTKI. BI sees migrant workers as a potentially profitable market for developing the BPR. Some programs are already underway. For example, the BPR, Bank Pasar Kulo Progo in Yogyakarta has a Memorandum of Understanding with a PJTKI that is an agent for many companies in Malaysia (InterBankNews.com, 2007).

2.7 Promoting investment of remittances – Developing the MSME sector

The extent to which migrants have an investment or a consumption orientation in the spending of remittances is another issue that has bearing on the development impact of remittances. While consumption spending is more stable, investment spending has more impact on long-term poverty reduction and sustainable development. Thus, there is thus an international consensus that investment spending of remittances should be encouraged. Such options might include local real estate markets or the purchase of bonds issued by local governments. More broadly, as many migrants and remittance recipients come from poorer households, support for micro-enterprises is essential to encourage options for investment of remittance income.

In Indonesia the Micro, Small and Medium Enterprise (MSME) sector is the Government's target sector for poverty reduction. It is recognised that the sector weathered the crisis in a way more formal sectors did not and that it makes a significant contribution to the economy. In Indonesia UMKM employ 79 million people, contribute 56.7% to GDP and 19.9% of non-oil exports (Primahendra, 2006).

However, as discussed above, financing for MSMEs is fairly minimal. The Government has a policy to develop the BPR sector as a means to finance MSME. It has developed a blueprint for the BPRs which include institution building, upgrading the regulatory framework, enhancing the effectiveness of supervision, capacity building, improved industry infrastructure, the development of a microfinance policy and a linkage program between commercial banks and BPR. The linkage program, which was launched by the BI Governor on 24 August 2005 involves the funding of BPR by commercial banks through three mechanisms. These are:

- channeling - whereby the BU would provide loan funds to the BPR for on lending to UMKM
- executing - where the BPR would act as an agent of the commercial bank in providing loan funds to the UMKM and joint financing

- program has also included a parallel program for Sharia Banks (Media Informasi BPR, Sept 2005)

At this stage the scale of rural banks is still small; total BPR assets are less than one percent of the total assets of the banking sector (InterBankNews.com 2006). However, BPR assets constitute 15% of the total assets of the microfinance sector (Media Informasi BPR, Sept 2005). Some of the initiatives to strengthen the BPR sector may be effective in enhancing the role of BPR in supporting the MSME Sector.

There are several pilots projects being undertaken working towards the establishment of an Apex bank for BPRs such as the LDA BPR in Central Java. Some of the proposed benefits of establishing the Apex institution including increased liquidity for BPRs, networked IT systems and a national network of ATMs and more competitive savings products. It is anticipated that eventually the Apex Institution may become an independent institution or commercial banks owned collectively by the BPRs which would allow the BPRs better access to funding by giving them a central platform to negotiate with potential funders (Media Informasi BPR, December 2005). If the BPR were to move in this direction it would not be unfeasible for the BPR to begin to be drawn into the payments system, if not for international transfers at least for domestic payments. However, a fair bit of development of the sector is still required before getting to that point.

3.0 RESULTS AND FINDINGS

3.1 Research methodology

Four villages in two sub-districts within the regional administrative area of Blitar in East Java were chosen for analysis: the villages of Bendosari and Maron In the sub-district of Kademangan, and the villages of Kalipucung and Sumberingin in the sub-district of Sanon Kulon.

Field study was carried out from June to August 2006. A structured survey was administered to 220 respondents from 163 migrant households and 57 non-migrant households. The non-migrant households were surveyed to provide a comparison on issues of income, household expenditure and livelihood activities. Respondents were selected via a purposive sampling method whereby the head of village was asked to identify households to participate in the structured survey. Researchers interviewed the household head or the migrant (if he or she had returned permanently or temporarily from migration). In the surveys, respondents were asked questions about their livelihoods, living conditions, use of financial services including money transfers services, loan and savings services, how remittances were used and their impacts on the living standards and livelihoods. In addition, in-depth interviews were carried out with 21 migrant households and focus group discussions were held with migrants and their family members, community leaders and other community members. The in-depth interviews explored issues relating to migration in more depth and the focus group discussions on the village livelihoods issues, the impact of migration and the use of financial services and villagers' aspirations.

