CHAPTER I
INTRODUCTION

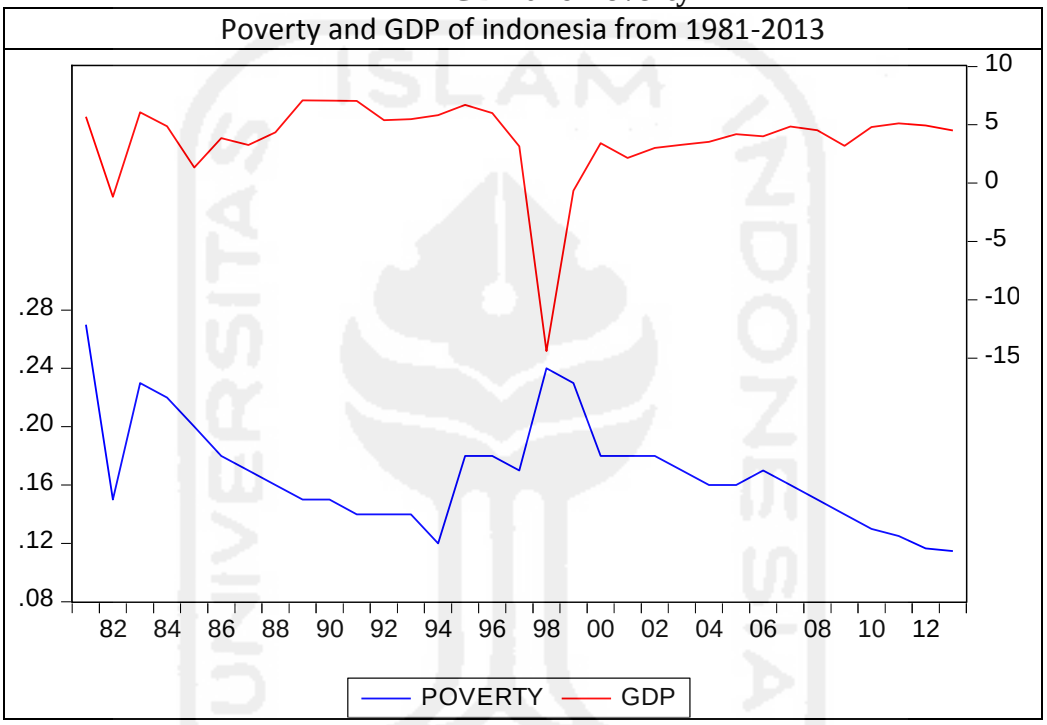
1.1 Background of Study

Indonesia is a developing country having a good rate of economic growth, but having a higher poverty rate at the same time. The World Bank reported that some countries have a high growth, but the population is still poor including Indonesia. In the classical economic growth theories showed that the economic growth is national output growth which is a function of factor function and production function. This means that a good production distributes to the GDP (gross domestic product). Then, when the GDP or the economic growth is higher, it means that the wage of labor increases and it should decrease the poverty indirectly. However, the other theory of growth and poverty stated that when trying to lower the poverty it will slow the rate of growth (Todaro and Smith, 2012).This is in line with the argument that countries with lower inequality would experience slow growth. This theory tends to deny the classical economic growth. That is why the researcher is interested to analyze the impact of economic growth towards poverty.

Poverty is a condition where a person lives below the poverty line. The person cannot fulfill the basic needs in life such as food, shelter, and health. In the country, the voices of poor people is unnecessary at all, for example in politics, the poor people did not have enough strength and do not have any authority to do that. If in the country economic shock occurs, those who will be the victims are poor people. It happens like the world intimidates the poor people. In fact the poor

people pay higher than the rich people, but the rich people get higher than the poor people. One word to say is *"inequality"*. Poverty in Indonesia and also in the world happens hereditary. When a parent from the poor family has a son or daughter, they also will live in poverty, just like their parents.

Graph 1.1
GDP and Poverty



Source: world bank, BAPPENAS, BPS (processed)

The researcher analyzed the data from that table that there is no significant correlation between the higher economic growth and the lower the poverty rate. Firstly, it can be seen in 1982 that the growth is 1,10% and the poverty rate is 0,15% , while in 1989the poverty is in the same rate, but the economic growth is the highest which is 9,08%. This is evidence that the economic growth does not have a significant correlation to the changes of poverty. The theory of Todaro and smith (2012) mentioned that *'when trying to lower the poverty it will slow the rate*

of growth ’this has been proven in 1982. In contrast, in 1989 the condition was different. The higher economic growth but the poverty rate as the same time was getting lower. In 1989, it was proven that the classical theory about gross domestic product will reduce the poverty because increasing the GDP means that the wage will increase and the income per capita will automatically increase as well. From the graph, it can also be seen that the lowest growth in 1999 is about 0,79%, but the poverty shows 0,23% which is higher than the growth of 1,10%.

