

20 Aceh's economy: prospects for revival after disaster and war

Peter McCawley

20.1 INTRODUCTION

Aceh has a troubled history (Box 20.1). During much of the last century, and notably during the three decades to 2005, local conditions across much of the province were hardly conducive to sustained economic growth and development. Although the development process proceeded apace across most of the rest of Indonesia, throughout much of this period broadly based development in Aceh was slow. Today, widespread poverty is still a major problem in many parts of Aceh and the challenges to be faced of promoting growth remain daunting.

In order to consider options for a development strategy during the period ahead, this chapter will first survey trends in Aceh during the past decade (section 20.2). It will then outline the key development challenges facing Aceh today, focusing first on the impact of the aid program and the 2005 Helsinki peace agreement, and then on the policy issues that need to be considered to promote development (sections 20.3–20.7). Finally, it will set out some of the main points of a development strategy for Aceh (section 20.8).¹

1 This chapter draws on the extended discussion of development challenges in Aceh set out in a study prepared for the United Nations Development Programme (UNDP) by Aspinall, Hillman and McCawley (2012). See Dawood and Sjaifrizal (1989) for an earlier, valuable survey of economic developments in Aceh in the 1970s and 1980s.

BOX 20.1 CHRONOLOGY OF EVENTS AFFECTING ACEH

1945	Indonesian independence.
1976	4 December: Hasan di Tiro declares independence for Aceh and forms the Free Aceh Movement (GAM).
1981	Zaini Abdullah (the current governor of Aceh) leaves Indonesia to live in exile in Sweden, where he stays for over 20 years.
1989	August: President Suharto declares a Military Operations Area in Aceh, usually referred to as the Daerah Operasi Militer (DOM) policy. The policy remains in force until 1998.
1998	August: DOM status is withdrawn three months after President Suharto resigns.
1999	National government legislates the initial <i>reformasi</i> -era laws on decentralization.
2001	March: Following continuing armed clashes in Aceh, the Indonesian cabinet declares GAM to be a 'separatist movement'.
2002	During 2002 and 2003, under President Megawati Sukarnoputri, the central government pursues efforts to establish arrangements with GAM for special autonomy for Aceh within the Unitary State of the Republic of Indonesia. Agreement cannot be reached, however.
2003	19 May: President Megawati imposes martial law in Aceh and declares a military emergency.
2004	National government legislates further <i>reformasi</i> -era laws on decentralization.
2004	26 December: Tsunami mega-disaster occurs, with an estimated death toll in Aceh of 167,000.
2005	January 15: Foreign Minister Hassan Wirajuda announces that the Indonesian government will resume peace talks with GAM.
2005	15 August: MOU signed in Helsinki.
2006	Law 11/2006 on the Governing of Aceh promulgated.
	11 December: Gubernatorial elections held in Aceh.
2007	8 February: Irwandi Yusuf sworn in as governor of Aceh for the five-year period from 2007 to 2012.
2012	25 June: Zaini Abdullah sworn in as governor of Aceh for the five-year period from 2012 to 2017.
2013	Matters of the provincial flag and emblem arise, posing difficulties for Aceh/ national government relations.

20.2 DEVELOPMENTS SINCE 2000

The past decade has been a tumultuous period for Aceh. In order to consider both the opportunities and the challenges that Aceh is facing today, it is necessary to consider the difficult situation in the province in the period after the turn of the century, and then the recent history of transformation since 2005.

In the first few years of the post-Suharto period, during the transition to the *reformasi* (reform) era, there was much political change across Indonesia and considerable political upheaval in Jakarta as several presidents came and went in quick succession. There was turmoil in Aceh too, but of a different kind. In the early 1990s the central government had initiated military operations against the separatist Free Aceh Movement (*Gerakan Aceh Merdeka*, GAM) and around 12,000 troops had been deployed to the province. Clashes between the Indonesian military and GAM were common, with frequent allegations of human rights breaches on both sides. Orderly governance in the province was barely possible. In many areas local government was badly held back.

Then, in the immediate post-Suharto period after 1998, the leadership of GAM became emboldened and the level of tension in Aceh rose markedly, especially in some of the more densely settled areas along the eastern coast.² In May 2003, President Megawati Sukarnoputri imposed martial law in Aceh and the central government launched a military offensive. As a result, in the period up to December 2004 when the tsunami struck, over 40,000 soldiers and police officers were engaged in operations against GAM.

The mega-disaster of the great Asian tsunami of 26 December 2004 effectively ended the period of open military hostilities between the central government and GAM. But the long period of conflict reflected deeply held views about the way that Aceh should be developed. The numerous issues that had underpinned the conflict – political, religious, social and economic – remained to be addressed.

The sustained tensions that these issues give rise to in current policy affairs is evident in various ways. For one thing, across Acehnese society there is a continuing deep suspicion and resentment of the central government, and of any institution (such as the Indonesian military or international oil and gas companies) that is seen as having close connections with Jakarta. Also, although Aceh is relatively peaceful for the time being, GAM supporters continue to maintain strong influence in

the province. Talk of full independence from Indonesia may have been set aside, but the long period of conflict has left a determination among GAM leaders to continue to press for greater autonomy from Jakarta.

The continuing – perhaps even growing – importance of GAM can be seen in the key roles that individuals with connections to the organization have had in the province, both in the past and currently. Two of the most well-known figures with close GAM links are the former governor, Irwandi Yusuf (who held the position from 2007 to 2012), and the current governor, Zaini Abdullah. Numerous other senior figures in the province are associated with GAM and support its aspirations for the future of the province.

Within this context, it should perhaps be noted that the goals and expectations of many members of the Acehnese elite have, for many decades, been ambitious ones. The gap between expectations, on the one hand, and the reality of what changes can reasonably be hoped for, on the other, appears to be large. Until that gap can be narrowed, it seems likely that there will continue to be much discontent in Aceh.