3.2 Characteristics of remitters

The vast majority of migrant households (84 per cent) were receiving remittances from a single migrant, 15 per cent were receiving payments from two migrants, and two households were receiving payments from three or more overseas sources. Remitters ranged in age between 17 and 55. There was little difference between men and women in age profiles, with a mean age of 31 for male migrants and 30 for females. The migrant education profile was low: only one migrant had a post-secondary qualification, two thirds had some secondary education, and the remaining third had not progressed beyond primary school. In keeping with their limited skills base, migrants were overwhelmingly concentrated in unskilled manual occupations. Women comprised 60 per cent of migrants, and more than 90 per cent of women were employed as housemaids. Around two thirds of male migrants were employed as construction labourers, while others worked in other unskilled occupations as drivers, factory workers, farm labourers and kitchen hands. Only three migrants, all male, were employed in supervisory or skilled occupations: one as a construction boss and two as technical workers.

Malayasia was the largest destination country, accounting for 43 per cent of migrants, followed by Hong Kong (27 per cent) and Taiwan (14 per cent) (Table 2). With the exception of Malaysia, where more than 85 per cent of male migrants were concentrated, there are limited offshore labour markets for Indonesian male workers. Women were found in a more diverse range of destination countries, due to strong demand for domestic servants across the East Asia region.

Table 2: Destination country by gender

	Male	**Female**	**Total**
Malaysia	64	18	82
Hong Kong	1	50	51
Taiwan	-	26	26
Singapore	1	11	12
Other n.e.s*	8	11	19
	74	**116**	**190**

* Brunei (9), Saudi Arabia (8), Kuwait (1), South Korea (1)

For most of the sample households, migration is a serial short-term phenomenon: the typical pattern is for one or two migrants to work overseas for up to five years before returning home; then after a few months the original migrant or another household member takes up another job abroad. Nearly two thirds of the migrant-sending households had previous overseas experience, including 10 per cent with a history of three or more previous migrations. At the time of the survey 51 per cent of migrants had been away for less than two years, 32 per cent had been away for 2-5 years and only one migrant had been away for more than 10 years. Nearly all migrants intended to quit their overseas jobs and return home within three years of the survey date.

3.3 Household livelihoods and income

The occupational profile in each of the case study villages is described in Table 2. The villages are based primarily on rice agriculture, with secondary crops of corn, soy bean and peanuts, but as agriculture does not provide a sufficient livelihood, most villagers have secondary income sources. Livestock such as goats, cows and chickens are reared, and forest and plantation products such as palm sugar and teak are collected. Other common microenterprises include trade, taxi-driving and tempe and tofu production, and many households derive some wage income from labouring work. Chicken farming for eggs is an important activity in Bendosari and Maron. Chicken farming is a larger scale enterprise than goat or cow rearing that requires much more capital but is potentially lucrative. In each of the villages there are over 100,000 chickens. In Bendosari villagers have been rearing chickens since the 1990s, however many households went bankrupt during the 1997 financial crisis as the price of inputs (feed and medicine) rose dramatically. There is a large local industry in teak furniture production. In Maron, villagers engaged in focus group discussions estimated that about 30% of the villagers were engaged in furniture making using the teak from state forest within the village. The large number of villagers engaged in this business is putting pressure on supplies. The villagers also lack skills, mechanised tools and access to markets, and are hit with heavy licensing fees.

Bendosari and Maron are 19 and 23 kilometers respectively from the regional town of Blitar. Bendosari is on the coast and Maron is slightly inland, with forest lands surrounding two border sides. Both villages are south of the river Berantas which divides the district of Blitar in half. The southern side is less fertile than the northern side, which is close to an active volcano and where the river branches into many subsidiaries providing water to the villages. Bendosari and Maron lack irrigation systems and practice dry land agriculture and rain-fed paddy cultivation. In most years only one annual rice crop can be planted, as well as one other crop if the rains are good. Kalipucung and Sumberingin are on the north side of the river, closer to Blitar (Kalipucung is adjacent to Blitar and Sumberingin is eight kilometers away) and are more fertile. Three harvests can be undertaken in a year (two rice crops and one *palajiwa*). The villages still suffer from water shortages in the dry season when water must sometimes be bought. Dryness affects food for livestock who eat grass and forest foliage.

