Title

Managing Risks: What do poor households in Yogyakarta do to smooth their consumption? (Synopsis of Research Results)

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Indonesia

Project Description

This study will explore the practice of poor people in Yogyakarta, Indonesia to protect against theft, fraud and other form of risk. Although the underlying protection processes are similar, the ways in which household smooth consumption are highly contextual, i.e. depend on the particular institutional, social and economic context they live in. Specifically, the study will describe what practice commonly observed in the poor household to protect against theft, fraud, and other form of risk; what type of assets held; and analyze factors determine the type of assets held. This research improves our understanding on the income and consumption smoothing behavior of the poor.

Researcher(s)

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About the Researcher(s)

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Synopsis of Research Results

This study is an empirical investigation of asset accrual and depletion strategies used to achieve consumption smoothing among the poorest household in Yogyakarta, Indonesia. Being able to smooth consumption reflects an important dimension of well-being as it reflects people's capacity to satisfy their basic needs in the present and to anticipate and prepare for future needs, thereby managing risk and reducing destabilization. Poor households in Yogyakarta face similar risks and shocks to those experienced by households elsewhere (Newhouse, 2005). However, this study is designed to compare smoothing strategies in Yogyakarta across job categories, regions, and genders in order to clarify patterns and anomalies in this context that may guide private sector investment and government policy.

Framework: Studies analyzing the relation between income and consumption show that, over time, household consumption is considerably smoother than income; a reduction in household income is not accompanied by a similarly large decline in consumption. In order to reduce the impact of income decline, households may follow a combination of different consumption smoothing strategies. We can distinguish six strategies or actions that can be grouped under two broader categories; *ex ante* strategies and *ex post* strategies. Each strategy reflects a distinct smoothing mechanism. The *ex ante* or mitigating strategies create alternative funding sources in case future income falls short of expected levels, reserving a portion of income for future contingencies. The *ex post* or coping strategies are employed to create alternative funding sources after it becomes clear that current income is not sufficient to satisfy basic needs. We can distinguish three different mechanisms; additional income generating activities (i.e. increase labour supply, home production or the selling of home produced goods), seeking credit/loans, or seeking transfers (Aryeetey, 2004).

In addition to the choice of income strategy, poor households make choices how they will store and safeguard assets. For the world's poor, low and variable incomes make it difficult to build up a buffer through saving, and those households that do accumulate savings face the additional obstacle of finding a liquid and safe store of value. Due to high overhead and the institutional inefficiencies associated with banks, few poor households have access to financial products and banking services. Informal community savings schemes are suboptimal because they do not provide a safe value store for households. Nonfinancial assets may present an alternative saving form, but it comes with its own risks. These assets can easily be expropriated through theft and, in the case of livestock, also drought; hence not secure stores of value. In addition, assets often require investments that are large relative to the household's income, which makes it more difficult to use assets to 'smooth' income.

Methodology: The research was conducted in five districts, including Kulon Progo, Bantul, Gunung Kidul, Sleman and Yogyakarta City. The 125 respondents, representing 25 households per district, consist of agricultural workers (farmers), fishermen, contracted workers, non-contracted workers, peddlers or street vendors, and producers (craftsmen). The sample is not differentiated based on gender, so men and women are not proportionately represented. The empirical data is the basis for factor analysis, designed to identify underlying variables, or factors, that explain the pattern of correlations within a set of observed variables.

Income Fluctuations and Ex-ante Strategies for Saving: The researchers found that in all five regions of Yogyakarta included in the study income and consumption fluctuations are tied most directly to occupational category, with fisherman having the highest rates of fluctuation for both income and consumption. Income fluctuations are specific to each type of income-generating labor and include factors such as seasons, natural disasters, and demand for products. These fluctuations affect the ability to save money, and the researchers found that poor workers in Yogyakarta stored money in various ways. Most (56%) store money in the house for maximum liquidity or due to limited access to formal financial institutions, whereas only 28.8% store money in formal or informal financial institutions (such as rotating savings associations). 44% store value in assets rather than in monetary form, including livestock, jewelry, vehicles, and appliances. The chi-square test further reveals that there are preferences for different types of savings across the job categories. For instance, farmers are least likely to store money in the house and most likely to store savings in the form of livestock assets. Fishermen, on the other hand, are much less likely to store money in assets and are more prone to put savings in formal financial institutions.

Ex-post Responses to Insufficient Income: Workers borrow and lend money, invest in assets, and store savings in different ways across job categories in Yogyakarta. This reveals variations in the level of organization and trust within communities of workers, as well as in levels of job security and in the need for working capital. Whereas borrowing money on a short-term basis is common among street vendors and fishermen when they have an income shortfall, farmers are more likely to sell assets in cases of shortfall, and non-contracted workers seek higher-wage work.

Fluctuations in Consumption: The researchers note a number of events that cause the most dramatic increases in consumption and thus put the most pressure on consumption smoothing strategies. The Muslim Eid celebration, for example, is predictable yet tends to create a sudden increase in consumption that is experienced as a shock. When neighbors celebrate an event, such as the birth of a baby, circumcision, marriage, or a funeral, people are expected to bring rice, vegetables, and other food to support the host and as a form of caring; this is particularly common in rural areas. In addition, the new school year brings predictable expenditures (such as uniforms, shoes, and books) for families with school-aged children that respondents experienced as unpredictable; such expenditures are outside the scope of everyday needs, and the price of these goods is often higher at the start of the new school year than at other times, increasing the financial strain on poor families unable to purchase in advance.

Conclusion: Analysis of the data suggests that there are fluctuations in income and expenditures experienced by poor workers (farmers, fishermen, contracted workers, non-contracted workers, peddlers/street vendors, and producers (craftsmen) that give rise to different ex-ante (anticipatory and mitigating) and ex-post (reactive and coping) consumption smoothing strategies. The researchers aim to use this study, which is based on a small sample, to design a study based on a larger proportional sample in order to increase the robustness of the findings.

--Photo #1: Cracker sellers income is dependent upon the number of beach visitors. Photo by Catur Sugiyanto.

--Photo #2: The farm worker only has seasonal jobs; his income is suceptible to weather. Photo by Catur Sugiyanto.

--Photo #3: The porridge seller does not have any collateral for borrowing to the formal bank. Photo by Catur Sugiyanto.

--Photo #4: The vegetable seller faces income shock when women helps their neighbor in preparing food for a party. Photo by Catur Sugiyanto.

Link to their working paper: Managing Risks: How do Poor Households Smooth Their Income and Consumption? (An Examination of Poor Households in Yogyakarta, Indonesia)