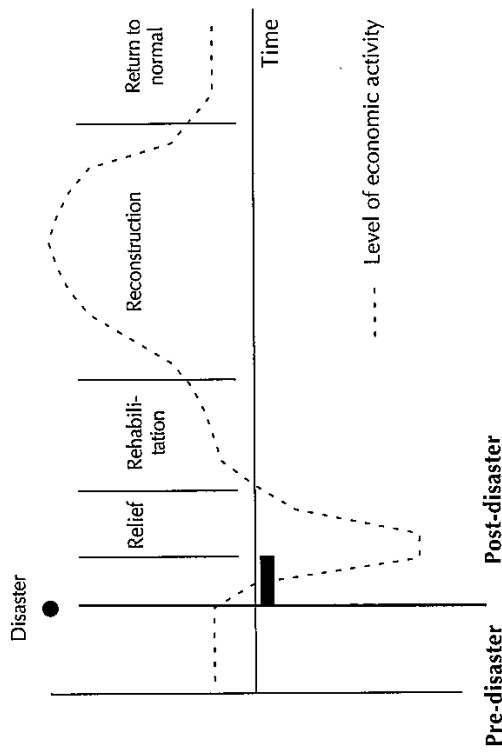
It is against this background that the two key events of the December 2004 tsunami mega-disaster and the peace settlement for Aceh agreed in Helsinki in 2005 together mark a turning point in the recent history of the province. The first event took the lives of perhaps 170,000 people. The disaster quickly led to the design and delivery of a large relief and reconstruction program in Aceh generally estimated at around \$7.5 billion over five years.³ The second event brought an end to the longstanding regional conflict across the province that had held back development for over two decades (World Bank 2008: 16). The peace settlement greatly facilitated efforts to strengthen the processes of orderly governance in Aceh.

Looking back over the post-tsunami recovery period to the end of 2010, it is difficult to disentangle the long-term effects of the large aid program on the one hand and of the 2005 peace settlement on the other. But difficult though the task may be, it is important to consider the inter-relationship between the two. For one thing, these two remarkable events are important case studies. Both have generated a large international literature that attempts to distil lessons that may be useful in comparable situations in other parts of the world. For another thing, the longer-term implications of the two events continue to affect events in Aceh today and are relevant in considering a development strategy for the province in the period ahead.

2 A useful survey is provided in the Wikipedia reference for 'Insurgency in Aceh' at https://en.wikipedia.org/wiki/Insurgency_in_Aceh.

3 A detailed overview of the first two years of the post-tsunami aid program in Aceh can be found in Nazara and Resosudarmo (2010).

Figure 20.1 Stages of response in Aceh following the tsunami



Source: Jayasuriya and McCawley (2010: 25).

20.3 AID TO ACEH

The overall post-tsunami aid program to Aceh, consisting of both international assistance and, importantly, a very large domestic Indonesian involvement, was a remarkable effort (Jayasuriya and McCawley 2010). The program began soon after the tsunami and was composed of a myriad of individual aid programs of varying effectiveness delivered over the next five years until around 2010. During this period, the activities of both Indonesian agencies and international donor agencies passed through a number of phases (Figure 20.1). Three main aspects of this aid program had important long-term implications for growth and governance in Aceh.

First, to a significant degree the economic effects of the aid program came to dominate the formal sector of the non-oil economy in Aceh for the five years following the tsunami. There was, not surprisingly, a surge in both financial and real flows of goods and services into the province, and especially into the tsunami-affected areas near Banda Aceh and along the west coast. This surge – which in some localized areas was very large relative to the size of the local economy – brought both benefits and challenges. Some of the assistance provided much needed physical assets

such as food and clothing, medicines, fishing boats, computers to assist with administration and so on. But just as important in terms of the economic impact on the local economy was the dramatic call on resources (both local and imported) generated by the remarkable increase in financial spending through aid programs.

A sharp increase in demand for local resources following a disaster can generate significant strains. This is what happened in various areas in Aceh – especially the disaster-affected areas – following the tsunami. In effect, shock followed shock. First, there was the trauma and shock of the natural disaster itself. Soon after, there was the economic and administrative shock of dealing with the demands arising from the response of well-meaning aid agencies to the disaster.

In Aceh the second shock led, not surprisingly, to 'Dutch disease' challenges for the local economy. This is an economic phenomenon that arises when there is a sudden, sharp increase in financial flows into a region. In essence, there is a local boom. The Dutch disease phenomenon increases demand for local human and physical resources; depending on the supply response, this is likely to stimulate increased employment, cause localized inflation and often lead to an inflow of goods from nearby regions and perhaps imports from overseas.

There were various manifestations of the Dutch disease phenomenon in Aceh. One of the earliest was a jump in prices for hotel rooms, and for the limited supply of well-furnished housing and offices, as the sudden influx of large numbers of aid workers led to a steep increase in demand. There was also a sudden, urgent need for well-trained Indonesian staff with appropriate skills, so local wages for skilled labour tended to increase quite quickly. Later in 2005, and into the next few years as a major construction boom got under way, prices for inputs into construction activities tended to rise as well. Some of these inputs were tradable and could be purchased from other parts of Indonesia, such as the neighbouring province of North Sumatra, but others (such as land) were not tradable and thus local prices tended to rise.

A second consequence of the large aid program was that, in effect, three parallel systems of administration were operating in Aceh during the five-year period from 2005 to 2009. First, there was the usual Indonesian structure of central (*pusat*), provincial and district/municipality (*kabupaten/kota*) governance arrangements. The normal governance link between Jakarta and Banda Aceh had been disrupted somewhat in 2004 when former governor Abdullah Puteh was forced to resign following corruption charges. He was replaced in early 2005 by acting governor Mustafa Abubakar, who administered the province until newly elected governor Irwandi Yusuf took office for the five-year period from 2007 to 2012.

However, administrative arrangements became more complicated in early 2005, shortly after the tsunami, when the central government established the Aceh-Nias Rehabilitation and Reconstruction Agency (Badan Rehabilitasi dan Rekonstruksi, BRR). BRR was formed to oversee much of the administration of the post-tsunami aid program and for some years became almost a parallel administration in Aceh.

The multitude of organizations making up the international donor community active in Aceh in the post-tsunami period made up yet a third layer of administration. Nominally, these organizations were accountable to the Indonesian central government, the provincial government and BRR, but in practice they often operated with a considerable degree of independence.