It can be seen in the graph that in 1998, the growth is very low or the number of growth is -14,39 which is extremely decreasing. What happens in Indonesia in 1998? Economic crisis happened at that time. All nations will remember that the tragedy was the worst economic disaster in Indonesia. The economic crisis in 1997-1998 reminded us as the black Tuesday. Besides, the beginning of the world’s economic recession on October 29th, 1929 was also known as malaise.

At that time, the government decision was not stable, the maturity of the foreign debt was on its due date, and of course international trade was less effective. The foreign debt in March 1998 reached 138 billion US dollars, and about 72.5 billion US dollars was private debt which is two-thirds of the short term, which was about 20 billion US dollars maturing in1998. And sadly the foreign exchange reserved about 14.44 billion US dollars because Indonesia at that time had no more trust to bring Rupiah currency to decline drastically from 4.850/US dollar in 1997 to a level around 17.000 dollar, on January 22nd, 1998, or depreciated by more than 80 percent.

Graph 1.2

Gini Ratio and Poverty

Source: BAPPENAS (processed), BPS

Based on the data above, the analysis on how poverty influence the welfare in this case the highest the Gini ratio, the lowest the welfare can be conducted. The data showed that the distribution of income whether it is good or not by looking at how much the inequality influenced by changes in poverty rate. It can be seen that in 1982 when the poverty rate was 0,15%, the Gini ratio or inequality was 0,3%.If compared in 2001, it showed the same inequality, but having a higher poverty rate, which was about 0,18% while the other data from 2002 showed the same level of poverty rate which was 0,18% with the inequality about 0,357.Then, in 2006 the lower poverty rate was about 0,16% and the inequality was 0,357%. According to the data, in some data the inequality were

not correlated with the poverty rate, meaning that the changes of the poverty rate were not followed by the changes in Gini ratio.

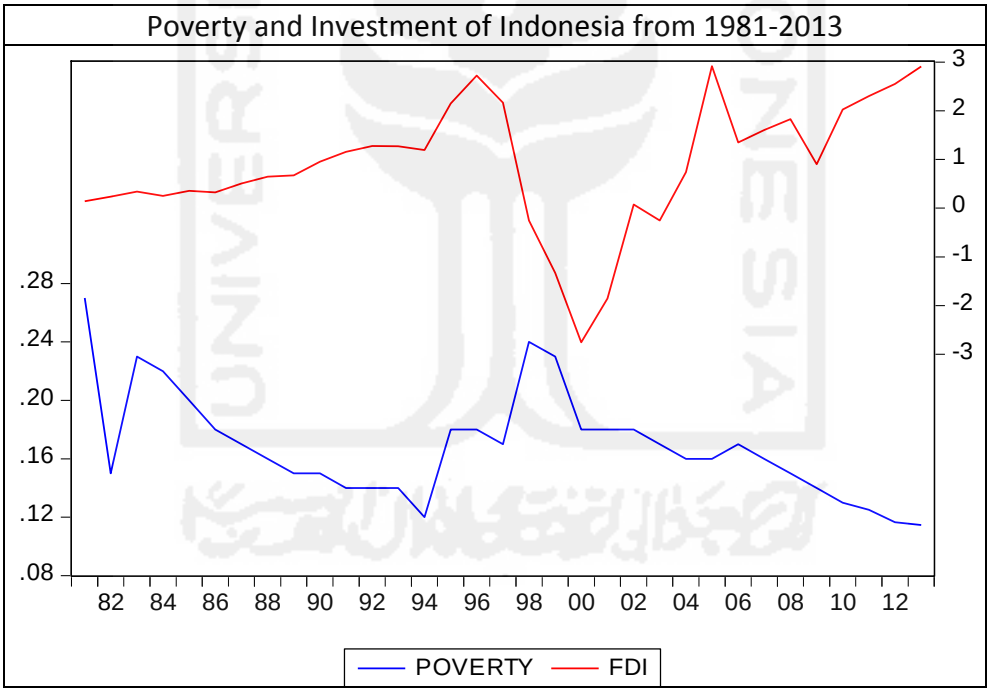
Based on the data of the poverty rate in 2011-2013, the rate was 12.50%, 12%, and 11% so that it showed a dramatically decrease. Compared to the percentage of poverty with the Gini ratio in the last 3 years (2011-2013), the numbers were 0.41%, 0.41%, 0.413. From these data, the researcher can conclude that as the poverty rate decreased, the Gini ratio also increased. It means that the decrease of the poverty rate caused the distribution of income getting worse, as can be seen in the increasing Gini ratio. The head of BPS – Mr. Suryamin was declared that it was the highest number that Indonesia ever had after its independence. Normally the number of Gini ratio starts from 0 to 1. Actually Indonesian Gini ratio number is around 0.33-0.38, but in the last three years the number of Gini ratio was in the 'caution zone'. It will be dangerous if the number of Gini ratio is more than 0.6. Then, the solution to fix the number of the Gini ratio is the quality of the economic growth.