In the 1950s and 60s Maron was a support base for the *Partai Komunist Indonesia (*PKI), which was targeted and maligned by the Soeharto Government. Maron was cut off from Government projects including infrastructure projects such as the building of roads until

1985. The village was thus very poor and hunger and malnutrition was widespread. In the early 1990s villagers started going overseas for work both as legal and illegal immigrants. Approximately 500 villagers are now working or have worked overseas. Migration for work has had a big impact on the village.

The higher-income villages of Kalipucung and Sumberingin on the northern side of the Berantas River are more closely engaged with the non-farm economy. In Kalipucung, land is in short supply. The majority of villagers own less than 0.25 hectares and many work as agricultural labourers. However, because the village is close to the city of Blitar other work is available. Factory work is available in chicken factories which produce up to five tons of eggs a day and in a Japanese owned furniture factory. Also, a higher proportion of villagers work as public servants or in the police or army than in any other of the villages. Many villagers also work as small-scale traders. Sumberingin possesses highly fertile land but also supports a large number of traders and livestock rearing activities. In addition to, there are areas of Sumberingin with rainfall all year around that are suitable for fresh water fish farming and seven hectares are used for that purpose within the village. There is also an active palm sugar industry, which used to be popular in Kalipucung but is less so now as the villagers there consider the work too hard.

Table 3: Main local income sources

Main occupation	No. of households	Per cent
Farming	3265	44.7
Farm labour	1484	20.3
Non-farm wage/salary employment	899	12.1
Microenterprise	1664	22.8
Total	**7312**	**99.9**

As Table 4 indicates, there is a vast income gap between migrant and non-migrant households. Non-migrants earn more than migrants from local income sources, particularly from microenterprises, which earn over three times more than those operated by migrant-sending households. However, remittances are far higher than local income sources, and as a result, migrant households earn more than twice as much on average as those which do not receive remittances.

The fact that migrant households earn less than non-migrants from local activities suggests that local income sources are to some extent displaced by remittances, and contributes to a very high level of remittance dependence among migrant households, averaging 82 per cent of household income. A fifth of migrant households had no local income sources at the time of the survey and relied entirely on remittances, and a further 10 per cent supplemented their remittances with very low-income farm-based activities earning less than $10 per month. Only 25 per cent of migrant households operated microenterprises, in comparison with 53 per cent of non-migrants.

Table 4: Mean household income by village and income source ($US per month)

Occupation	Migrant households	Non-migrant households
Farming and farm labour	23	30
Microenterprises	20	75
Non-farm wage/salary employment and other n.e.s	13	16
Remittances	249	0
Total	**305**	**121**

3.4 Remitting behaviour

The average size of migrant-sending households was 3.6 (excluding the migrant), and more than two thirds of household contained at least one child under 16. Nearly half of the households (46 per cent) consisted of parents receiving remittances from sons or daughters overseas, while 42 per cent consisted of husbands or wives receiving remittances from their spouses. In addition, female household heads sending money home to their children comprised 15 per cent of female migrants.

Migrants remitted an average $152 per month. Women remit more than men, averaging $173 and $118 respectively. The highest remitting destination on average is Singapore ($206), followed by Hong Kong ($198) and Taiwan ($151), while Malaysia was one of the lowest, at $110. These findings are consistent with data on remittances by occupation, which indicate that remittances from the male-dominated construction worker and agricultural labourer categories are among the lowest, at $97 and $115 respectively, compared with an average value of $174 for housemaid remittances. The highest-remitting occupations in the sample were drivers ($318) and technical workers ($271), although this data should be treated with caution due to the small number of observations.

Most households receive remittances infrequently: around 10 per cent received payments on a monthly basis and a third received three to six payments a year, while more than 50 per cent reported receiving fewer than three payments a year. In addition, more than a third of respondents reported that migrants brought cash with them when they returned home on completion of a contract or on holiday, with an average value of $416, and 28 per cent reported receiving in-kind remittances of TV sets, DVD players, jeweler and gas stoves.