While officials in the different systems tried their best to coordinate activities, some problems of setting objectives and implementing programs were inevitable (Nazara and Resosudarmo 2010: 115). The three different systems were often, to some extent, working towards different political and governance goals. To complicate matters, their internal administrative procedures were rather different. One result of this situation was that governance arrangements within the province of Aceh did not really converge towards the arrangements that prevailed in most other provinces until 2010. And even when BRR and most international donors had ceased work in Aceh, some difficult post-tsunami issues, such as the vexed and complex one of arranging the transfer of valuable post-tsunami assets, needed further attention.

Another result of the complicated governance arrangements in the province in the period up to 2010 was that the difficult task of designing a program to implement the provisions of the 2005 Helsinki memorandum of understanding (MOU) was, in effect, postponed. Like many agreements of its kind, the Helsinki MOU was a compromise document that left a range of items on which there was disagreement to be resolved at some later time. It is likely that, on one side, the central government hoped that GAM supporters would be prepared to drop some of their demands over time, while on the other side, the GAM delegates believed that further gains might be possible once they had been able to strengthen their position in Aceh.

A third consequence of the presence of the large aid program was to concentrate the attention of many senior policy makers on the challenges of reconstruction in the disaster-affected areas of Aceh. This was, of course, understandable. However, it meant that, over time, communities in other parts of Aceh, such as the poorer districts in southwest Aceh (including Nagan Raya, Southwest Aceh, South Aceh and Aceh Singkil) felt increasingly neglected. A lot of money seemed to be being spent in places like Banda Aceh. Poor communities in other areas increasingly

began to wonder why the much vaunted bonanza of international aid brought them so little benefit.

In addition to these considerations, a major policy issue that remains unresolved relates to the 'linking relief, rehabilitation and development' (LRRD) process. Debates about LRRD have received much attention in the international disaster literature in recent years. The central issue relates both to the timing of the delivery of assistance and to the broad goal of aid programs following a disaster: should money be spent quickly so as to provide fast relief, or should an important underlying goal be the promotion of long-term development? The different views on these issues are important because they are reflected in the design and delivery of aid programs after disasters.

The issue of the long-term sustainability of activities supported by aid programs following mega-disasters such as the 2004 Asian tsunami was addressed in a major report released in early 2009 (Brusset et al. 2009). The promotion of the broad sustainability of activities supported by humanitarian aid programs following disasters is not an issue that the international aid community has learned to deal with especially well. It is true that the global aid community has given much attention to challenges of sustainability in the context of environmental issues. However, it has found it much harder to ensure that international aid activities, including humanitarian aid activities following disasters, are sustainable in the broad sense of remaining viable once donor support stops.

By late 2009, Aceh had entered the transition to a return-to-normal phase. Commenting on the need for a 'post-tsunami paradigm', the Banda Aceh daily, *Serambi Indonesia*, summarized some of the main concerns as follows:

... [S]tudies of post-disaster reconstruction are marked by the speed of infrastructure development in Aceh. But there is no guarantee that things will get better, or become more peaceful, or that there will be prosperity. The reality is that large amounts of funds have flowed into Aceh but have not reached out to touch basic social and real needs, especially for those who are economically, politically, socially and legally vulnerable. Good roads and luxurious buildings can exist alongside people who are still living in barracks, suffering from bad nutrition, and not getting health and education services – and this is both a bad precedent as well as an indicator that development in Aceh is still below what it should be. Furthermore, there are certain groups who aim to create disturbances in Aceh and who are irresponsible, discriminative, and who form 'organized gangs' with the potential to do damage in Aceh ('Mengubah paradigma pascatsunami' [Changing the post-tsunami paradigm], *Serambi Indonesia*, 26 December 2009).

Senior policy makers in Aceh in 2010 were well aware of the fact that the past benefits from the tsunami reconstruction and rehabilitation process would not be sufficient to overcome the wide range of social and

development challenges in the province. What was less clear was how to design a viable post-tsunami development strategy.

20.4 THE 2005 HELSINKI PEACE AGREEMENT

The other key event in the recent history of the province was the signing of the 2005 Helsinki peace accord. Earlier attempts to broker an agreement between GAM and the central government had failed, and in 2003 the security situation had deteriorated sharply once again (Box 20.1). But following the dreadful event of the tsunami there was a renewed determination on both sides – arguably for a range of different reasons – to try once more to reach agreement.

In mid-January, less than four weeks after the tsunami, Indonesian foreign minister Hassan Wirajuda announced that the Indonesian government would resume talks with GAM representatives. Events moved quickly. Within two weeks, talks between delegations from both sides began in Helsinki in Finland. The negotiations were difficult and threatened to break down on several occasions. But eventually an acceptable compromise was reached and a peace agreement was signed in Helsinki on 15 August 2005.

Three aspects of the peace agreement were central to the restoration of medium-term stability and growth in Aceh. First, it was agreed that fighting would stop, that GAM would demobilize and that it would surrender all arms and explosives it possessed. Second, key arrangements were put in place to allow for the political participation of 'Aceh-based political parties' across the province. This opened the way for GAM to become an accepted, active political organization in Aceh. Third, it was agreed that a new Law on the Governing of Aceh would be promulgated to provide significantly increased authority to key leaders and stakeholders in Aceh.⁴

These three elements of the Helsinki MOU, along with other supporting parts of the agreement, provided acceptable political room for both GAM and the central government to cease hostilities. It is true that the MOU left important matters of disagreement to be settled in later discussions. But these unresolved issues notwithstanding, the Helsinki agreement represented a turning point in ending the longstanding regional conflict in Aceh (Aspinall 2005).

As many senior GAM supporters in Aceh still see things in 2013, some of the main central promises set out in the Helsinki MOU have not been

met. One of the main reasons for this is that, for various reasons, GAM supporters were not in a position to press for the further implementation of the provisions of the MOU until the main post-tsunami assistance effort had ended. After that, the tussle for influence within GAM between supporters of Governor Irwandi Yusuf and followers of traditional GAM figures such as Zaini Abdullah served to further divert the attention of supporters from the issue of implementation of the Helsinki MOU. It was only when Abdullah defeated Yusuf for the governorship of Aceh in 2012 that GAM judged that the time was right to return, after a period of seven years, to a political program of renewing pressure on the central government to implement key parts of the agreement.