At the same time, the Deputy of Balance and Statistical Analysis of BPS – Mr. Kecuk Suharyanto gave an additional explanation about what really happened in the last three years. From the income side, Indonesian people's income is categorized into three classes. The top high class is 20%, middle class is 40% and the bottom class is 40%. In 2005, the bottom class received benefits from the economic growth of 21% which means that they just received a half of it. However, in 2013 it has decreased by 16.9%. Meanwhile, in 2015 the high class got 40% and increased by 49% from the GDP in 2013. This means that the

benefits received by the high class were higher than the middle and bottom class. It is the reason why the Gini ratio became larger, meaning that the rich will be richer and the poor will get poorer. Suharyanto also said that even though the economic growth is high, but the quality is bad because it was not supported by tradable sectors. It can also be seen a bad economic growth quality: open unemployment declined slowly, poverty rate was stagnant, inequality was large, and inflation was getting worse.

Graph 1.3

Investment and Poverty



Source: world bank, BAPPENAS (processed)

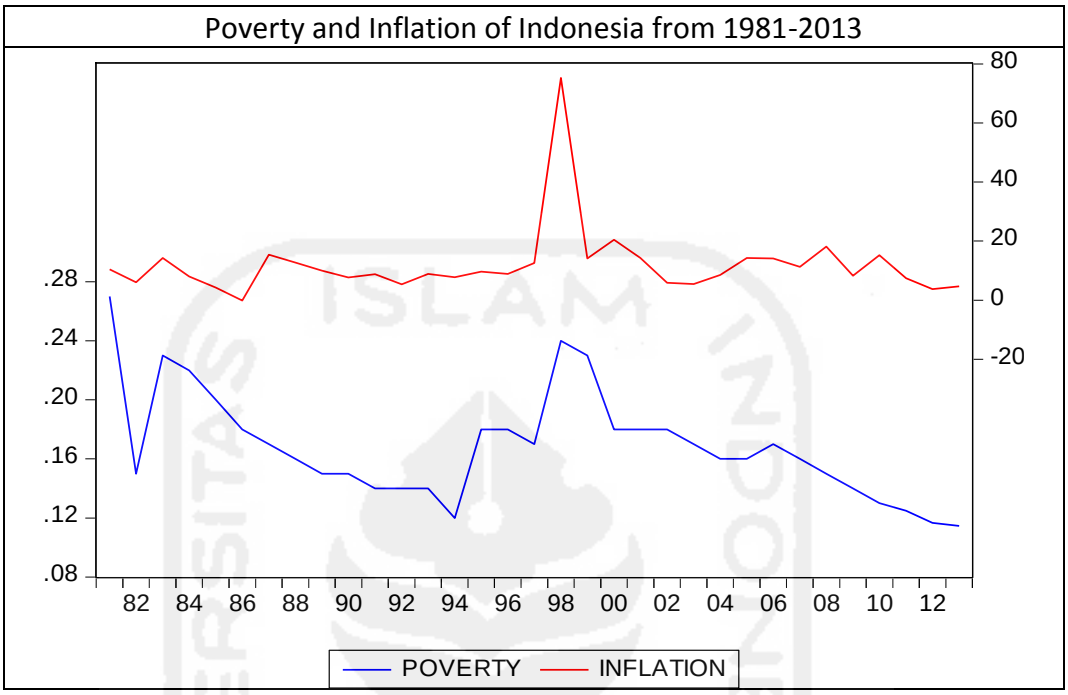
Foreign and poverty reduction (Klein, 2011) "FDI is a key ingredient of the successful economic growth and development in developing countries. Foreign direct investment is especially well suited to affect this transfer and translate it into a broad-based growth, not least by upgrading human capital.

Growth is the single most important factor in poverty reduction." We can restated what Klein said that FDI is has a tight relation with the growth and as what the researcher has explained before that growth has a relation also to the poverty reduction. There are also an empirical study from Pakistan stated that the role of investment in poverty reduction in short-run is not significant (Chani et al, 2011).In 1981 investment was 0,14% and poverty was 0,27% if compared with in 1990 the investment was 0,96%, the poverty reduced to 0,15% and then in 1996 the FDI increased to 2,76% and the poverty increased to 0,18%. Based on the data, the researcher can analyze that there is no significant relation between foreign direct investment and poverty decrease.