3.5 Household expenditure

In addition to the amount of money that migration injects into the community, another issue that affects the impact of migration on the local economy is how the remittances are spent. Indonesian Government officials often lament the consumption rather than investment orientation among migrants. Our study showed a mix of consumption and investment spending by migrants. The most frequently mentioned item was routine household spending followed by savings, education, loan repayments and capital for an enterprise. The high incidence of ‘routine spending’ as the most frequent item mentioned for use of the most recent transfer suggests a dependence on remittance transfers among recipient households.

The most frequent change in expenditure since migration is being able to build a house (reported by 43 per cent of migrants), purchase of a vehicle (38 per cent), educate children to high school (35 per cent) and buy land (27 per cent). Housing was very important for migrants. Almost all migrants had either or planned to “upgrade” their house from bamboo or tin to brick or to do extensions on their existing brick house. It is common in Indonesia for people to build their house in stages as funds become available. People will live in houses with un-plastered walls and unfinished floors as they slowly finish building the house over a number of years. Among rural community members, if a household is able to build a brick house then they may feel reduced pressure to raise their earning capacity. Other factors that put pressure on household income are children’s education costs and health costs.

3.6 Remittances and microenterprises

The extent to which investment spending of remittances can improve the long term livelihood prospects of migrant households is limited by the impediments to the development of the enterprises of these households. Micro-enterprises, such as those which the respondents are engaged in, employ a majority of Indonesians. These enterprises generally have a number of characteristics including:

- scale of enterprise which is too small to cope with the cost of inputs
- lack of patrons and connections which means that micro-entrepreneurs often pay high costs and fees.
- limited access to credit
- low level of investment
- lack of formal training and low level of technology leading to poor product quality
- either direct marketing to consumers in local markets or supplying distant market through traders. Traders create a monopolistic market through forcing the price and supply of goods.
- a small number of workers employed
- no differentiation between personal and business resources

In spite of their many problems, micro-enterprises were able to withstand the financial crisis while other sectors collapsed. Supraktikno has pointed out some key advantages of MSMEs:

- a core element of the economy which other sectors depend on
- accustomed to elastic profit margins
- gather in clusters so that which enables them to generate some shared benefits in purchase of materials and use of skills and marketing.

The structural limitations and characteristic of micro-enterprises are such that, while they have durability as a means of survival, they are difficult to strengthen and develop including from remittances. This can be seen in regard to the enterprises of the households interviewed.

Chicken farming, for example, requires a high level of investment: about Rp 40 million. Because community members lack access to capital they have an arrangement with a monopoly trading company, PT Poltry whereby it sells inputs and buys produce from the chicken farmers. Chicken farming has very elastic profit markets due to the volatility of sale prices and of inputs, which are either imported (medicines) or difficult to access at particular times of the year (feed). When market conditions are favourable, such as they were at the time of interview (the price of eggs was Rp 7000 per kilogram), profits could be approximately Rp 3 million per month. If the price is low, however, the farmer can only just cover costs. In addition to the volatility, chicken farming is high risk due to the high level of morbidity and mortality among the birds. All of this risk is borne by the farmers and the anecdotal evidence of our survey suggested that is was not at all uncommon for farmers to go bankrupt and lose their entire investment.

Furniture making is popular in the village of Maron. The furniture makers buy teak from village members growing teak on their land to make chairs, doors and tables, amongst other things. They have not had any formal training but have generally picked up the skills from their neighbours. They use simple traditional tools and sell their product in local markets. The villagers lack access to capital, which might enable them to upgrade their tools, because their land has not been properly registered. Furthermore, banks are reluctant to take land which is not close to main roads as collateral. The villages would like to receive skills training and access to markets further afield, including export markets.

Over time the availability of teak is decreasing as more community members are taking up furniture making. Often it is necessary to buy wood from outside the village including wood that has not yet been felled. Due to laws intended to curb illegal logging, licenses are required for cutting trees and government fees are incurred every time any logging is carried out. Fees must be paid at village levels, sub-district levels and to the forest department, *Perhutani.* In the focus group discussion the villages stated that even when they had paid the fees they would often have to bribe police when transporting materials.