20.5 STOCKTAKE OF THE ECONOMY

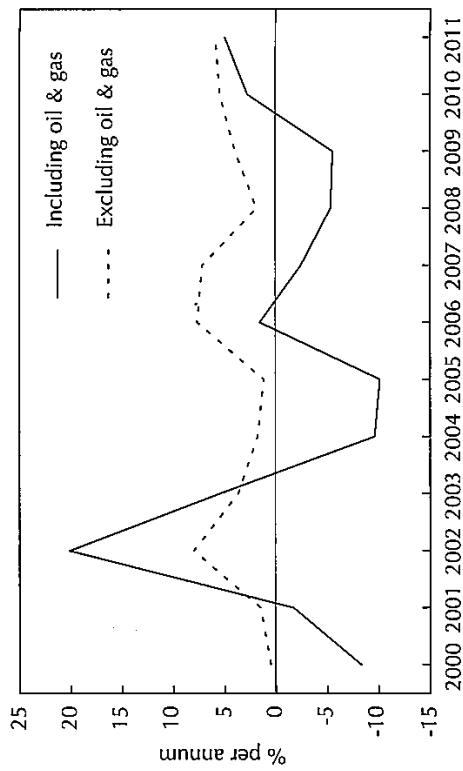
Economic analysis of the overall performance of the Acehese economy in recent years is complicated by the fact that the regional economy is marked by two distinct forms of dualism. The first is the sectoral dualism reflected in the difference between the resource-rich oil and gas part of the economy (concentrated particularly around the Lhokseumawe area in the district of North Aceh) and the non-oil and gas sector. The second is the urban-rural dualism reflected in the different levels of development in the better-off urban areas (especially Banda Aceh) and in the other parts of the province that do not have oil and gas resources.

The sectoral dualism of the Acehese economy is clearly evident in gross regional product (GRP) data. At the broadest level, total GRP (including oil and gas) has fluctuated markedly since 2000 (Figure 20.2). Moreover, average annual real growth over the 12-year period from 2000 to 2011 was *negative* 0.7 per cent (Table 20.1). Clearly, in overall terms, the Acehese economy has performed very poorly during the past decade.

But a second view of the regional economy that focuses on non-oil and gas activities is just as useful. Production operations in the oil and gas sector are mainly enclave activities that have few direct linkages with the rest of the regional economy. When they are excluded from the regional economic statistics, a rather different picture emerges. Economic growth in the non-oil and gas sector has fluctuated markedly since 2000, but not nearly as sharply as in the oil and gas sector (Table 20.1). The main characteristics of the growth pattern in the non-oil sector since 2000 are, first, positive though somewhat disappointing growth (of around 4 per cent on average over the 12-year period), and second, a boom of sorts in 2006 and 2007, presumably reflecting the stimulus following the post-tsunami aid and reconstruction effort.

4 This was achieved in 2006 with the passage of Law 11/2006 on the Governing of Aceh.

Figure 20.2 Real economic growth in Aceh, including and excluding oil and gas, 2000–11



Source: BPS and BPPA (various years).

In reviewing the current state of the Acehese economy, it is also helpful to survey recent patterns of economic growth in the province at the sectoral level. These indicate marked variations in growth patterns. The steady downward trend in oil and gas output shows up in the sector's sharp negative contributions to overall growth in the province (Table 20.1). In contrast, the non-oil sectors of the economy show stronger signs of growth. Not surprisingly, the impact of the tsunami is reflected in output in several of the main sectors in 2005. In the agriculture, utilities, construction and finance sectors, growth was held back in the immediate wake of the tsunami. There was then strong growth in several key sectors in 2006 and 2007 as spending on rehabilitation and reconstruction began to gather pace. The construction sector expanded by a remarkable 48 per cent in 2006 and another 14 per cent in 2007. There were also marked increases in output in several other sectors (trade and hotels, and transport and communications) resulting from the large increases in aid spending.

The net result of these differences in growth rates in different parts of the Acehese economy was that the structure of the economy changed dramatically during the 12-year period from 2000 to 2011. The contribution of the oil and gas sector to GRP fell sharply from over 40 per cent in 2000 to under 20 per cent in 2011. Within the non-oil and gas sector,

Year	Agriculture	Oil & gas	Manufacturing	Trade, hotels & restaurants	Other services	Total (including oil & gas)	Total (excluding oil & gas)
2000	1.5	-21.6	-11.3	-1.1	5.0	-8.3	0.5
2001	-3.2	-5.4	-31.3	11.3	11.8	-1.7	1.5
2002	2.1	34.8	61.6	2.2	7.5	20.1	8.0
2003	3.3	7.3	1.6	2.5	6.1	5.5	3.7
2004	6.0	-20.3	-37.3	-2.7	12.4	-9.6	1.8
2005	-3.9	-23.8	-5.1	6.6	4.3	-10.1	1.2
2006	1.5	-7.3	1.1	7.4	21.7	1.6	7.7
2007	3.6	-19.9	8.5	1.7	5.2	-2.4	7.2
2008	0.8	-23.1	3.6	4.6	1.1	-5.3	1.9
2009	2.6	-36.6	4.5	4.9	4.7	-5.5	4.0
2010	5.0	-11.7	6.4	6.4	5.2	2.8	5.5
2011	5.6	-0.6	5.9	6.8	5.6	5.0	5.9
Average	2.1	-10.7	0.7	4.2	7.6	-0.7	4.1

Table 20.1 Real economic growth in Aceh, 2000–11 (% p.a.)

Source: BPS and BPPA (various years).

the shares of agriculture and the tiny non-oil manufacturing sector also fell slightly, while the services sector, broadly defined, expanded (Figure 20.3).

In summary, the broad trends evident in the recent data on economic growth across the province are the following.

- Overall growth in the non-extractive economic sectors has been significant but not high since 2000 – on average, about 4 per cent per annum.
- In the oil and gas sector, large and continuing reductions in output have markedly affected the overall provincial growth rate.
- Tsunami spending provided a significant boost to activity in the non-oil and gas sector, especially in 2006–07. However, just as the initial burst of tsunami spending stimulated growth through a positive economic multiplier effect, so the winding down of activities appears to have contributed to a slower growth rate through a negative multiplier effect.
- Economic activity appears to have accelerated in 2010–11; nevertheless, economic growth in Aceh has remained significantly below the average growth rate for the overall Indonesian economy.