As can be seen in the graph that the foreign direct investment is fluctuated. It keep decreasing from 1981 until 1997, but because the economic crisis at that time so that the number of foreign direct investment was -0.25 in 1998 and continued to a minus in 1999, 2000, and 2001. However, in the latest four years which were in 2010, 2011, 2012, and 2013, foreign direct investment kept increasing. The data from 2015 from Indonesian investment website publicated that foreign direct investment has grown by 29.2% in 2015.

graph 1.4

Inflation and Poverty



Source: world bank, BAPPENAS (processed)

The result from an empirical study journal from Pakistan stated that inflation has a positive impact on poverty (Chani et al, 2011). It can be analyzed that when inflation increases then the price of goods will increase and at that time the wage does not increase because this will increase the inflation rate. For example, the fact today that before the inflation of the price of basic needs such as rice which is per kilo about $1 dollar, but when the inflation increases the price will be $2 dollar per kilo. This causes the people's ability to buy the basic needs decreases and then they will be measured as a poor people when they cannot buy the basic needs. In addition, based on the data analysis above in 1981, the inflation rate was 10,44 % and the poverty was 0,27% compared with in 1982 which the inflation rate was 6,06% and the poverty was 0,15%.In this case, the poverty has reduced

as the decrease of the inflation rate. However, in 1999-2000 the inflation rate increased and reduced the poverty rate.

From the data, it can be seen that the inflation rate fluctuated, but the graph showed that in 1998 the inflation rate was so high because of the economic crisis. At that time, the inflation rate was around 200% which was the most severe along the new order. It can be identified by the decrease of Rupiah currency against the Dollar currency and also the very drastic decrease of Indonesian nation's percapita income. So far, all these things drive a number of factories and industries that will collapse by creditors following some businessmen debt maturing in1998 will be generating thousands of new unemployment with a series of social problems.

1.1 Problem Identification

The increasing economic growth should support the decrease of poverty rate because of the economic growth measurement is Gross Domestic Product (GDP). When GDP increases, it means that the total of production increases, and then the wage will be increased automatically so that the economic condition will be good because it will increase the income per capita. The researcher aims to identify why the increase of the economic growth does not always reduce the poverty. This issue what makes the researcher confused why the inequality between poor people and rich people being larger and cannot decrease as the increase in the GDP or the economic growth rate.

Foreign direct investment or FDI is a key ingredient of successful economic growth and development in developing countries (Klein, 2011). Empirical study from Pakistan found the role of investment in poverty reduction in a short run

which is not significantly correlated. Then, about the inflation and poverty relationship, when the inflation increases it must also increase the number of the poor because the price of goods is getting increased and the ability of people to buy goods will decrease as a result of the increasing the price. An empirical research from Pakistan (Chani et al, 2011) proved that inflation has a positive impact on poverty. However, the researcher analyzed the data that the increase in inflation is not always followed by the increase of the poor number.

1.2 Problem Formulation

- Does increase economic growth reduce the poverty rate?
- Does increase of inflation rate increase the poverty rate?
- Does increase of investment reduce the poverty?
- Does decrease of poverty rate decrease the Gini ratio?

1.3 Problem Limitation

The topic or the aspect that the researcher will be focused is economic development. The limitation of this research is using four variables having the impact on the poverty, which are the economic growth, investment, inflation, and the Gini ratio. The researcher is also trying to explain about the welfare based on Gini ratio.

1.4 Research Objectives

To answer the problem formulation, the researcher has determined the research objectives as follows:

a. The researcher tries to analyze the impact of economic growth, investment, inflation and Gini ratio towards the poverty rate. Also, the

relationship between those variable, for example *'does the decrease in poverty rate also decrease the Gini ratio?'* or how does the increase of the economic growth not reduce the poverty rate. The researcher also tries to analyze the welfare through Gini ratio with poverty rate and also tries to analyze and explain that welfare can be increasing because of the poverty reduction or even there is no significant change in the poverty rate.

1.5 Research Contribution

a. The benefits that the researcher can get from this research are that she will get deeper knowledge about how the economic growth, Gini ratio, inflation, and investment impact on the poverty rate.

b. Who will benefit from this research

- For university students, this research will probably be useful for those need information about this research topic which is related to economic development.
- For society, this research contributes as a reflection about the economic development.

1.6 Systematics ofWriting

Chapter I discusses about Introduction. The Chapter I explains about the background of the study and also explains about the reasons why the researcher is interested to conduct a researchabout the impact of economic growth, gini ratio, inflation, and investment towards the poverty rate. In Chapter II, the researcher discussed about the theory, literature review, and hypotheses. Chapter III explains

about data collection and data analysis. Chapter IV discusses about findings and discussions. Then, Chapter V discusses about conclusions and recommendations.