Other micro-enterprises are also subject to limitations. Circular traders buy ready made goods and only have access to limited local markets and there is a limit to how much these enterprises can be bolstered by additional investment. Farmers may buy more land, which will increase their earnings, but they are still subject to the availability of water, the quality of seed and other inputs and access to markets. Because of the multifaceted limitations on their enterprises, community members tend to have a survival, rather than an expansionary orientation. Migration helps them to fund key expenses such as housing, healthcare and education which are a struggle to pay for without the cash injection from overseas work. While they may also direct their earnings towards their micro-enterprises, this may not result in a dramatic improvement in their income earning capacity. Productive assets – such as vehicles – may be sold later on if funds are short.

3.7 Vulnerability of migrant workers to extortion

Aside from transfer costs, another factor that cuts into migrants' income is the fees paid to migration agents. The fees cover the cost of flights, passports, visas and health checks, as well as a placement fee. There is substantial evidence that some migrants are charged exorbitant fees, with 14 per cent of respondents paying between $500 and $1,000 to migration agents, and 8 per cent paying between $1,000 and $1,500. Over three quarters of migrants borrow to finance pre-departure costs, and the vast majority of these took loans from migration agents, with fewer than 25 per cent taking loans from banks or informal sources of finance.

Being deceived, stolen from and 'ripped off' are other factors that negatively impact on remittances. The study did not collect quantitative data on such issues, however there were a number of anecdotes that emerged through the in-depth interviews. For example, a respondent from Bendosari paid Rp 15 million to work in Malaysia but for two years all that his employer gave him was cigarettes. Another respondent made his down-payment to go to Malaysia but the company went bankrupt and he lost his money.

Migrant workers are highly vulnerable to theft and extortion and they have little protection from the law. Women workers in Saudi Arabia (who are unable to leave the house and therefore manage their own transfers, and illegal migrants in Malaysia are particularly vulnerable). The fact that migrants seem to be more inclined to make transfers through the bank and less inclined to carry cash has reduced their vulnerability to theft, although many remittance recipients are still concerned about carrying large amounts of cash on the journey back from collecting the transfer in Blitar city.

4.0 FINANCIAL SERVICES

4.1 Transfer methods

Over 70 per cent of households used financial institutions to transfer remittances, and 12 per cent used informal methods, in most cases cash brought back by the migrant or a friend. Only four respondents reported using Western Union, and only one used the postal service. Nearly all remittances were taken entirely in cash: only 15 per cent of respondents reported using direct deposit facilities for remittances. Transfer costs are relatively low, at around $8 per transfer. Recipients typically pay an administration fee of $1-3. Recipients were generally poorly informed about transfer costs, which are borne predominantly by the migrant, but discussions with returned migrants indicated an average sending cost of $3-5 per transfer.

Table 5: Institutions where transfers were collected

Transfer agency	Per cent
Bank Rakyat Indonesia	17
Bank Negara Indonesia	61
Other bank	8
Western Union	2
Informal methods	12
Total	100

Another transfer-related expense is the cost of travel to the bank to pick up the transfer. Most respondents have to travel to Blitar, as this is where all the money transfer providers are located, apart from BRI which has branches at sub-district level. Two thirds of the respondents live more than 10 kilometers from Blitae, and fifth live more than 20 kilometers away. Several respondents said that they would travel 3-4 times into town when collecting the transfer because once they got the call from the migrant that the transfer had been paid, they weren't exactly sure when the transfer would be made. From the more remote villages of Bendosari or Maron every trip would cost about $5, adding considerably to the cost of the transfer.

Table 5 above shows from which financial institutions transfers were received. BNI is the most popular bank for transfers, even in the more rural villages, despite the fact that BRI is much closer to the homes of most migrants. There was a perception that the BRI sub-district unit office was a stand alone unit and not linked to a network of banks. There was also a perception that the fees were higher, although BRI staff stated that there is no charge to receive a transfer. For example, one respondent said that when Rp 1 million (approximately $1,100) was transferred to his BRI account, only Rp 910,000 was paid out.

4.2 Savings accounts

In 55 per cent of migrant households, at least one household member maintained a savings account at a bank, MFI or savings and loans group. Non-migrant households were less likely to hold savings in a financial institution, at 39 per cent. Given that the majority of respondents use banks to transfer remittances, it is likely that the higher level of savings accounts among migrant households may be due to coming into contact with financial institutions through the process of arranging money transfers. For most migrants, the household savings account was the account into which remittances were transferred. As Table 6 shows, the use of savings and loans groups/cooperatives for saving was limited, except for PIDRA groups which were quite well utilised by community members in Bendosari and Maron where the PIDRA microfinance project operated (see section 5.3).