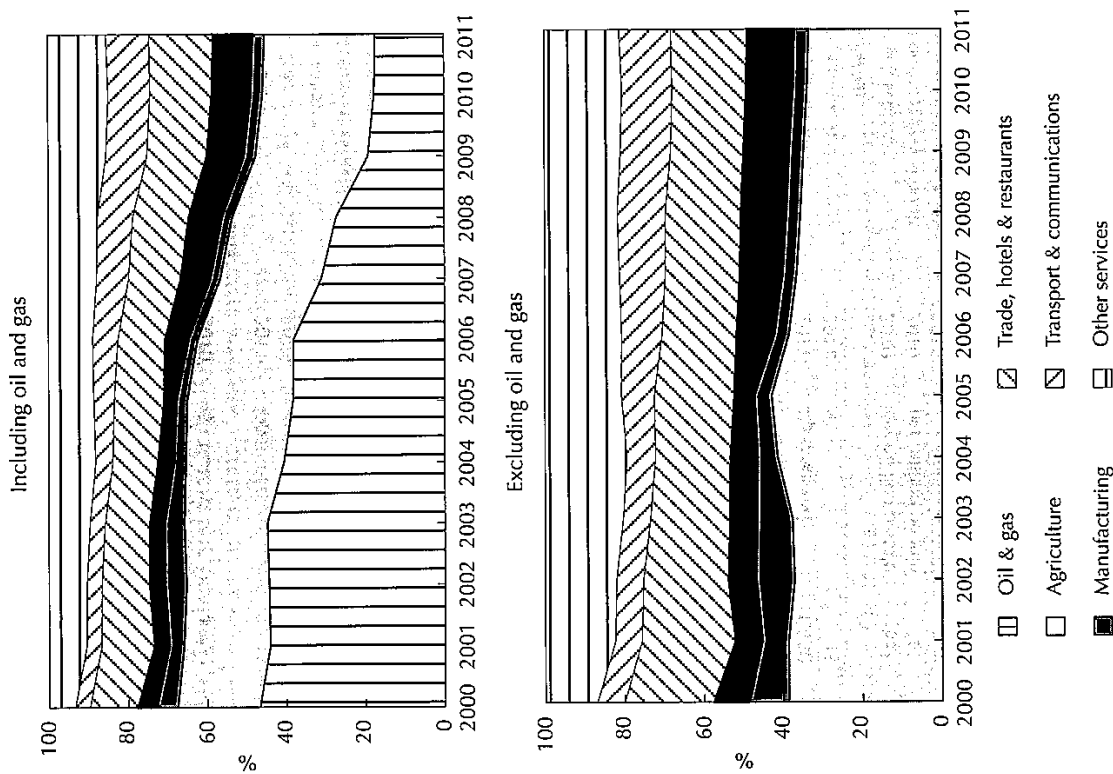
Looking ahead, a key priority for economic policy makers in Aceh is to accelerate growth in the non-oil sector. To do this, they will need, on the one hand, to adjust development programs to deal with the impact of the sharply declining contribution from the oil and gas sector, and, on the other hand, to build on the various physical and institutional assets that now exist in the province following the significant boost to development provided by the post-tsunami assistance programs.

20.6 ISSUES OF SIZE

In reviewing the structural aspects of the provincial economy and in thinking about economic policy, it is useful to take note of absolute magnitudes (Table 20.2). In monetary terms, bearing in mind that the population of the province is around 4.5 million, the economic magnitudes being discussed are not large. Total GRP in 2011, including the oil and gas sector, was around Rp 86 trillion (approximately \$8.6 billion). GRP excluding oil and gas was around Rp 72 trillion (\$7.2 billion).

These magnitudes are important. First, Aceh is one of the so-called resource-rich provinces of Indonesia, with both the advantages and challenges that this brings. One of the main advantages is the expanded flows of natural resource revenues available to Aceh. One of the main

Figure 20.3 Sectoral shares of gross regional product in Aceh, including and excluding oil and gas, 2000–11



Source: BPS and BPPA (various years).

Table 20.2 Selected key facts: Aceh and Indonesia

	Year	Unit	Aceh	Indonesia
Population				
Total	2010	million	4.5	237.6
Population density	2010	per km ²	77	124
GDP & income per capita				
GDP	2010	\$	7.8	642
Rp per year per capita	2010	Rp thousand	17,223	27,030
\$ per year per capita	2010	\$	1,722	2,703
Government				
Provinces	2011	no.	1	33
Districts	2011	no.	23	497
Subdistricts	2011	no.	287	6,747
Government expenditure				
Aceh province	2009	Rp trillion	9.8	
		\$ million	980	
Aceh districts	2009	Rp trillion	10.4	
		\$ million	1,040	
Indonesia	2010	Rp trillion		1,042
		\$ million		104,000
Economic structure				
Workforce				
Agriculture	2010	%	46	40
Manufacturing	2010	%	5	13
Construction	2010	%	6	5
Trade, hotels & restaurants	2010	%	18	21
Transport & communications	2010	%	4	5
Other services	2010	%	21	15
Total	2010	%	100	100
Minimum wage				
Rp per month	2011	Rp thousand	1,350	989
\$ per month	2011	\$	135	99
Education				
Primary schools	2010	per million people	858	696
Junior secondary schools	2010	per million people	267	185
Senior secondary schools	2010	per million people	87	45
Health				
General hospitals	2009	per million people	9	6
Public health clinics	2009	per million people	69	37
Poverty				
Urban	2010	% poor	13.7	9.2
Rural	2010	% poor	21.9	15.7
Total	2010	% poor	19.6	12.5

Source: BPS (2011), Statistik Indonesia.

disadvantages is the pressures arising from the Dutch Disease phenomenon, including, importantly, a loss of economic competitiveness when compared with other provinces in Indonesia, especially the nearby province of North Sumatra, which is generally better endowed with facilities (such as the main port of Medan).

A second aspect of the magnitudes is that, in economic terms, the Aceh economy is small. Some comparisons provide context. The Aceh economy in total is somewhat less than 2 per cent of the Indonesian economy, and much smaller than the neighbouring economies of Malaysia, Thailand and Singapore. Obviously, the differing population sizes need to be borne in mind. However, even allowing for the relative sizes of populations, the differences are striking.

Size has a number of significant policy implications. Most individual production units (farms, firms and equivalent units) in Aceh are, in economic terms, very small indeed. The Establishment Census, which collects data on non-agricultural firms in Aceh, reports that in 2006 approximately 750,000 people were employed in almost 370,000 enterprises across the province. Several things are striking about this situation. First, the overwhelming majority of enterprises were really micro-enterprises, employing just one or two people. Only a few firms had over 10 employees. This structural feature of the Aceh economy is very significant, because production units of this kind are quite unable to achieve modern economies of scale. Second, most enterprises (over 90 per cent) reported that they had no legal status. In effect, the great bulk of enterprises were operating in the informal sector with little direct contact with the formal institutions of the state. Third, the majority of people were active in just two areas: trading and manufacturing. In the former sector, the operation of small-scale stalls and shops was presumably the main activity, while the supply of manufacturing services, such as the repair of cars and motorcycles and the manufacture of simple metal-based products, was included in the latter category.

The policy response towards this phenomenon of smallness needs to be two-fold. On the one hand, appropriate packages of support (credit, infrastructure, marketing arrangements) need to be designed to fit the special needs of micro-entrepreneurs, especially female entrepreneurs. On the other hand, policies are needed to encourage the development of larger firms, because it is unrealistic to imagine that an economy composed almost entirely of micro-firms can compete successfully with the larger firms that exist in nearby economies such as North Sumatra (Medan), Malaysia and Singapore.

Another aspect of size is reflected in provincial government expenditures across Indonesia. As noted earlier, because Aceh is one of the resource-rich provinces, its provincial revenues benefit from the tax

revenues received from the resource sector. This allowed the provincial government of Aceh to maintain a level of total budgetary expenditure in 2011 of around \$800 million, or around \$175 per person per annum.

Three aspects of this level of provincial expenditure need to be noted. One is that it is relatively high by Indonesian standards. For example, in 2011 the average level of per capita expenditure by provincial governments in Java (excluding the special case of Jakarta) was a remarkably low \$24 per capita.

Second, although high by Indonesian standards, the level of expenditure in Aceh is extremely low by international standards, and severely limits the level of services that can be provided to the community. Similar levels of government in rich OECD countries (in provinces, or province-like, jurisdictions) often maintain levels of annual spending of around \$6,000–8,000 per capita. Thus, whether the level of spending by the Aceh provincial government is seen as high or low depends entirely upon the benchmark that one chooses to use as a measuring rod.

A third aspect to note is that although the main focus of this chapter is on the processes of government at the provincial level, expenditure at the district (*kabupaten/kota*) level is important as well. In Aceh, total expenditures at the district level in 2011 (of around \$1.2 billion) were about 50 per cent more than spending at the provincial level (\$800 million). For Indonesia as a whole, expenditures at the district level in 2011 (of almost \$40 billion) were roughly three times the total amount of expenditures controlled by provincial governments (\$13 billion). The clear implication of this situation is that many of the challenges of provincial budget management are just as relevant for budget management at the district level in Aceh.

20.7 THE PROBLEM: LOOKING AHEAD

Looking ahead, from the point of view of governance and capacity building in Aceh, there appear to be two fundamental challenges that need to be addressed. The first is to promote economic growth, especially in a way that creates jobs and supports income-earning activities in small-scale activities. The second is to convert government financial revenues obtained from the resource sector and other revenue areas into public goods (roads, water supplies, electricity, health, education) that supply services of tangible benefit to the majority of the population. More specifically, it is useful to consider four strategic issues that require immediate attention: widespread poverty, and the associated need to promote development; rural policy; the role of the provincial government; and the proliferation (*permekaran*) of local governments across the province.

Poverty

Various surveys have drawn attention to the enduring problem of poverty across Aceh. The World Bank's (2008) *Aceh Poverty Assessment* discusses trends in detail, as do numerous other studies prepared during the past few years (Cosgrave 2009a, 2009b; BPS, Government of Aceh and UNDP 2010). The key findings of the different surveys may be summarized as follows.

First, the 2004 tsunami caused huge economic damage as well as enormous personal and psychological loss in the affected areas; the province-wide impacts, however, were more limited. The largest damages and losses were generally concentrated in the areas directly affected by the disaster. Although province-wide measured poverty increased slightly after the tsunami, the statistical increase in poverty was rather short-lived. Among other things, the provision of relief, rehabilitation and reconstruction aid, in many different ways, appears to have been effective in helping alleviate the expected impact of the tsunami on poverty.

Second, setting the effects of the tsunami aside, widespread poverty has been a major problem in Aceh for decades. Largely because of the effects of conflict across the province, which have, among other things, greatly hampered rural development, Aceh has had poverty levels well above those seen in most other regions in Indonesia in recent decades (BPS, Government of Aceh and UNDP 2010). The high levels of poverty, especially in rural areas, are closely correlated with low or negative overall economic growth across the province. Although the main reason for slow growth was the longstanding conflict affecting the province, structural economic issues (connected especially with the large oil and gas reserves on Aceh's east coast) also appear to have affected the pattern of economic development. One central challenge in the immediate future, therefore, will be to promote economic expansion in ways that help to sustain social stability and peace in the province.