Table 6: Savers: financial institutions in which savings are kept

Financial Institution	Per cent
Bank Negara Indonesia	52
Bank Rakyat Indonesia	22
Other banks*	7
PIDRA	12
Other savings and loans groups and cooperatives	7
Total	**100**

* Bank Central Asia, Lippobank, Bank Mandiri

More than three quarters of respondents who operate savings accounts with banks prefer to conduct transactions over the counter rather than using an ATM. The most commonly cited reason for not using ATMs was the fees charged, however some respondents also said that they were too poor or too old to understand them.

4.3 Loans

In general, migrants are less likely than non-migrants to take a loan from a financial institution. Kalipucung is the only village where a smaller percentage of non-migrant households had loans than migrant households. In the focus group discussions in Kalipucung group members specifically mentioned the reluctance of villagers to borrow money from financial institutions. A number of reasons for this reluctance were given by the villagers, including embarrassment at having their house surveyed, a preference for borrowing from family members rather than from institutions, a lack of knowledge about bank products, repayment regimes that are unsuitable for farmers whose income is seasonal, complicated procedures and a feeling that borrowing from banks introduced a burden in their lives that they would rather be without.

A total of 88 respondents, of whom 58 were from migrant households, reported having taken a loan from a financial institution. Around 40 per cent of borrowers had taken a loan from a bank. BRI, which operates a well-established microcredit program, is the largest bank lender, accounting for the majority of bank loans. In other commercial banks, which do not issue microcredit, the effective minimum loan size is above $5,000, placing them outside the credit market for migrant families. Thus the BNI Bank, which is the preferred remittance transfer agency and where most savings accounts are held, was not named as a lending institution by respondents.

Sixty per cent of the respondent borrowers took loans from MFIs. A number of MFIs are well-established in the Blitar region, reducing dependence on informal lenders, and only one respondent reported taking a loan from a moneylender. The villages closer to Blitar have a greater variety of MFIs with banking licenses including BPRs, Bank Jatim and Village Credit Banks. In the rural villages these institutions have less of a presence. The

BPR sector has received much attention from the government in recent times as a potential ‘motor’ for the micro-enterprise sector. There are nine BPRs in Blitar, and these are located in six sub-districts and have branches in other sub-districts. The study was able to get data on five BPRs and found that they had approximately 21,000 savings accounts with BPRs and disposed 9000 loans. The average loan size for a BPR is about Rp 2-3 million. The BPRs seem to have reasonable coverage of the Blitar district and more appropriate loan products than the commercial banks, but still there was little reach from the BPRs among the respondents surveyed.

The Largest source of micro edit loans, at 56 per cent, was the IFAD loan project, PIDRA, which focuses on the empowerment of poor communities living in the upland areas of three Provinces, East Nusa Tenggara, West Nusa Tenggara and East Java, and operates in the survey villages of Bendosari and Maron. PIDRA aims to increase the incomes and food production of about 100,000 poor families living in the 500 poorest villages in the three provinces. PIDRA does this by inviting the target beneficiaries to participate in voluntary self help groups (VSHGs) which are a vehicle to provide a range of support services including savings and loans facilities, business development services and training in financial management. PIDRA has selected the poorest members of the community to participate in the groups and adopted an approach of encouraging independence and empowerment among group members. The project has also assisted with the improvement/maintenance of village infrastructure and natural resources.

The study findings show the PIDRA Project to have broad outreach, as it stands out at the biggest source of loans for households. However, in general the loan sizes are very small. Loans are provided through savings and loans groups (the VSHGs) where members are required to attend monthly meetings and provide a contribution. Program funds were not provided for six months while the members received training in financial management. After this, tranche funds were provided to a maximum of Rp 10 million over three years depending on the performance of the group.

In the PIDRA project, skills training was also provided in organic fertilizer making, home industries (tempe and tahu), chicken farming and other activities. The groups were able to pursue their own strategies and some of the groups had taken up livestock breeding where the group would purchase livestock (goats and cows) and lend them to group members for rearing and breeding. While respondents appreciated the approach of the PIDRA project (particularly in Bendosari) the loan sizes, which were generally under Rp 500,000, were too small to really help their businesses. No further funding was available after the first three years, it was up to villagers to grow the funds through their SLGs or access outside funding. Village level “federations” have been created to support the process of accessing outside funds, among other things.

The P4K project was also active in Maron where 13 farmer groups, with sixteen members per group, had been established by the project. The P4K project was much more generous, providing Rp 7 million grants to each member over a five year period. Not surprisingly, villagers in Maron preferred the P4K project to the PIDRA project. Another interesting savings and loans group was the Kelompok Rukun Mulya (KRM) that was started by a group of villagers in 1983 who made about Rp 15 million selling rocks to a government project asphalting the road. With some of the money they formed a savings and loans group. The group now has 70 members and Rp 100 million circulating. Loans are provided for up to a year with three percent interest. There are even members joining from other villages.

Particularly in the villages further away from the city, where financial institutions are scarce and social cohesion is strong, community members seem to be good at running savings and loans groups. There may be potential for forming a remittance based group which would enable migrating households to “grow” their remittances while providing capital for other village members. Another service which would also be useful would be the transport of remittances from the banks in Blitar to the local village. A cooperative or SLG could combine this function with providing loans.

5.0 CONCLUSIONS AND POLICY RECOMMENDATIONS

5.1 Conclusions

The key conclusions of this study are:

- The impact of migration and remittances has been significant. However, the cost of transfers and of obtaining employment contracts has reduced the potential impact on receiving households.
- Most remittances are transferred through the banking system. Direct transfer costs were generally low, but the distance traveled to collect remittances adds significantly to transfer costs.
- The central bank of Indonesia allows the handling of remittances by fully fledged commercial banks only. The only entry by an MFI into the money transfer market is BRI which is a state owned bank with a specific mandate for microfinance.
- Current regulations stipulate that Banks and other non-banking agencies report on transfers to and from the country. Banks are also required to implement Know-Your-Customer (KYC) policies to identify and assess customers, monitor accounts and transactions, and manage risks.
- The spending of remittances has been for both consumption and investment such as housing, education and capital for an enterprise. However, the MFIs are not able to leverage remittance flows effectively due to various constraints such as legislation, the remoteness of remittance receivers and consumer preference for commercial banks.
- Savings and loans groups, particularly in the more rural villages, were well managed by the villages and were a useful contribution to the communities, although in the case of the PIDRA project, the funds available were too small.

Establishing rotating funds for remittances, which would also provide a service transporting the remittances from the district capital to the villages, would be a potentially useful way to develop the contribution of remittances.

- The study findings suggested that rather than emboldening migrants to develop their enterprises by using their remittances as a down-payment, migrants might be less inclined to borrow than non-migrants. Further investigation of this issue is required.
- Microenterprise development is constrained by the high costs of inputs, lack of skills, lack of access to markets and exploitative relationships with law enforcers and government bureaucracy.
- The Indonesian Government is perceived as not having done enough to support its citizens working overseas. Efforts to improve financial services for migrants have been limited. There are a few programs aimed at increasing financial intermediation among migrants and involving the banking sector in pre-departure loans. However, the financial services industry itself is not well disposed to innovating and developing services for migrants due the structure of the industry itself. The commercial banks are not orientated toward micro-finance and MFIs, although numerous, remain small and fragmented and not responsive at the local level.
- Theft and non-payment by employers and exorbitant pre-departure fees charged by migration agents were problems for migrant workers.

5.2 Recommendations

1. Integrate cooperatives and MFIs into the finance system

The analysis of the economies of four East Java villages supported the findings of other studies that financial intermediation between commercial banks and rural communities is low, particularly in regard to the provision of credit. The work that is being done to support the BPRs is important, but it is unlikely to be sufficient to really boost the micro-enterprise sector. The BPR sector remains small and constrained by a stifling regulatory regime (eg. the very high minimum capitalisation requirements) and low human resource capacity.