Third, poverty in Aceh (using conservative poverty levels) is especially marked in rural areas. In 2012, over 20 per cent of rural households were living below the poverty line (Table 20.3). Bearing in mind that the rural poverty line was approximately Rp 308,000 (\$31) per person per month – which is significantly below the widely used international poverty line of \$1.25 per day – it is clear that rural poverty is widespread in Aceh. Non-income characteristics associated with high poverty are the ones that are common in many developing countries, such as large households, low education levels, a high proportion of female-headed households and a high share of households predominantly dependent on agriculture. Issues affecting women – including access to assets (land, housing and other assets), pressures of household maintenance and care of children, opportunities to earn income and protection against

Table 20.3 Poverty in Aceh, March 2012^a

	Number of poor (thousand)	Poor as share of total population (%)	Monthly poverty line	
			Rp thousand	\$
Aceh				
Rural poor	737	22	308	31
Urban poor	172	13	350	35
Total poor	909	19		
Total population	4,600			
Indonesia				
Rural poor	18,400	15	229	23
Urban poor	10,650	9	267	27
Total poor	29,230	12		
Total population	241,180			

a Data are approximate. Total population data and poverty data are from different surveys, so some totals do not match exactly.

Source: BPS (2012), *Statistik Indonesia*.

violence – became particularly important in the post-tsunami period. All these issues had important implications for household incomes (IDLO and UNDP 2007; BPS, Government of Aceh and UNDP 2010).

Rural policy

Rural policy is a second strategic issue that needs attention. Given the patterns of poverty across the province, pro-poor development programs during the return-to-normal period will need to focus on promoting growth in both agricultural and non-agricultural activities in rural areas. One main step will be to implement programs at the province-wide level to promote overall economic growth (World Bank 2009). In recent years, the Indonesian government has aimed for a national growth rate of around 6.5 per cent per annum.⁵ It would seem that similar rates of

5 Details of the economic growth targets for the period to 2014 are set out in the National Medium Term Development Plan for 2010–2014 (Rencana Pembangunan Jangka Menengah Nasional 2010–2014), released in February 2010. A useful summary may be found at World Bank (2010). See also the growth targets set out in the Masterplan for the Acceleration and Expansion of Indonesia's Economic Development 2011–2025 (MP3EI).

growth at the provincial level in Aceh will be needed to make significant inroads into poverty.⁶ However, it is also necessary to recall that different patterns of economic growth have different impacts on the overall level of poverty. Economic growth that has a higher poverty elasticity is more beneficial to the poor. But a significant share of the overall measured economic growth in Aceh during the past decade or so has been of a capital-intensive nature in enclave activities in the oil and gas sector. In general, economic growth of this type often fails to have regional spread effects that benefit the poor. This appears to have been the case in Aceh. Indeed, the 'enclave development' pattern of growth in the province was identified as a challenge for policy makers over 20 years ago, when Dawood and Sjafrizal (1989: 122) noted that 'The challenge for the provincial government is to harness the indirect effects of the [oil and gas] boom to develop the potential for the rest of the economy'. This is a challenge that still needs to be addressed by policy makers in Aceh.

To make inroads into poverty, especially in rural areas, a second main policy step is to find ways of encouraging development that are pro-poor. In particular, an increasing emphasis on development in rural areas is needed during the return-to-normal period to address concerns that some aspects of the post-tsunami assistance have been too urban-oriented. Measures would appear to be needed on both the supply and demand sides of local rural economies in Aceh. On the supply side, programs to increase the productivity of farmers would help to increase output. But it is very discouraging for farmers to put effort into increasing production only to find that it is difficult to sell their goods. Thus, on the demand side, programs to improve access to markets are also needed. Improving rural infrastructure (roads, markets, village infrastructure) would help improve access to markets for farmers as well as create jobs and stimulate local economies. Indeed, it was measures along these lines that Dawood and Sjafrizal (1989: 122) identified two decades ago to promote development in Aceh:

[T]o ensure efficient resource allocation and exploitation of the province's abundant natural resources, continuing massive investments in infrastructure – particularly roads – are required. All the major agricultural subsectors have considerable potential if the current transport bottlenecks can be removed. ... [I]n conjunction with these investments, there needs to be an expansion in agricultural extension programmes in fisheries, forestry, livestock, non-rice food crops, and selected estate crops. These measures will provide the 'unity of the dual economy' and will be important in restoring Aceh to its position as one of the most prosperous and progressive regions in Indonesia.

6 Sulaiman (2009) provides some details of steps taken by Governor Mustafa Abubakar during 2006 to promote economic growth in Aceh in the period following the tsunami.

Looking ahead, these recommendations for infrastructure investment and other supply-side measures to boost productivity seem just as appropriate today as when they were set out in the late 1980s. But other steps should also be taken to promote rural development, including programs to improve access to markets for rural producers, and targeted measures to reach the poor in rural areas.

Role of the provincial government

A third area of strategic focus relates to the relationship between the provincial government and the wider community. The political and social environment in Indonesia in 2013 is very different to that which prevailed during the Suharto New Order period. Indonesia is now widely recognized as one of the most democratic countries in Asia.

The shift towards a much more contestable political model at the national level has been reflected in changes at the local level as well. It is now quite common across Indonesia for the decisions of political leaders at both the provincial and district levels of government to be discussed vigorously by regional media (such as the daily newspaper, *Serambi Indonesia*, in Aceh) and by civil society groups. To give just one example of the way that issues are discussed in this open and contestable environment, in December 2009 a *Serambi Indonesia* columnist levelled a series of criticisms at the Aceh provincial government (Nivada 2009). The article detailed concerns regarding the administration of the Agency for the Peaceful Reintegration of Aceh (Badan Reintegrasi Damai Aceh); the work of the Committee for the Acceleration of Neglected Areas of Aceh; the activities of the Sabang Area Management Agency; the credit issues of the Regional Development Bank of Aceh; the moratorium on illegal logging; and the suggestions of increasing corruption in Aceh.

Considered in their entirety, the comments seemed to suggest incompetent administration within the provincial government. Whether this was true in the case of the particular examples mentioned is undoubtedly open to question. More generally, however, what is notable in the current environment of public discourse in Aceh is a perceived freedom on the part of civil society actors to criticize governments, as well as a willingness on the part of governments to respond to such criticisms.

Another aspect of the vigorous public policy dialogue taking place in Aceh is that discussions focus on both the formulation and implementation of policy. Some commentators press for better and clearer policies in such areas as post-tsunami policy development and government management. Others are more concerned with down-to-earth issues such as perceived shortcomings in service delivery in sectors such as health, education, basic transport, and law and order.