On the other hand, in the villages studied, savings and loan groups flourished. In a number of cases (PIDRA, PKK, Koperasi Rukun Jaya) villagers were able to grow seed funding through savings and loans groups over a number of years. Funding for these groups came from within the villagers' own resources and/or government/donor projects. Commercial funding was not available. Given the success and importance of these groups in the village contexts, it is good that project support is available to provide seed funds and provide capacity building in financial management activities. Commercial funding would allow the villages to access finance to a level that is appropriate for the scale of their business. The limits on loan sizes in government programs are often set too low to be of real use to the villagers' enterprises. This was found this to be the case with the PIDRA project.

There are a range of reasons for the reluctance of the banks to fund micro-enterprises, including the conservatism of the sector in the aftermath of the Asian financial crisis. But one thing that is not supportive is the way in which cooperatives are vertically integrated. The supervision, regulation and funding of cooperatives is organised separately from the financial sector (through the Department of Cooperatives) and this pretty much categorically prevents them accessing commercial finance from the banks (unless it is as part of a government program).

Regardless of the specific role of cooperatives, ideally there should be space for a range of providers to grow. Diversity should be encouraged by a regulatory environment that provides a tiered structure of prudential and non-prudential regulations allowing for providers of different scope and capacity. The MFI Law, when it is finally released, will recognise and support this principle. In particular, consideration should be given to how the cooperative sector is integrated into the financial system.

2. Pilot a program of transferring remittances from the district capital to the village

The study identified that the majority of transfers were done to the BNI which is located at the level of district town. Travel from rural villages to district towns to collect transfers was a source of complaint by remittance recipients due to the cost of transport and fear of theft on the journey home. Further, it was found that funds circulating in savings and loans were effectively managed and used by the villages. It would be useful if there was a way in which remittance recipient households who wished to bank their remittances could do so within a savings and loans cooperative located in the village. In this way while they were not being used, the funds could be available as finance to other villagers.

One way in which cooperatives/savings groups might be able to attract remittance-receiving households to bank their money with them would be if they were able to provide facilities transporting remittance transfers from the district capital to the village. Due to regulatory issues and the rudimentary stage of development of the payments system, it is likely that the only way in which this could work would be if remittances were sent to an account at a commercial bank held by the cooperative. The Government or another development partner may be interested in supporting a pilot project along these lines.

3. Address the impediments to micro and small enterprise development in a holistic manner

The study found that while lack of credit was a major impediment to the development of micro-enterprises, it was not the only one. There were a range of issues facing development of villagers' micro-enterprise development such as a dearth/high cost of inputs, lack of skills training, lack of technology and lack of access to markets. The influx of funds from remittances will not transform micro-enterprises if there are structural impediments holding them back. To seriously support the development of micro-enterprises, there needs to be a good understanding of all the issues and how they fit together.

There is a need for more analysis to better understand micro-enterprises in Indonesia. Micro-entrepreneurs should be connected with a range of resources to support them in their different areas of need. Ideally, community members should be supported to seek out and access the resources they need rather than waiting for resources to come to them through government projects with limited life-spans.

ACRONYMS

ADB - Asian Development Bank
APEC - Asia Pacific Economic Cooperation
ASEAN - Association for Southeast Asian Nations
BCA - Bank Central Asia
BNI - Bank Negara Indonesia (Central Bank)
BI - Bank Indonesia
BoP - Balance of Payment
BPD - Village Development Bank
BPR - *Bank Percreditan Rakyat* (People's Credit Bank or rural banks)
BRI - Bank Rakyat Indonesia
BU - Bank Umum
GDP - Gross Domestic Product
GDRP - Gross Regional Domestic Product
IFAD - International Fund for Agriculture Development
IMF - International Monetary Fund
KSP - *Koperasi Simpan Pinjam* (name of cooperative)
KBU - *Kelompok Tani* (name of cooperative)
KYC - Know your Customer
MFI - Microfinance Institution
MSME - micro, small and medium enterprises
PIDRA - Post Crisis Programme for Participatory Integrated Development in Rainfed Areas
PJTKI - Migrant Placement Agents
PKI - *Partai Komunist Indonesia*
PKK - Kecematan (Sub-District) Development Program
P4K - Income Generation Project for Marginal Farmers
Rp - Ruppiah
SLG - Savings and Loan Group
VSHG - Voluntary Self Help Groups

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