Proliferation of local governments

The fourth strategic issue requiring attention is the proliferation of subnational governments. In recent years, there has been a remarkable increase in the number of regional government units in Indonesia at both the provincial and district levels through the splitting of existing regions. This process has become known as *pemekaran*, literally meaning 'blossoming'. In historical terms, there was a marked phenomenon of *pemekaran* during the 1950s, especially the latter part of the decade.⁷ The process slowed somewhat during the 1960s, and then largely stopped during the long 28-year period from 1971 to 1998 comprising the main part of the New Order period. But following the surge in support for decentralization that occurred after the main decentralization laws were passed in 1999, the process of *pemekaran* led to a jump in the total number of large regional units (provinces and districts) from around 330 in 1998 to over 520 a decade later.

Although widely seen as a welcome change at the end of the Suharto era, the process of *pemekaran* has become increasingly controversial.⁸ It has presented important challenges for the government of Aceh, where 11 of the existing 21 district governments have been formed since 2000, and the number of subdistricts (*kecamatan*) increased from 243 in 2006 to 276 just two years later. The formation of so many new administrative units reflects strong local political pressures from political actors and communities who believe they will be advantaged by *pemekaran*. In February 2010, for example, demonstrations in the capital of South Aceh, Tapaktuan, obliged the district head to agree to put a proposal to the local assembly proposing the further fragmentation of the district through the formation of new subdistricts.⁹

In Aceh, as elsewhere across Indonesia, *pemekaran* has led to new demands of various kinds, affecting both the dynamics of provincial politics as well as administrative and financial arrangements. Moreover, the capacity of the administrative units varies widely.¹⁰ Importantly, the

7 See UNDP (2009: 5) for details on the historical background of the tension between centralistic tendencies and pressures for decentralization in Indonesia.

8 See, for example, the critical comments by a spokesperson for the Indonesian Human Rights Committee for Social Justice reported in the article 'Pemekaran wilayah: jumlah kota di Indonesia meningkat 57 persen lebih' [Regional *pemekaran*: total number of municipalities in Indonesia jumps by over 57 per cent], *Korpias*, 12 October 2011.

9 'Ribuan warga menuntut pemekaran kecamatan' [Thousands demand the creation of subdistricts], *Serambi*, 27 February 2010.

10 For a useful survey of financial management performance at the district level in Aceh in mid-2006, see World Bank (2007).

establishment of each new regional unit automatically leads to the establishment of a regional assembly with a full set of political powers.

This, in turn, has led to new social, financial and political debates at both the local and provincial levels. As a study by USAID-DRSP (2009: 17) has observed: 'The creation of new minorities within the new regions also holds the potential for conflict, and raises the possibility of subsequent claims for new regions or reconfiguration of regions'.

20.8 DEVELOPMENT STRATEGY FOR ACEH

At the broadest level, Aceh currently faces a daunting array of development challenges at the human, physical, and government and capacity-building levels. But now, perhaps for the first time in almost 40 years, leaders in Aceh appear to have a relatively free hand to support local economic and social reform in an environment largely free of conflict. The new governor, Zaini Abdullah, was able to win a clear mandate in the 2012 elections. Now, at this early point in his term, he is in a relatively strong position to promote change. In principle, the opportunities open to the local elite to promote effective governance are the most promising they have been since the mid-1970s.

A useful survey of the main human development challenges in Aceh can be found in the 2010 *Provincial Human Development Report* for the province (BPS, Government of Aceh and UNDP 2010). It is clear that a comprehensive development strategy for Aceh needs to set out programs for reform across numerous sectors. But in broad terms, and considering the limited resources of governments in Aceh, it would seem appropriate for both the provincial and district governments to focus on two main priorities in the period ahead: promoting economic growth, and reforming the role of government.

Promoting economic growth

A provincial development strategy for Aceh for the next five years might focus on two areas in particular. The first is to promote economic growth in ways that are pro-job and that support income-earning activities in small-scale informal-sector activities, especially in rural areas. The second is to convert government financial resources obtained from the resource sector as well as other revenue areas into public goods that supply much needed services such as roads, water supplies, electricity, health and education.

The promotion of economic growth, in turn, implies a focus on increasing the level of investment in the private and public sectors. An

effective strategy will need both to set goals and to discuss, in detail, how those goals are to be achieved.

Rural development in particular needs to be a central part of Aceh's provincial development strategy. A package of measures focusing on both the supply side and the demand side would be appropriate. A set of possible approaches to rural development might include improved infrastructure, promotion of productivity at the farm level, provision of key social services and support for the development of the private sector.

The effective mobilization and use of financial resources, especially to create public goods to be supplied to the majority of the population, should also be a central part of the provincial development strategy. Management of provincial public finances currently presents a major problem for the government of Aceh. Steps to improve the situation are urgently needed.

Reforming the role of government

Surveys of public opinion suggest that the Acehnese community looks to the government to provide peace and prosperity, and for the efficient delivery of basic public goods such as health, education, infrastructure services (water and electricity) and support for agricultural and business development. For their part, in numerous public documents and statements, governments in Aceh have committed themselves in principle to improving the supply of public services. Arguably, then, since the policy commitment is clear, the effective *implementation* of policy, rather than the more detailed *definition* of policy, is now the main priority for the effective delivery of good government in Aceh.

But the capacity of governments to deliver what is expected of them is often limited. Governments everywhere, including in Aceh, have strengths to draw on but also face challenges of implementation. For governments in Aceh to become more effective, they need to define their roles carefully. In particular, in view of their quite limited capacities, they need to decide which services will be provided directly by government agencies, and which will be supplied indirectly by relying on service providers in the private sector. In each case, the role of the government and government agencies is very different.

Looking to the future, it would seem inevitable that Aceh's provincial and district governments will need to aim to strengthen *both* the private sector across the province *and* the internal capacity of government to regulate, and to strengthen, local markets. Reform in this direction will require improved skills within government to foster the private sector, while also providing an appropriate regulatory environment for the private sector to expand.

In broad terms, an approach of this sort suggests that moving towards a more performance-based model of government in Aceh would have substantial advantages. A strengthening of mechanisms of 'exit' and 'voice' would be consistent with this strategy and would help empower the citizens of Aceh to participate fully in the development of Acehese society.

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